OLA

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial-Related Audit

Lake Superior College

July 1, 1996, through December 31, 1999

SEPTEMBER 7, 2000 **00-42**

Financial Audit Division

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- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

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Dr. Kathleen Nelson, President
Lake Superior College

We have audited selected areas of Lake Superior College for the period July 1, 1996, through December 31, 1999, as further explained in Chapter 1. Our audit scope included tuition and fees, payroll, operating expenditures, state and private financial aid, and bookstore operations. We also reviewed the college's internal controls over compliance with federal student financial aid for fiscal year 2000.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, as issued by the Comptroller General of the United States. These standards require that we obtain an understanding of management controls relevant to the audit. These standards also require that we design the audit to provide reasonable assurance that Lake Superior College complied with the provisions of laws, regulations, contracts, and grants significant to the audit. Management of the college is responsible for establishing and maintaining the internal control structure and for compliance with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission, the management of Lake Superior College, and the members of the Minnesota State Colleges and Universities Board of Trustees. This restriction is not intended to limit the distribution of this report, which was released as a public document on September 7, 2000.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: April 20, 2000

Report Signed On: August 29, 2000

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Renee Redmer, LPA	Audit Manager
Jack Hirschfeld, CPA	Auditor-In-Charge
Neal Dawson	Auditor
Dan Kingsley	Auditor
Mike Willis	Auditor

Exit Conference

The following staff from Lake Superior College and the MnSCU system office participated in the exit conference held on July 31, 2000:

System Office:	
Laura King	Vice Chancellor, Chief Financial Officer
Rosalie Greeman	Associate Vice Chancellor, Financial Reporting
John Asmussen	Executive Director of Internal Auditing
Deb Winter	Director of Campus Accounting
Kim McLaughlin	Audit Coordinator
Andrew Boss	Chair, MnSCU Audit Committee
Lake Superior College:	
Kathy Nelson	President
Rick Halvorson	Vice President
Wendy Venier	Accountant

Report Summary

Lake Superior College operated within available financial resources and generally complied with applicable legal provisions and management's authorization. The college made significant improvements in its financial management since our last audit report was issued. However, we found the following internal control weaknesses impacting the safeguarding of assets and recording of financial activities in the college's accounting systems:

Key Findings:

- Lake Superior College did not verify the accuracy of its accounting records. (Finding 1, page 6)
- The college did not limit access to its computer systems. (Finding 2, page 8)
- The college did not maintain sufficient collateral for its local bank account. (Finding 3, page 9)
- The college did not properly monitor academic progress for recipients of financial aid resulting in overpayments to eleven students. (Finding 7, page 19)

Lake Superior College is part of the Minnesota State Colleges and Universities (MnSCU) System. This **financial –related audit report** represents the conclusions of our audit of the college's tuition and fees, payroll, bookstore operations, private grants, and other operating expenditures for the period July 1, 1996, through December 31, 1999. We also reviewed the college's internal controls over compliance with federal student financial aid for fiscal year 2000. The college's response is included in the report.

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Chapter 1. Introduction

Lake Superior College is one of 35 colleges and universities included in the Minnesota State Colleges and Universities (MnSCU) System. The MnSCU Board of Trustees appointed Dr. Kathleen Nelson as president of Lake Superior College on July 1, 1997.

Lake Superior College is a comprehensive community and technical college in Duluth, Minnesota. Most of the college's programs and services are located on the main campus. The college also operates a fire fighter training site and an off-campus diesel and truck-driving program. On January 14, 2000, Lake Superior College opened its new Technology Center in the Duluth Technology Village. The technology center will provide regular workshops and classes in a computer lab, and will include internship programs for computer majors.

Lake Superior College offers certificate diplomas in technical programs and Associate in Arts and Associate in Science degrees, as well as the Minnesota Transfer Curriculum. The fastest growing segment of the college's student body is made up of students preparing to transfer to four-year colleges and universities. The number of students attending Lake Superior College for the year ended June 30, 1999, totaled 4,569. This represents 2,178 full-time equivalent students.

