

**STATE OF SOUTH CAROLINA**

**INDEPENDENT AUDITORS' REPORT ON  
INTERNAL CONTROL OVER FINANCIAL  
REPORTING AND ON COMPLIANCE AND  
OTHER MATTERS BASED ON AN AUDIT  
OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH *GOVERNMENT  
AUDITING STANDARDS***

**June 30, 2006**

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**Independent Auditor’s Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards**

The Honorable Mark Sanford, Governor  
and  
Members of the General Assembly  
State of South Carolina  
Columbia, South Carolina

We have jointly audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of South Carolina as of and for the year ended June 30, 2006, which collectively comprise the State's basic financial statements and have issued our report thereon dated November 21, 2006. We did not jointly audit the financial statements of certain component units and agencies of the State of South Carolina, which represent the indicated percent of total assets and total revenues as presented in the table below. Those financial statements were audited by other auditors, whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those component units and agencies, is based solely on the reports of the other auditors.

	<b>Percentage audited by other auditors</b>	
	<b>Total Assets</b>	<b>Total Revenue</b>
<b><u>Government-wide</u></b>		
Governmental activities	66	19
Business-type activities	97	81
Component units	100	100
<b><u>Fund Statements</u></b>		
Governmental Funds	23	9
Enterprise Funds	97	81
Internal Service Funds	78	91
Fiduciary Funds	98	100

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### **Internal Control Over Financial Reporting**

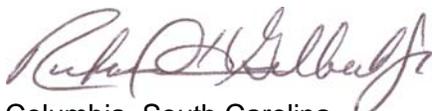
In planning and performing our audit, we considered the State of South Carolina's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State of South Carolina's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and responses as items 06-01 through 06-08.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the State of South Carolina's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Governor, Members of the General Assembly, and the governing body and management of State agencies and is not intended to be and should not be used by anyone other than these specified parties.



Columbia, South Carolina  
November 21, 2006



Baltimore, Maryland  
November 21, 2006

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

## **06-01 Financial Reporting**

### **The School for the Deaf and the Blind**

Section 3.9 of the Comptroller General's GAAP Closing Procedures Manual states, in part, that "when construction of the capital asset is substantially complete and the asset is ready to be occupied or placed into service, you must reclassify Construction in Progress to the appropriate capital asset categories."

We determined that the capital asset closing package submitted by the School for the Deaf and the Blind (the "School") to the Comptroller General's Office included projects in their construction-in-progress account that were substantially complete or already in use. These projects should have been capitalized and depreciated during the current fiscal year.

By not capitalizing construction-in-progress that is substantially complete or in use, the School understated their expenses for depreciation in the current year.

We recommend the School develop and implement a policy that requires a review of the construction-in-progress accounts at year-end to determine whether or not the School has appropriately classified its capital projects based on the projects' current completion status.

## **06-02 Financial Reporting**

### **Department of Corrections**

GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions", requires that recipients of grant awards "recognize receivables (or a decrease in liabilities) and revenues (net of estimated uncollectible amounts), when all applicable eligibility requirements, including time requirements, are met." Additionally, "resources transmitted before the eligibility requirements are met should be reported as . . . deferred revenues by recipients."

We determined that the Department of Corrections (the "Department") grants/contributions receivable and deferred revenues closing package submitted to the Comptroller General's Office recorded receivables that should have been classified as deferred revenue. This resulted in an overstatement of both the receivable balance and the deferred revenue balance.

The Department uses an account to record grant activity (a clearing account). The Department analyzes and makes adjustments to the account to properly reclassify the clearing account balances. The Department did not make the necessary adjustments at year end to reclassify the clearing account balances. As a result, the Department's receivables and deferred revenues accounts were both overstated.

We recommend the Department implement a procedure to ensure that grant activity is properly recorded in their accounting records. The Department should consider the effectiveness of using a clearing account, instead of initially recording all transactions in the appropriate general ledger account. If the clearing account is maintained, the Department should implement a policy whereby the clearing account is examined monthly and all necessary adjustments are made.

## **06-03 Financial Reporting**

### **Department of Revenue**

Section 59-21-1010(B) of the South Carolina Code of Laws, specifies that 1 percent of the 5 percent state sales tax must be deposited by the State Treasurer in the South Carolina Education Improvement Act of 1984 Fund as a fund separate and distinct from the general fund of the State.

