THE MEDICAL UNIVERSITY OF SOUTH CAROLINA

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

JUNE 30, 2000

State of South Carolina

Office of the State Auditor

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December 8, 2000

The Honorable Jim Hodges, Governor
and
Members of the Board of Trustees
The Medical University of South Carolina
Charleston, South Carolina

This report on the internal control of The Medical University of South Carolina for the fiscal year ended June 30, 2000, was issued by Rogers & Laban, PA, Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,

Thomas L. Wagner, Jr., CPA
State Auditor

TLWjr/cwc

ROGERS & LABAN, PA
CERTIFIED PUBLIC ACCOUNTANTS AND FINANCIAL CONSULTANTS

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

Mr. Thomas L. Wagner, Jr., CPA,
State Auditor
State of South Carolina
Columbia, South Carolina

In planning and performing our audit of the financial statements of The Medical University of South Carolina (MUSC), Charleston, South Carolina, for the year ended June 30, 2000, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. However, we noted certain matters as detailed on pages 2 to 4 involving the internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the organization's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

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 errors or irregularities in amounts that would be material 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 internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. We believe the conditions noted on pages 2 to 4 are material weaknesses.

We also noted other matters involving internal control and its operation as detailed on pages 4 and 5.

A violation of state law was noted as detailed on page 2.

This report is intended solely for the information and use of the board of trustees and management of the University and is not intended to be and should not be used by anyone other than these specified parties.

Rogers + Laban P.A.

November 4, 2000

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A. VIOLATIONS OF STATE LAW

INTEREST INCOME NOT REMITTED TO STATE GENERAL FUND

The University received approximately $1,200,000 in interest from the Medical University Research Foundation in the current year which had been earned in the current and prior years on funds that the University had on deposit with the Foundation. The University did not have authority to retain the interest earnings and did not remit these interest earnings to the State General Fund as required by Section 11-13-120 of the South Carolina Code of Laws.

We recommend that the University remit the interest earnings to the State General Fund as required by law.

MANAGEMENT'S RESPONSE:

This finding relates to interest earnings on the as yet unspent Healthy South Carolina Initiative Grant funds received from the Dept. of Health and Human Services (HHS) in 1997. The University believes it has been handling these funds in accordance with donor instructions. The University has been working with the State Treasurer's Office and HHS to clarify the proper treatment of these funds. In response to documentation issues raised by the auditor in the prior year, interest earned on the funds was moved from the MUSC Foundation for Research Development to the University. The interest is currently held in the MUSC funds on deposit with the State Treasurer while the proper treatment is being determined.

B. MATERIAL REPORTABLE CONDITIONS

ERRORS IN ACCOUNTING FOR EQUIPMENT EXPENDITURES

The Medical Center of the University entered into a master lease agreement to purchase various pieces of equipment. A deposit for approximately $430,000 that paid in a prior year was inappropriately expensed instead of being recorded as a deposit. The University still has not taken delivery of the equipment as of June 30, 2000. In addition, the University advanced its own funds of approximately $623,000 instead of using the note proceeds which were available for the purchase of the equipment. The University later requested reimbursement from the note proceeds for the use of its own funds. The $623,000 was recorded as an expense. This amount should have been recorded as a receivable due back from the Trustee under the master lease agreement and not as an expenditure under generally accepted accounting principles for colleges and universities. In addition, a portion of the note payable relating to this $623,000 should have been recorded in the investment in plant subfund since the expenditures qualified under the University's capitalization policy. Adjusting entries were made to properly record these transactions.

We recommend that the University ensure that all transactions are properly and timely posted.

MANAGEMENT'S RESPONSE:

Management agrees with this recommendation. All transactions relating to this master lease agreement for purchase of Medical Center equipment are being coordinated with Medical Center Purchasing and University Physical Asset Management to ensure that all transactions are properly and timely posted.

ERRORS IN ACCOUNTS PAYABLE SCHEDULE

Our audit of accounts payable disclosed the following deficiencies:

1 The University included approximately $7,200 in accounts payable for goods or services received after June 30, 2000.

2. Our review of invoices paid subsequent to June 30 disclosed that the University excluded approximately $31,000 in accounts payable for goods and services that were received prior to fiscal year end.

3. Two invoices totaling approximately $73,500 were included twice in the manually prepared accounts payable listings prepared subsequent to year end.