Lake Superior College funds its operations from three main sources: state appropriation allocations, tuition and fees, and federal revenue. Table 1-1 provides a summary of the college's financial activity for fiscal year 1999.

Table 1-1
Lake Superior College Revenues, Expenditures/Expenses, and Changes in Fund Balance
Fiscal Year Ended June 30, 1999

	General Fund	Special Revenue Fund	Enterprise Fund	Trust Fund
Revenues:				
State Appropriations	$11,145,449	$ 0	$ 0	$ 0
Tuition and Fees	6,004,143	249,635	6,010	0
Sales and Services	81,639	4,578	448,071	0
Federal Grants	0	3,241,094	0	0
State Grants	1,033,023	0	0	0
Private Grants	3,750	0	0	185,682
Other Income	101,658	1,151	3,335	0
Total Revenues	$18,369,662	$3,496,458	$457,416	$185,682
Expenditures/Expenses:				
Salaries	$11,629,293	$ 777,689	$186,386	$ 0
Purchased Services	1,716,000	35,938	39,220	0
Utilities	381,132	0	0	0
Contracts/Consultants	96,483	0	0	0
Supplies	1,068,877	125,272	5,504	0
Financial Aid	751,163	1,832,480	0	188,930
Capital Expenditures	298,314	48,598	0	0
Debt Service	734,666	0	0	0
Other	280,551	91,961	3,800	0
Total Expenditures/Expenses	$16,956,479	$2,911,938	$234,910	$188,930
Transfers:				
Transfers-In	$ 733,164	$ 51,764	$ 12,583	$ 0
Transfers-Out	(39,293)	(601,787)	(99,891)	0
Net Transfers	$ 693,871	($ 550,023)	($ 87,308)	$ 0
Change in Fund Balance	$ 2,107,054	$ 34,497	$135,198	$ (3,248)
Beginning Fund Balance	2,018,008	281,724	635,555	7,763
Ending Fund Balance	$ 4,125,062	$ 316,221	$770,753	$ 4,515

Note 1: This statement is prepared on the budgetary basis of accounting and is provided for informational purposes only. MnSCU budgetary accounting, which is the basis for annual budgets and the allocation of state appropriations, differs from GAAP. MnSCU budgetary accounting includes all receipts and expenditures up to the close of the books (mid-September) for the budget fiscal year. Revenues not yet received by the close of the books are not included. The criterion for recognizing expenditures is the actual disbursement, not when the goods or services are received. Capital project revenues and expenditures are not included. Beginning and ending fund balances do not reflect assets, such as accounts receivable and prepaid assets, or long-term liabilities, such as debt and compensated absences.

Note 2: Compensated absence liabilities at June 30, 1999, were $1,115,598, $53,460, and $18,402 for the General Fund, Special Revenue Fund, and the Enterprise Fund, respectively. These liabilities represent the amount due college employees for accrued vacation leave, sick leave, and compensatory leave at June 30.

Note 3: The General Fund ending balance included an unrestricted reserve of $1,247,638, as calculated by the college. The reserve was part of the college's general operating budget for which no use is currently planned. The remaining fund balance was restricted for various commitments, including retiree health benefits of $1.5 million, contract obligations, and departmental activities.

Note 4: Enterprise funds do not include all operating costs, such as rent or utilities. Indirect costs totaling $10,186 were allocated to bookstore operations for fiscal year 1999.

Note 5: Enterprise Fund sales and services are net of cost of goods sold, as follows:

Sales and Services-Gross	$1,303,437
Cost of Goods Sold	855,366
Sales and Services-Net	$ 448,071

Note 6: Transfers of approximately $470,000 were made from the Special Revenue Fund to the General Fund in fiscal year 1999. The transfers were for federal reimbursements of prior year's costs incurred for the Aircraft Rescue Fire Fighting Facility.

Source: Prepared by MnSCU accounting staff as adjusted by OLA auditors.