The Department of Revenue (DOR) collects state sales tax and transfers the 1 percent tax to the Department of Education (DOE). During September 2005, the DOR processed a series of transfers to the Education Improvement Act (EIA) fund account. Because of an error that occurred during processing some of the transfers were processed twice.

The DOR experienced an error in one of the nightly computer processing jobs that prevented the completion of the job. The output of this job creates a file of all the EIA transfers processed for day. That file is used to create EIA transfer vouchers. Because a file of new EIA transfer vouchers was not created, the computer program defaulted to the previous day's file and generated EIA transfer vouchers from the prior day's output.

We recommend the DOR implement controls to prevent or timely detect errors of this nature from occurring. Additionally, we recommend the DOR consult with members of the General Assembly to determine if the overpayment should be returned to the General Fund of the State by the Department of Education or if it should make an adjustment to future allocations.

#### **06-04 Information Technology Access Controls**

##### **Medicaid Processing Support Services Provided by Clemson University**

Access controls are designed to provide reasonable assurance that computer resources (data files, application programs, and computer-related facilities and equipment) are protected against unauthorized modification, disclosure, loss, or impairment. Such controls include physical controls, such as keeping computers in secured rooms to limit physical access, and logical controls, such as security software programs designed to prevent or detect unauthorized access to sensitive files.

Inadequate physical and logical access controls diminish the reliability of computerized data and increase the risk of destruction or inappropriate disclosure of data. Potential consequences of inadequate access controls could allow an individual to have: (1) direct access to a data file enabling them to make unauthorized changes or obtain sensitive information. (2) obtain access to application programs used to process transactions, enabling them to make unauthorized changes to programs or introduce malicious programs, which in turn could be used to access data files, resulting in situations similar to those described above, or to process unauthorized transactions.

During our review of the South Carolina Department of Health and Human Services Medicaid Management Information System (MMIS), we noted that twenty-two (22) Clemson University programmers have access to the MMIS production libraries. Users with this level of privileged access can modify production code without HHS management approval. This could potentially compromise the availability, confidentiality, and integrity of the MMIS System and/or Data. The librarian function used in controlling production library versions had not been implemented at the time of this review.

We also noted that Clemson University maintains the University's mainframe-based applications as well as the South Carolina Department of Health and Human Services MMIS programs within the same Logical Partition (LPAR) of its Operating System. A logical partition is a mainframe security feature, used to logically separate operating environments and / or data, a virtual boundary between different entities, when operations of different entities are processed by the same service organization. These logical partitions permit systems administrators to apply different security profiles and settings to suit each entity's security policies without impacting the integrity of other entities; in this case the college's open access network policy should not be placed on the same partition with highly sensitive privacy information contained in the MMIS System.

We recommend restricting programmer access to production code/modules and the implementation of a librarian function to move development code to production. This function should be restricted to a small number of users not involved in software development. We also recommend the use of multiple logical partitions (LPAR) to segment sensitive data and production systems. The use of LPARs to segment data and production systems with differing security requirements is considered a best practice in mainframe operations.

**06-05 Information Technology Access Controls**

**Medicaid Processing Support Services Provided by Clemson University**

We noted that user access is not regularly reviewed for appropriateness. South Carolina Department of Health & Human Services (SCDHHS) management has not reviewed its users with access to the MMIS application to ensure all authorized users required such access and that the level of access or privilege assigned to users was commensurate with their job responsibilities in conformity with the principle of least privilege. Also, SCDHHS management could not determine if invalid UserIDs (UserIDs of terminated individuals) had been deleted from the system. Management is in the process of implementing an annual recertification review to clean-up invalid user accounts. Until this clean-up is performed, former employees may still be able to access sensitive information and use this information for malicious purposes.

We recommend that management should consider a review process to confirm that all users of the MMIS systems still require access and that the appropriate rights are in force. Management would ideally perform this review on a quarterly basis.

