Lower Columbia College
July 1, 2013 through June 30, 2014

2014-001 The College should improve internal controls over 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. We identified deficiencies in internal controls that could adversely affect the College's ability to accurately report its financial statements.

Description of Condition

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

- Those preparing the statements lacked adequate resources to ensure transactions were appropriately reported under generally accepted accounting principles.
- The review performed on the financial statements and notes was not adequate to ensure they were complete and accurate.

Cause of Condition

This is the first year that the College has prepared financial statements. The College relied heavily on one individual to prepare the financial statements and has not dedicated sufficient resources to ensure accurate financial reporting.

Effect of Condition

We identified the following errors in the original financial statements we received for audit:

- The College mistakenly reported Stafford Loan proceeds and repayments of $6,555,074 on their operating statement.
- The College misclassified $6,962,158 of Pell Grant revenue as operating revenue rather than non-operating revenue.

- The College misclassified $1,943,197 of head start receipts as "Other Revenues" rather than federal revenues.
- On the statement of cash flows, the College misclassified debt receipts of $13,059,327 and Pell Grant proceeds of $6,962,158 as operating cash flows rather than financing cash flows.

The errors noted above were corrected in the College's final financial statements.

Recommendation

We recommend the College dedicate the necessary time and resources to ensure procedures are in place, such as training and oversight, to ensure the financial statements are accurate, complete and in compliance with generally accepted accounting principles.

College's Response

Thank you for working with Lower Columbia College (LCC) on our FY13-14 inaugural Financial Statement Audit. LCC is one of 34 colleges in the community/technical college system creating GASB financial statements for the first time in their history and produced its FY13-14 GASB financial statements with guidance and direction from State Board for Community and Technical Colleges (SBCTC) accounting staff. The GASB financial statements were prepared and reviewed by LCC finance office staff along with the assistance of an independent contractor.

The College finds it difficult to agree that it should have put more resources into preparing and reviewing the GASB financial statements. Since 2008, LCC has experienced around 25% reductions in its state allocation, making it difficult to allocate limited resources from its core business operations (Instruction and Student Services) to the finance office to prepare and review GASB financial statements. Nonetheless, LCC did allocate additional resources to the preparation and review of the GASB financial statements by assigning these duties to current LCC staff and hiring an independent contractor to assist them. The errors identified in the original financial statements were the result of misclassifications due to this being our first year of producing GASB financial statements and were easily corrected in our financial statements. We are confident that the College's future financial statements will be free from similar misclassifications.

Auditor's Remarks

We understand the difficult challenge of allocating limited resources between competing demands and thank the College for its cooperation and assistance during the audit. We will review the corrective action taken in our next regularly scheduled audit.

Applicable Laws and Regulations

Government Auditing Standards, December 2011 Revision, paragraph 4.23, states:

> 4.23 When performing GAGAS financial audits, auditors should communicate in the report on internal control over financial reporting and compliance, based upon the work performed, (1) significant deficiencies and material weaknesses in internal control; (2) instances of fraud and noncompliance with provisions of laws or regulations that have a material effect on the audit and any other instances that warrant the attention of those charged with governance; (3) noncompliance with provisions of contracts or grant agreements that has a material effect on the audit; and (4) abuse that has a material effect on the audit.

The American Institute of Certified Public Accountants defines material weaknesses and significant deficiencies in its *Codification of Statements on Auditing Standards*, Section 265, as follows:

> **.07** For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:
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> Material weakness. A deficiency, or a 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.
>
> Significant deficiency. 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.

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.