Similar deficiencies were noted in the prior year's management letter.

We recommend that the University review all of its procedures in preparing the schedules to support accounts payable at year-end to ensure that invoices are not included for goods or services, which were not received, and all accounts payable are included.

MANAGEMENT'S RESPONSE:

Management agrees with this recommendation. We will continue to refine our procedures in preparing the year-end schedule of accounts payable, which includes a manual review of material invoices paid subsequent to June 30. Additional review procedures to detect errors will be included for fiscal year 2001.

DEFICIENCIES IN BANK ACCOUNT RECONCILIATIONS

Our audit disclosed the following deficiencies in the reconciling of the various bank accounts of the University:

1. There are two bank accounts for the University's master lease agreements for the Medical Center which are not reconciled on a monthly basis. The University does not receive copies of the bank statements on these two accounts from the Trustee. The balance of approximately $10,000,000 for one of the accounts was not recorded until after year-end by journal entry that included the recording of approximately $120,000 in interest earnings on the funds.

2. Reconciling items which are found during the bank reconciliation process are not posted. The vendor account had reconciling items from December, February and March which were not posted until after year -end by journal entry .A reconciling item for one account from June, 1998 was not posted until after the end of the current year by journal entry.

3. The June, 2000 reconciliation for the vendor account and the payroll account showed unreconciled differences of approximately $12,000 and $32,000, respectively. The April reconciliation for the payroll account showed a different amount for the unreconciled difference. An entry was made by the University to adjust the vendor account difference but the payroll account difference was not recorded.

4. The clearing account which the Medical Center has with the State Comptroller General contained approximately $57,000 in tax garnishments and $18,000 in credit card receipts which had not been recorded. Some of the tax garnishments were from April.

Good internal controls require the timely recording of all transactions and the proper reconciling of all bank accounts.

We recommend that all bank account activity including interest earnings and reconciling items be recorded in a timely manner. The University should ensure that it receives bank statements supporting all account activity and that all bank accounts be reconciled so that there are no unreconciled differences.

MANAGEMENT'S RESPONSE

Management agrees with this recommendation. For the Medical Center Equipment Lease accounts, copies of the bank statements will be received from the Trustee so that the accounts may be reconciled and all transactions recorded properly and in a timely manner. On the University bank accounts, additional procedures have been added to the reconciliation review process to ensure that all reconciling items are addressed timely.

PAYROLL LIABILITIES NOT RECONCILED TO SUPPORT

Our audit disclosed that University personnel are not reconciling the payroll liability accounts per the general ledger to supporting documentation. University personnel spent a significant amount of time subsequent to year-end at our request in trying to reconcile these account balances and found some of the following causes.

1 The University had paid in amounts for health insurance for employees which was not due. The University had not prepared the paperwork necessary to delete these employees from the billing prepared by the Office of Insurance Services. The Office of Insurance Services has told University personnel that they would not refund more than three months of premiums per employee once notice of terminations is received. Therefore any overpayments in excess of three months would be lost.

2 Departments had been charged for health insurance for employees which had not actually been paid.

3. Annuity payments had been withheld from some employees paychecks and had not been remitted to the carrier.

Good internal controls require the timely reconciliation of all balance sheet accounts. The failure to timely reconcile these accounts resulted in the loss of funds to the University and resulted in the University not properly remitting all funds that had been withheld from employee's paychecks.

The same finding was reported in the prior year's management letter.

We recommend that a formal reconciliation process be established for each payroll liability account. All amounts withheld from an employees paycheck should be remitted in a timely manner and all paperwork should be prepared and submitted timely.

MANAGEMENT'S RESPONSE:

Management agrees with this recommendation. Implementation of a new payroll system during the current year required significant human resources and impeded efforts to timely reconcile all balance sheet accounts. The University is currently bringing all reconciliations current and has added new insurance reconciliation reports to facilitate monthly reconciliations of liability accounts.

C. OTHER WEAKNESSES

IMPROVEMENTS NEEDED IN CONTROLLING FIXED ASSETS

In testing items located at the University to its fixed asset ledger records, we noted that ten items out of twenty were located in a location different than shown on the fixed asset ledger records. 7 of the 10 assets were located in a different building. In addition one of the twenty items could not be located at all. The same finding was cited in the prior year's management letter.