**06-06 Information Technology Access Controls**

**Medicaid Processing Support Services Provided by Clemson University**

We noted that password settings for the mainframe platform that hosts the MMIS application are not in accordance with industry best practices. Weak passwords increase the chances of unauthorized users gaining access to sensitive resources. The following chart documents current and recommended settings:

<b><i>Password Setting</i></b>	<b><i>Description</i></b>	<b><i>Recommended Setting</i></b>	<b><i>State of SC Setting</i></b>
Password length	Number of characters that make up a password	6-8	5
Password Expiry Date	Time interval within which passwords must be changed.	30-60 days	90 days
Grace logins allowed	Number of unsuccessful login attempts before an account is locked or suspended.	3	6

We recommend that management implements the following recommended settings: (1) Increase the Password Length for the Mainframe platform to 6-8 characters, (2) Reduce the Password Expiry Date to 30-60 days, and (3) reduce the grace Logins Allowed to 3 iterations.

## **06-07 Information Technology Access Controls**

### **Medicaid Processing Support Services Provided by Clemson University**

We noted that the number of users with access to the Clemson Data Center appears excessive. The number of Clemson University employees and Contractors with access to the Data Center housing the SCDHHS' Medicaid Management Information System (MMIS) appears excessive. The August 2006 user list reviewed identified 141 users with access to this area.

It becomes increasingly difficult to administer and monitor user access to restricted areas when the number of users is as elevated as is the case with the Clemson data center. Unauthorized users may go undetected and they may use this access for malicious purposes.

We recommend that Clemson University management closely review each individual who has access to the Data Center and revoke access for individuals who do not require this access in the daily execution of their duties. For individuals with this access who do not provide hardware/software support services we recommend their access be limited to business hours only.

## **06-08 Information Technology Access Controls**

### **Medicaid Processing Support Services Provided by Clemson University**

Terminated user's system access is not revoked in a timely manner. Based upon a review of 10 randomly sampled terminated employees we determined 6 of the 10 individuals MMIS Central Version (CV) ID and RACF ID was removed 3 to 21 days after their termination date. Although we are aware that SCDHHS resets users passwords after they are informed by Human Resources that an individual is leaving, SCDHHS could not provide documentation of this process. Therefore, based on documentation we received identifying the date the user's CV and RACF ID was deleted/revoked we determined access is not being removed in a timely manner.

We recommend that SCDHHS maintain evidence of timely revocation of system access and document a Security Policy that stipulates the time frame in which user's accounts should be revoked after their termination.

## **SUMMARY OF PRIOR FINDINGS**

During the current engagement, we reviewed the status of corrective action taken on the findings in the prior report on compliance and internal control over financial reporting at the basic financial statement level, dated November 30, 2005 to determine if the conditions still existed. Based on our audit procedures, we determined that adequate corrective action for the Financial Reporting deficiency at the Employment Security Commission, the Financial Reporting deficiency at the Department of Natural Resources, and the Financial Reporting deficiency at the Department of Social Services have been implemented. As such, these comments have not been repeated in this report.

**MANAGEMENTS' RESPONSES**

# SOUTH CAROLINA

## SCHOOL FOR THE DEAF AND THE BLIND

*Serving Individuals Who Are Deaf, Blind or Sensory Multidisabled*

SHEILA S. BREITWEISER, ED.D.  
PRESIDENT

December 13, 2006

Mr. Richard H. Gilbert  
Deputy State Auditor  
Office of the State Auditor  
1401 Main Street  
Columbia, South Carolina 29201

Dear Mr. Gilbert:

The South Carolina School for the Deaf and the Blind ("SCSDB") strives to submit accurate and complete Closing Financial Reports to the Comptroller General's Office. It appears that the Capital Asset Closing package for Fiscal Year 2006 was in error due to the incorrect classification of Walker Hall due to some open contractor/building issues. Fortunately, this error did not materially impact South Carolina fixed asset ledger. In the future, SCSDB will ensure an annual assessment of the current status of capital projects

is completed by the schools Construction Engineer and this information is provided to the assigned person completing this package to ensure this report is accurate and complete and construction-in-progress is placed in the appropriate classification based on its disposition.

Please give us a call, if there is any other additional information necessary to address this request.