Chapter 2. Financial Management

Chapter Conclusions

Lake Superior College operated within available resources and generally complied with applicable legal provisions and management's authorization. However, we found the following internal control weaknesses impacting the safeguarding of assets and recording of financial activities in the college's accounting systems. The college did not verify the accuracy of accounting records, limit access to its business systems, or properly monitor collateral for the local bank account. Other control weaknesses included not maximizing the investment of local funds and not monitoring renewal of the child care center contract.

Lake Superior College uses the MnSCU accounting system to record its financial activity and to initiate transactions. MnSCU accounting interfaces with the statewide accounting system (MAPS) to generate warrants from the state treasury. MnSCU system office also requires that all campuses use the MnSCU accounting system to account for money maintained outside of the state treasury. Lake Superior College administered certain funds, including financial aid and enterprise activities, in one local bank account. This account also served as the state depository for transfer of funds into the state treasury.

Audit Objectives and Methodology

Our review of Lake Superior College's financial management focused on the following objectives:

- Did the college's internal controls provide reasonable assurance that it properly recorded financial activities on the MnSCU and MAPS accounting systems?

- Did the college's internal controls provide reasonable assurance that it operated within available financial resources in compliance with applicable legal provisions and management's authorization?

- Did the college's internal controls provide reasonable assurance that it had an appropriate relationship with its foundation?

- Did the college comply with applicable legal provisions regarding local bank accounts?

Lake Superior College

To answer these questions, we interviewed college staff to gain an understanding of the college's use of MnSCU accounting for programs in our audit scope. We also gained an understanding of the management controls, including budgeting, budget monitoring, and reconciliations of local bank account activities. We reviewed local bank account activity to determine compliance with material finance-related legal provisions, such as the adequacy of collateral. We also reviewed the college's relationship with its foundation. Finally, we reviewed security privileges to determine whether the college had adequately restricted access to its computerized business systems.

Budgetary Controls

MnSCU receives the majority of its funding for operations from General Fund appropriations. The MnSCU system office allocates appropriated funds to Lake Superior College and all colleges and universities based on an allocation formula. In addition, Lake Superior College, like other campuses, retains the tuition and other receipts it collects to arrive at its total authorized spending level.

After our last audit in 1997, Lake Superior College established a finance committee composed of faculty and administrative officials to oversee the budgeting process. This committee receives and reviews departmental budget requests and submits a budget to the president for approval. Once the president determines the college's authorized spending level, the finance committee allocates spending budgets to the various administrative areas and academic departments. The college establishes individual cost centers for each department or office to monitor its budget status. The finance committee monitors projected versus actual student enrollment to ensure that sufficient tuition revenues will be received to support the spending budget. The college also builds a reserve balance into its budget formula. As of June 30, 1999, Lake Superior College had about an eight percent budget reserve, or approximately $1,248,000.

Conclusions

Lake Superior College has made significant improvements in its overall financial management since our last audit. Some notable areas of improvement include appropriate budgetary controls, ongoing reconciliations of the local bank account cash balances, the timely input of new employees in the personnel system, and increased controls over fixed assets.

Lake Superior College operated within available resources and generally complied with applicable legal provisions and management's authorization. However, we found the following internal control weaknesses impacting the safeguarding of assets and recording of financial activities in the college's accounting systems. The college did not verify the accuracy of its accounting records, limit access to its business systems, or properly monitor collateral for the local bank account. Other control weaknesses included not maximizing the investment of local funds and not monitoring the renewal of the child care center contract.

1. PRIOR AUDIT RECOMMENDATIONS PARTIALLY RESOLVED: Lake Superior College did not verify the accuracy of its accounting records.

Lake Superior College had not ever reconciled the MnSCU and MAPS accounting systems. Although the college had attempted to reconcile the financial transactions on MnSCU accounting to MAPS, it had not resolved certain variances dating back to 1995. The federal grant account and the general appropriation account had unresolved cash balance differences at March 2000 of $218,000 and $255,000, respectively. In addition, the college had not attempted to reconcile the payroll clearing account. The reconciliation process is important to ensure that the college has properly recorded its financial activity.

