Whatcom Community College
July 1, 2013 through June 30, 2014

2014-001 The College's controls over financial reporting are inadequate to ensure accurate financial reporting.

Background

It is the responsibility of the College to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting. Our audit identified a material weakness in controls that adversely affects the College's ability to produce reliable financial statements.

Government Auditing Standards, prescribed by the Comptroller General of the United States, require the auditor to communicate material weaknesses as defined below in the Applicable Laws and Regulations section, as a finding.

Description of Condition

We identified the following deficiencies in internal controls over financial reporting that, when taken together, represent a material weakness over financial reporting:

- College staff did not adequately research or seek technical guidance on how to appropriately record transactions on the financial statements.
- Although the College has procedures in place to perform a final review of the prepared financial statements prior to audit, the review was not effective in detecting significant errors.

Cause of Condition

This is the first year that the College has prepared financial statements. The College has not committed the necessary time and resources to ensure staff understand and are trained in proper accounting procedures.

Effect of Condition

We identified the following errors in the financial statements we received for audit that were not detected by College management:

Under-reported the following:

- Capital assets, net of depreciation by approximately $1,961,171

Over-reported the following:

- Federal grants and contracts revenue and Scholarships and fellowships expense each by $5,193,842.
- Cash and cash equivalents by $87,731.

Misclassified the following:

- Net investment in capital assets by $255,000.
- Restricted for student aid for $77,453

We also identified several presentation errors in the financial statements that individually were not significant; however, impair the understandability of the financial report.

The College subsequently corrected all identified errors.

These deficiencies in internal controls make it reasonably possible that additional misstatements could continue to occur and not be prevented or detected by the College in the future.

Recommendation

We recommend the College:

- Dedicate the necessary time and resources to ensure procedures are in place, such as training and oversight to ensure reported financial statement balances are valid, accurate, complete and adequately supported.
- Establish an effective review process of the financial statements by a person knowledgeable of GAAP reporting requirements to ensure accurate preparation and reporting of the College's financial statements.

College's Response

The College acknowledges that errors were made in the process of producing its inaugural set of GASB compliant financial statements. Actions have already been taken, and procedures put in place to rectify the causes for misclassification.

Training for staff involved in the booking of capital assets has taken place. Further, a process to communicate with the facilities staff to properly classify capital expenses during construction has been developed.

The method to re-classify revenue from federal student loan funds to prevent double-counting by the financial system is now fully understood, and clearly documented for future financial statement preparation. While the adjusting entry was not recorded in the accounting system, the College acknowledges the misstatement and believes the error was due to inexperience with the use of the NACUBO form, rather than a lack of internal control.

Additional training, experience, and a more favorable timeline will ensure that the College's financial statements will be free from similar misclassifications and reporting errors in the future.

Auditor's Remarks

We appreciate the steps the College is taking to resolve this issue and thank the College for its cooperation, assistance and corrective action taken during the audit. We will review the condition in our next audit.

Applicable Laws and Regulations

Government Auditing Standards, July 2007 Revision – Section 5.11 provides that auditors should report material weaknesses and significant deficiencies in internal control.

The American Institute of Certified Public Accountants, Statement on Auditing Standards No. 115 defines significant deficiencies and material weaknesses as follows:

> a. Significant deficiency: A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.
>
> b. Material weakness: A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

RCW 43.88.160, Fiscal management – powers and duties of officers and agencies, states in part:

(4) In addition, the director of financial management, as agent of the governor, shall:

(a) Develop and maintain a system of internal controls and internal audits comprising methods and procedures to be adopted by each agency that will safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies for accounting and financial controls. The system developed by the director shall include criteria for determining the scope and comprehensiveness of internal controls required by classes of agencies, depending on the level of resources at risk.

The Office of Financial Management's *State Administrative and Accounting Manual* (SAAM), states in part:

Section 20.15.30.a *Who is responsible for internal control?*

The agency head or authorized designee is ultimately responsible for identifying risks and establishing, maintaining, and reviewing the agency's system of internal control. If the agency head delegates this responsibility, the designated person should have sufficient authority to carry out these responsibilities. Normally, this person is a senior agency manager who does not serve in the internal audit function.

Section 20.15.40.c *Control Activities*

Control activities help ensure risk responses are effectively carried out and include policies and procedures, manual and automated tools, approvals, authorizations, verifications, reconciliations, security over assets, and segregation of duties. These activities occur across an agency, at all levels and in all functions, and are designed to help prevent or reduce the risk that agency objectives will not be achieved. Managers set up control activities to provide reasonable assurance that the agency and business unit objectives are met. An example of a control activity is something as simple as listing tasks assigned to staff members and then periodically checking the list to verify that assignments are completed on time. Refer to Section 20.25 for further discussion of control activities.

Section 20.15.40.e *Monitoring*

Things change and, by monitoring the risks and the effectiveness of control measures on a regular basis, an agency can react dynamically to changing conditions.

Monitoring evaluates the effectiveness of an agency's internal controls and is designed to ensure that internal controls continue to operate effectively. Monitoring is effective when it leads to the identification and correction of control weaknesses before they materially affect the achievement of the agency's objectives. An agency's internal control is most effective when there is proper monitoring, results are prioritized and communicated, and weaknesses are corrected and followed up on as necessary.

There are two types of monitoring: ongoing and periodic. Ongoing monitoring occurs in the course of operations. It includes tasks such as supervisory reviews of reconciliations, reports, and processes. Periodic monitoring includes tasks such as periodic internal audit sampling and annual reviews of high-risk business processes. Internal control deficiencies uncovered by monitoring should be reported to higher levels of management.