It appears that the Department responsible for the fixed asset ledger records is not being notified when equipment is moved from one location to another. The failure to report the changes in locations of fixed assets resulted in an excess amount of time being spent by University personnel and the auditors in attempting to locate the items.

We recommend that the University review its procedures over the control of fixed assets. The individual departments of the University should be held responsible for ensuring that all required forms are completed and submitted to the fixed asset department in a timely manner for changes in custodians and movement of equipment. University internal auditor's should perform surprise fixed asset observations during the year.

MANAGEMENT'S RESPONSE:

The University agrees with this recommendation. All departments will be reminded of the need to report changes timely to Asset Management. In addition, procedures are being developed to make compliance easier for the user departments, including the use of an "on-line" equipment movement form.

OLD OUTSTANDING CHECKS NOT BEING TIMELY VOIDED

Our audit disclosed that the University is not timely making entries to void old outstanding payroll checks. Approximately $42,000 in outstanding payroll checks from the year ended June 30, 1999 had not been voided. In addition, approximately $62,000 in payroll checks that were voided in July, 1999 attributable to the period ended June 30, 1998 was posted to a miscellaneous revenue account instead of a liability account. State law requires the voided payroll checks to be remitted to the State Treasurer. A further review of the $62,000 disclosed that approximately $5,000 of these subsequently cleared the bank account but that no entry had been made to record this transaction. This is one of the causes for unreconciled difference condition cited earlier in the management letter comment titled "Deficiencies in Bank Account Reconciliations".

University policy requires outstanding checks to be voided annually.

The same finding was cited in last year's management letter.

We recommend that the University timely void old outstanding checks. The University should attempt to determine why the checks were not cashed and reissue if necessary. Any voided checks should be recorded in a liability account and remitted to the State Treasurer as required.

MANAGEMENT'S RESPONSE

The University agrees with this recommendation and will take steps to ensure that the University policy requiring timely voiding of checks and remission to the State Treasurer is followed.

DEFICITS IN AGENCY FUND BALANCES

Our review of the balances that comprised the agency fund balances disclosed that one account had a negative cash balance that had not had any activity since June, 1997. Another account which accounts for purchases by the vendor that handles the University's computer services had a overdraft balance of approximately $1,265,000 which represents disbursements on the vendor's behalf for which the University had not been reimbursed and one of the component units had an overdraft balance of approximately $31,000.

By allowing accounts to have an overdraft balance, the University is at risk of losing University funds and causes the State to lose interest earnings.

We recommend that the University develop and implement procedures that requires periodic monitoring of agency fund accounts. In addition, the University should ensure that controls are in place that will prevent accounts from expending funds in excess of available resources.

MANAGEMENT'S RESPONSE:

Cash Management will establish procedures to review agency funds monthly to identify and follow up with departments and related parties for corrective action as necessary.

STATUS OF PRIOR AUDIT FINDINGS

We performed an audit similar in scope for the year ended June 30, 1999. A management letter dated November 19, 1999 was issued which contained the following findings:

A. Material Reportable Conditions
   - Errors in accounts payable schedule
   - Deficiencies noted in accounting for grants
   - Entries posted without review of supporting documentation
   - Medical Center not timely recording activity with component units.
   - Plant fund assets not reconciled to detailed listings
   - Allowance account for Medical Center patient receivables understated
   - Pharmacy accounts receivable not reconciled to supporting documentation

B. Other Reportable Conditions
   - Improvements needed over student loans and accounts receivable
   - Errors noted in inventory counts, pricing and listings

C. Other Weaknesses
   - Improvements needed over fiscal management and responsibility
   - Improvements needed in controlling fixed assets
   - General ledger accounts not reconciled to supporting documentation
   - Old outstanding checks not being timely voided
   - Invoices not paid timely

Corrective actions was taken on the following:

A. Material Reportable Conditions
   - Deficiencies noted in accounting for grants
   - Entries posted without review of supporting documentation
   - Medical Center not timely recording activity with component units
   - Plant fund assets not reconciled to detailed listings
   - Allowance account for Medical Center patient receivables understated
   - Pharmacy accounts receivable not reconciled to supporting documentation

B. Other Reportable Conditions
   - Improvements needed over student loans and accounts receivable
   - Errors noted in inventory counts, pricing and listings

C. Other Weaknesses
   - Improvements needed over fiscal management and responsibility
   - Invoices not paid timely

The remaining findings are also cited in the current year's management letter comments on pages 2 to 5.