We identified various errors in the recording of financial activity on MnSCU accounting. The errors resulted in certain financial activities being recorded in the incorrect fund type at year end. The college should record its financial activity correctly to ensure the integrity of the accounting records. Table 2-1 shows certain recording errors we identified during our audit.

Table 2-1
Financial Activities Not Properly Recorded
July 1, 1996, through December 31, 1999

Financial Activity	Recording Issue
Payroll Clearing Account/Agency Fund	The college recorded bond proceeds and equipment expenditures totaling $1,635,000 in its payroll clearing account during fiscal year 1997. This amount was not cleared out of this account as of March 2000.
	The MnSCU system office recorded chargebacks as receipts totaling $1,368,000 for fiscal years 1997 and 1998 to the general payroll posting errors cost center. Chargebacks include various system office administrative costs funded by state appropriations. The college had not properly allocated these costs to the appropriate programs as of March 2000.
Federal Grants/Special Revenue Fund	The college did not properly record the transfer of federal reimbursements totaling $230,000 to the General Fund.
Higher Education Preservation /General Fund	This account showed expenditures of $30,355 for fiscal year 2000; however, the college had not recorded the related appropriation.
Private Grants Account /Endowment Fund	The college did not record certain grants in the Endowment Fund for fiscal year 2000. The college recorded student tuition grants of $185,000 for fiscal year 1999. However, in fiscal year 2000, the account showed only limited financial activity. Due to modifications in the tuition receivable system, the financial activity was recorded in the General Fund.

Source: Auditor prepared.

Lake Superior College has started to investigate and resolve these errors. Complete and accurate accounting records are necessary to evaluate the financial status of the college activities.

Recommendations

- *Lake Superior College should reconcile the financial activity on the MnSCU and MAPS accounting systems annually to ensure that it has been correctly recorded.*
- *Lake Superior College should correct the recording of financial activity in the MnSCU accounting system.*

2. Lake Superior College did not limit access to its computer systems.

Lake Superior College did not adequately administer and control access to its computerized business systems, including MnSCU accounting, SCUPPS Human Resources and the accounts receivable module in the Integrated Student Information System (ISRS), and the SEMA4 payroll system. Three individuals have responsibility for computer system access. The director of computer services is responsible for access to the local network. The human resources director is responsible for access to SCUPPS, and the registrar is responsible for access to the other ISRS systems. The college has primary responsibility to ensure employee access is necessary based upon job responsibilities. Our review of the security administration's access to college computerized systems disclosed the following weaknesses:

- One employee had incompatible access to MnSCU's payroll and personnel systems. This employee had full payroll access in SEMA4 and had update access to critical screens in the SCUPPS human resources module. This employee had the ability to create employees, establish salary information, and could enter payroll transactions. By giving incompatible access to the payroll and personnel systems, a user could create fictitious employees and initiate fraudulent payroll warrants.

- Three employees had incompatible access to accounts receivable and cashiering screens on the accounts receivable module. These users had the ability to update tuition and/or fee rates, perform cashiering and A/R functions, enter tuition waivers and deferments, and change the residency code for any student. These users have the potential to inappropriately modify tuition and registration charges, and also improperly adjust accounts receivable and waivers. The capability to produce tuition adjustments and waivers should not be assigned to users with cashiering functions.

- Six employees had unnecessary update access to screens in the accounts receivable module. In addition, we found that 17 employees had update access to the accounts receivable and accounting modules, giving them the ability to change tuition rates and fees. Eleven of the 17 employees with improper access were system office employees. This creates a risk that users could initiate unauthorized transactions. Users should only be granted the minimum amount of access necessary to perform their job responsibilities.

- Nine MnSCU system office employees had the ability to update Lake Superior College's accounting, accounts receivable, and human resources data. These employees do not need to have update access.