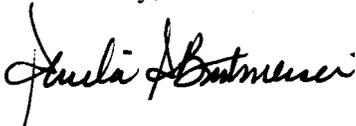


Esther A. Leslie Avery  
Assistant CFO



Jon Castro  
CFO

Sincerely,



Sheila S. Breitweiser, Ed.D.  
President



MARK SANFORD, Governor

JON OZMINT, Director

January 3, 2007

Mr. Richard H. Gilbert  
Deputy State Auditor  
1401 Main Street, Suite 1200  
Columbia, SC 29201

Dear Mr. Gilbert:

We have reviewed the auditor's comment which addresses the use of a clearing account for recording grant transactions. The comment states, " The Department should consider the effectiveness of using a clearing account... If the clearing accounting is maintained, the Department should implement a policy whereby the clearing is examined monthly and all necessary adjustments are made."

Use of the clearing account was required of the Department; therefore the Department will continue its use. Funds are received into the clearing once per quarter, therefore there is need to examine the clearing account and make any necessary adjustments only at the end of each quarter.

The Department will implement a policy to examine the clearing account at the end of each quarter and make any necessary adjustments.

Sincerely,

A handwritten signature in black ink, appearing to read "Bruce Burnett". The signature is stylized and includes a circled "H" at the end.

Bruce Burnett

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**State of South Carolina**  
Department of Revenue  
**301 Gervais Street, P.O. Box 125, Columbia, South Carolina 29214**

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December 15, 2006

Mr. Richard H. Gilbert, CPA  
Deputy State Auditor  
SC Office of the State Auditor  
1401 Main Street, Suite 1200  
Columbia, SC 29201

Re: Response to Management Letter Comment--September 2005 (FY2006) EIA transfers

Mr. Gilbert:

This will serve as the Department of Revenue's response to the management letter comment referenced above.

There is an extremely high volume of sales tax transactions daily that impact transfers of the 1 penny sales tax to the Education Improvement Act (EIA) fund. Because of the high volume of transactions, the process for creating transfer/voucher documents to transfer money from sales tax into the EIA general ledger account within the Department of Revenue is handled through automation, with no manual intervention. As noted in the management letter comment, there

were duplicate transfers of EIA money to the State Department of Education during September 2005 (FY2006) that occurred as a result of our automated process. This was a one-time, isolated occurrence that was not repeated again during the remainder of FY2006.

To significantly reduce, or timely detect, the occurrence of duplicate transfers of EIA money in the future, the Department of Revenue has implemented the following procedures:

1. Through automation, the program that creates the file of EIA transfer documents has been removed from the original voucher reporting job and has been added to the job that creates the transfers/vouchers. This will insure that a new EIA transfer file is created each time the vouchering program is executed.
  
2. Each day, employees in the Office of Financial Management will attach a copy of the EIA transfer documents produced that day to the source documents (deposit vouchers, journal vouchers, internal correcting vouchers and certain disbursement vouchers) containing sales tax transactions on which the EIA percentage was computed. When attaching copies of the EIA transfer documents to source documents each day, Financial Management personnel will also physically look at each source document to confirm that there has not been a similar transfer document already created for, and attached to, that same source document.

3. The Office of Financial Management will maintain a spreadsheet of all EIA transfers made during the month, and will compare the transfer activity for the current month to the prior months transfer activity to identify any significant 'spikes' or unusual increases in the amounts transferred. Any unusual increases will be researched.

4. Each quarter, the Office of Financial Management will request from the DOR information technology area a report of all system generated vouchers that contain duplicate dollar amounts. Transfer documents containing duplicate dollar amounts will be researched to ensure correctness.

Again, implementation of these procedures should significantly reduce, or timely detect, the occurrence of any duplicate EIA transfers.

As recommended, the Office of Financial Management will work closely with our agency legislative liaison, the Department of Education, and other agencies as needed, to determine if the overpayments made during FY2006 should be returned to the State General Fund or if adjustments should be made to future allocations.

Please do not hesitate to contact either of us if you need additional information.

Sincerely,



D. John Taylor  
Sr. Administrator, Chief Financial Officer  
803.898.5415  
[taylorj@sctax.org](mailto:taylorj@sctax.org)



Kevin L. Dailey  
Controller  
803.898.5413  
[daileyk@sctax.org](mailto:daileyk@sctax.org)



# State of South Carolina

## Department of Health and Human Services

Mark Sanford  
Governor

Robert M. Kerr  
Director

December 18, 2006

Mr. Richard H. Gilbert  
Deputy State Auditor  
1401 Main Street, Suite 1200  
Columbia, South Carolina 29201

Dear Mr. Gilbert:

As requested, the following is Department of Health and Human Services' response regarding the State of South Carolina's statewide joint audit of the general purpose financial statements relating to the Fiscal Year Ending June 30, 2006.

### **06-04 Information Technology Access Controls**

#### *Restrict Programmer Access*

Clemson University/ISD has procedures in place for implementing development code changes in production. Procedures require a comparison of code and sign-off prior to code being moved. Also, Clemson is able to determine when source code and JCL was updated and the ID of the person that did the update. Additionally, SMF reports can be run to show the person who accessed the file, the date and time of the access, and the type of access. RACF controls are in place to control who can actually update the files.

#### *Implement Librarian*

SCDHHS and Clemson University/ISD staff are working to implement a librarian function in a way that does not create a bottleneck or cause delays in moving changes to production. Additionally, DCIT is looking into standards for software development and maintenance for Clemson University as part of strategic planning for IT. As these standards are established, SCDHHS will apply them to MMIS software development.

*Multiple Logical Partitions (LPAR)*

Clemson University/DCIT has always used strong RACF controls to protect production files, libraries and resources on the Clemson mainframe. We have always supported disparate workloads on our mainframe, since long before LPAR technology was available, and have sought ways to do this safely and economically.

Workloads are segregated at Clemson by several methods:

- o Separate group structures. Clemson administrative work, MMIS production and development, and academic computing are organized into different RACF group structures. There is no crossover between these groups, except in controlled circumstances.
- o Separate security administration. Each of these groups manages its own RACF security. Security for academic computing is handled by DCIT's Computer Resources group.
- o Separate database administration. ISD and DAPS (the group that maintains Clemson's applications) maintain separate DBA staffs. The DBA groups may collaborate as colleagues, but their areas of responsibility are kept separate by RACF controls.
- o Separate storage administrator controls. Clemson uses RACF, a z/OS system exit (IGGPREE00) and DFSMS controls to break the available DASD into storage pools. One group cannot allocate or manage space that belongs to another group.

By maintaining these forms of separation, DCIT continues to avoid the expense and complexity of an LPAR environment. If a separate LPAR was established for HHS work:

- o Additional hardware (DASD, tape drives, CPU memory, network) would be required. These resources are currently shared in a single-image system.
- o Additional support staff would be required to manage the LPAR environment.
- o Software licensing would become more complex, and probably more expensive.
- o These additional costs would have to be passed on to HHS, DCIT's primary external customer.

Finally, it should be noted that students at Clemson do not have general access to Clemson's mainframe any more. They have userids defined for them in RACF, but are only allowed to use end-user course-management applications (registration, drop-add, etc) via web-based front ends.

SCDHHS does not find it cost effective to implement a separate LPAR based on the compensating controls that are in place.

Mr. Gilbert  
December 18, 2006  
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**06-05 Information Technology Access Controls**

SCDHHS will develop a quarterly review process to confirm that users of the MMIS system still require access and that the appropriate access is in place.

**06-06 Information Technology Access Controls**

We will modify the password settings for the MMIS application to meet industry standards.

**06-07 Information Technology Access Controls**

Clemson University/DCIT management will review access to the Data Center to insure that only those employees who need access to perform their job duties will have access. Access after business hours is already more restricted.

**06-08 Information Technology Access Controls**

SCDHHS promptly resets passwords as soon as we are notified a person is leaving the agency. An email message is sent from Human Resources indicating the person is leaving and the effective date. We have modified our procedures to maintain screen prints of the password reset function as evidence of timely revocation of system access. A request for the deletion of the ID is then sent to Clemson University. Procedures are being modified to stipulate the timeframe in which the ID must be deleted by Clemson University. However, the user is unable to access the system because of the password being reset.

Sincerely

A handwritten signature in black ink, appearing to read "Rhonda Morrison". The signature is fluid and cursive, written in a professional style.

Rhonda Morrison  
Bureau Chief

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