Recommendation

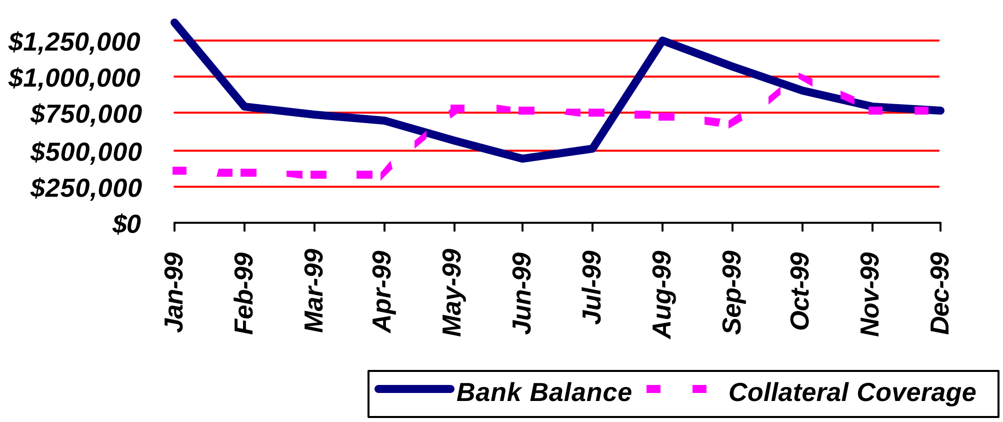
- *The college should periodically review system access, limit access to current staff requiring it to complete their job responsibilities, and eliminate any incompatible access. If the college is unable to eliminate incompatible access, it must develop detection controls that would provide a periodic and independent review of the employees' work.*

3. PRIOR AUDIT FINDING PARTIALLY RESOLVED: Lake Superior College did not maintain collateral for its local bank accounts.

Lake Superior College did not maintain the legally required amount of collateral for its local bank account. In our prior audit report, we recommended that the college comply with the statutory requirements and maintain collateral sufficient to secure the local bank account cash balance. Since the prior audit, the college has established an agreement with its bank to provide collateral for its account. However, the college did not adequately monitor its cash balance and maintain sufficient collateral. Figure 2-2 compares the month-end bank balances with the amount of collateral coverage for calendar year 1999.

Figure 2-2 shows that for calendar year 1999 the month-end bank balance exceeded the collateral coverage (including FDIC Insurance) for 8 out of 12 months. Similar shortages also occurred throughout the month. The college needs to continually determine the maximum uninsured amount and establish the necessary collateral. MnSCU board policy 7.5 requires that colleges maintain sufficient collateral for its bank accounts.

Figure 2-2
Collateral Coverage vs. Bank Balances
Calendar Year 1999



Source: Lake Superior College Bank Statements and Collateral Statements.

The college has recently obtained the ability to monitor the bank balance through the Internet. Using this option, the college will be able to review its bank balance on a daily basis and require the bank to pledge additional collateral as necessary.

Recommendation

- *Lake Superior College should comply with statutory requirements and obtain sufficient collateral to secure the local bank account cash balance.*

4. The college did not maximize its investment earnings for funds in its local bank account.

Lake Superior College did not properly invest available cash in its local accounts. We determined that the college had approximately $620,000 as of March 2000 in its local checking account that could be invested at a higher rate. This amount represents cash in the bookstore, food service, parking permits, student life, and health services. At the time of our review, cash in the local checking account earned interest of approximately 1.10 percent annually. However, the college's bank also offered an interest bearing account with an interest rate of approximately 6.25 percent. This option would include a daily sweep of available cash, which would be transferred to the higher interest bearing account. The cash would still be available on a daily basis as needed by the college. The management of the college is responsible for the effective and reasonable use of available funds, including the investment of money not required for immediate need.

Recommendation

- *Lake Superior College should analyze its cash needs and establish a cash management strategy to maximize its investment earnings.*

5. The college did not adequately monitor the status of the child-care contract.

The college did not renew the expired contract for the child-care center. The college had a service contract with a vendor to operate a child-care center. The contract did not require an exchange of funds. This service contract expired on June 30, 1999. The contract provided that it could be renewed by written agreement of the parties. However, the college did not renew the agreement, even though the vendor continued to operate the child-care center. The college also did not maintain a copy of the insurance certificate. The college is susceptible to increased risk and significant potential liability without a clear definition of the rights and obligations of the parties. It is important to have current contracts and other supporting documents for contractual arrangements.

Recommendations

- *The college should renew the contract with the vendor providing child-care services.*

- *The college should obtain copies of insurance certificates when required by contracts.*

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Chapter 3. Tuition and Fees

Chapter Conclusions

Lake Superior College's internal controls provided reasonable assurance that the appropriate tuition and fee revenues were collected, adequately safeguarded, and accurately reported in the accounting records. For the items tested, the college complied with applicable finance-related legal provisions and management's authorization. However, as discussed in Chapter 2, Finding 2, the college did not adequately restrict access to its accounts receivable system.

Lake Superior College collected approximately $20.3 million in tuition and fees during the period from July 1, 1996, through December 31, 1999. The college collected tuition at a resident rate of $41.60 per quarter credit plus fees for fiscal year 1997 and $42.45 per quarter credit for fiscal year 1998. In fiscal year 1999, the college changed to a semester system and assessed resident students $66.25 per semester credit. In fiscal year 2000, the college assessed resident tuition at $68.25 per semester credit. Table 3-1 shows the tuition, fees, and non-credit tuition revenue for fiscal years 1997 through 1999.

Table 3-1
Tuition and Fee Revenues
Fiscal Years 1997 through 1999

Revenue Source:	1997	1998	1999
Tuition	$3,743,006	$4,215,585	$4,399,526
Fees	444,189	480,817	784,436
Non-credit tuition	787,807	959,308	1,075,906
Total	$4,975,002	$5,655,710	$6,259,868

Note 1: Tuition amount is net of tuition refunds.

Source: MnSCU accounting system.

Lake Superior College collected tuition and fees at the college business office. The college used the Collegiate Information System for registration, fee assessment, and accounts receivable functions during fiscal year 1997-1999. The business office reconciled each day's tuition receipts to a daily report generated by ISRS, prepared the deposit, and entered the receipts into the MnSCU accounting system. In fiscal year 2000, the college implemented the Student Information System Accounts Receivable module, which automated certain recording functions.

In addition to its regular programs, the college provided non-credit programs consisting of customized training and continuing education, as well as senior citizen programs.

Lake Superior College

Audit Objectives and Methodology

Our review of Lake Superior College's tuition and fees focused on the following questions:

- Did the college design and implement internal controls to provide reasonable assurance that the appropriate tuition and fee revenues were collected, adequately safeguarded, and accurately reported in the accounting records?

- Did the college comply with applicable legal provisions and management's authorization?

To answer these questions, we interviewed staff to obtain an understanding of the internal controls over billing, collecting, depositing, and recording tuition and fee revenues. We tested a sample of transactions to determine if deposits were timely made and if the college accurately recorded tuition and fee transactions on the MnSCU accounting system. Finally, we reviewed how the college monitored and pursued collection of outstanding accounts receivable.

Conclusions

Lake Superior College internal controls provided reasonable assurance that the appropriate tuition and fee revenues were collected, adequately safeguarded, and accurately reported in the accounting records. In addition, for the items tested, the college complied with material finance-related legal provisions and management's authorization. However, as discussed in Chapter 2, Finding 2, the college did not adequately restrict access to its accounts receivable system.

Chapter 4. Payroll

Chapter Conclusions

Lake Superior College's controls provided reasonable assurance that payroll expenditures were accurately reported in the accounting records and in compliance with applicable legal provisions and management's authorization. For the items tested, the institution complied, in all material respects, with the significant finance-related legal provisions concerning payroll. However, the college did not monitor the input of leave balances for the payroll officer. In addition, as explained in Chapter 2, Finding 2, the college did not adequately restrict employee access to its human resource and payroll systems.

Payroll represents the college's largest expenditure, totaling $ 12.6 million in fiscal year 1999. The university had separate human resources and payroll departments. The payroll department reviewed, approved, and processed payroll data. Human resource staff reviewed, approved, and processed personnel data. Lake Superior College used the State Employee Management System (SEMA4) and the State Colleges and Universities Personnel/Payroll System (SCUPPS) to process payroll information. Staff assignments, pay rates, and bargaining agreement information were maintained in SCUPPS. SCUPPS interfaces into SEMA4 to generate employee paychecks or direct bank deposits.

Audit Objectives and Methodology

Our review focused on the following objectives:

- Did the college's internal controls provide reasonable assurance that payroll expenditures were accurately reported in the accounting records and in compliance with applicable legal provisions and management's authorization?

- For the items tested, did the college comply, in all material respects, with material finance-related legal provisions governing payroll?

To answer these questions, we made inquiries of college staff to gain an understanding of the internal control structure over the payroll and personnel process. We analyzed payroll expenditures to determine proper recording of payroll transactions, reviewed source documents to determine proper authorization, and tested salaries to ensure proper payment pursuant to contract provisions. We reviewed and tested employee leave balances maintained by the college.

Conclusion

Lake Superior College's internal controls provided reasonable assurance that payroll expenditures were accurately reported in the accounting records and in compliance with applicable legal provisions and management's authorization. For the items tested, the institution complied, in all material respects, with the significant finance-related legal provisions concerning payroll. The college did not monitor the input of leave balances for the payroll clerk. In addition, the college did not adequately restrict access to it payroll and human resources systems as discussed in Chapter 2, Finding 2.

6. Lake Superior College did not monitor the input of hours worked for the payroll clerk.

The college did not independently verify leave balances for the payroll clerk, who inputs her own hours worked and leave taken. While we did not find any exceptions in our testing, the possibility of errors or irregularities exists when there are not appropriate controls over the input of transactions. The monitoring of the payroll clerk's leave balances by an independent employee would help to ensure that transactions were appropriately recorded.

Recommendation

- *The college should establish an independent verification of the recording of the payroll clerk's hours worked and leave taken.*

Chapter 5. Administrative Expenditures and Equipment

Chapter Conclusions

Lake Superior College's internal controls provided reasonable assurance that it accurately recorded expenditures in the accounting records and adequately safeguarded fixed assets. In addition, for the items tested, the college complied with material finance-related legal provisions and management's authorization.

Lake Superior College incurred expenditures for purchased services, supplies, consultant contracts, utilities, and equipment totaling $13.6 million during the period from July 1, 1996, through December 31, 1999. The college had a centralized purchasing department that was responsible for ordering supplies, equipment, and services. Departments submitted purchase requisitions to the purchasing staff. The purchasing agent entered the purchases into the accounting system and determined whether there were sufficient funds available to make the purchase. The purchasing agent followed MnSCU guidelines to solicit bids or quotes and select vendors to complete purchases. Accounts payable staff matched invoices to the respective purchase order and verified that the goods or services were properly received.

Lake Superior College has improved its controls over fixed assets. In the prior audit report issued in 1997, we noted that the college had not taken a physical inventory. However, since 1997, the college has implemented a new inventory system. The college verifies that fixed assets are properly recorded on their inventory listing, and does a complete physical inventory annually.

Audit Objectives and Methodology

Our review of administrative expenditures focused on the following objectives:

- Did Lake Superior College design and implement internal controls to provide reasonable assurance that the assets acquired were adequately safeguarded and that expenditures were accurately reported in the accounting records?

- Did the college comply with material finance-related legal provisions and management's authorization?

To meet these objectives, we interviewed college staff to gain an understanding of the internal controls over the procurement and disbursement processes for purchased services, consultant/contract services, supplies, utilities, and equipment. We performed analytical reviews and tested transactions to determine whether Lake Superior College properly procured goods and services, disbursed funds, and recorded expenditures in the accounting system.

Conclusions

Lake Superior College's internal controls provided reasonable assurance that expenditures were accurately recorded in the accounting records and that fixed assets were adequately safeguarded. In addition, for the items tested, the college complied with material finance-related legal provisions and management's authorization.

Chapter 6. Federal Student Financial Aid

Chapter Conclusions

Lake Superior College's controls provided reasonable assurance that student financial aid transactions were properly recorded in the accounting system and administered in accordance with applicable federal regulations. For the items tested, the college complied with federal regulations over receiving federal funds. The college's controls provided reasonable assurance that only eligible students received financial aid in the appropriate amounts. However, we did find that the college overpaid financial aid to eleven students who did not meet the college's satisfactory academic progress policy.

In fiscal year 2000, Lake Superior College packaged and awarded financial aid through the PC SAFE financial aid software package. PC SAFE interfaced with other modules within MnSCU's Integrated Student Record System (ISRS), such as the accounts receivable and student records modules. It electronically received and stored the Student Aid Report, and also accepted and stored the institutional financial aid application and tax data from the student. A comparison of application data provided by the student to the Student Aid Report (SAR) identified any discrepancies, beyond accepted tolerances, in a process called "verification." The electronic version of SAR is called the Institutional Student Information Record (ISIR). PC SAFE enforced compliance with federal and state financial aid program requirements through a series of computerized edits that were activated at the discretion of the institution. Through interfaces with the accounts receivable and student record modules, PC SAFE automatically adjusted awards by updating to the correct data. Similarly, adjusted expenditures were interfaced into MnSCU accounting.

Since PC SAFE was a new application in fiscal year 2000, the college had some problems, but developed alternate controls to resolve these issues. There were some concerns with PC SAFE not properly generating student award letters. Since PC SAFE had some corrupted data and could not generate award letters for certain students, the college processed these award packages manually.

Lake Superior College participated in various student financial aid programs administered by the U.S. Department of Education. Table 6-1 shows the programs reviewed and federal financial aid payments made to students during the 1999 fall term.

Table 6-1
Federal Financial Aid Payments to Students
1999 Fall Term

CFDA	Financial Aid Program	Students	Payments
84.063	Federal Pell Grant	853	$855,220
84.032	Federal Family Education Loan (FFEL) - Subsidized Stafford Loan	744	$918,051
84.032	Federal Family Education Loan (FFEL) - Unsubsidized Stafford Loan	579	$792,123
84.033	Federal Work-Study Program	99	$97,550
84.007	Federal Supplemental Education Opportunity Grant (FSEOG)	117	$58,000

Source: MnSCU Financial Aid Module.

The State of Minnesota and private foundations also provided funding for scholarships. The college was responsible for determining the eligibility of students for these scholarships. These programs complement the federal financial aid available to eligible students and include funding for tuition, fees and books, employment of students, and childcare. The largest state program is the Minnesota State Grant. For the 1999 fall term, the college disbursed Minnesota State Grants totaling $335,403.

Audit Objectives and Methodology

The primary objectives of our audit were to answer the following questions:

- Did the college design internal controls to provide reasonable assurance that it was managing federal student financial aid programs in compliance with applicable laws and regulations?

- Did the college comply with applicable laws and regulations for managing federal cash and reporting federal expenditures?

To meet these objectives, we interviewed employees from the college financial aid and business offices. We reviewed and tested controls over compliance with federal and state legal requirements for packaging, awarding, and disbursing student financial aid for the 1999-2000 academic year. We also reviewed and tested controls over compliance for federal cash management and reporting requirements.

Conclusions

Lake Superior College's controls provided reasonable assurance that student financial aid transactions were properly recorded in the accounting system and administered in accordance with applicable federal regulations. For the items tested, the college complied with federal regulations over receiving federal funds. The college's controls provided reasonable assurance that only eligible students received financial aid in the appropriate amounts. However, we did find that the college overpaid financial aid to eleven students who did not meet the college's satisfactory academic progress policy.

7. The college did not properly monitor academic progress for recipients of financial aid resulting in overpayments to eleven students.

For the fall 1999 semester, the college paid financial aid to eleven students who did not meet the college's policies for satisfactory academic performance. The college inappropriately awarded and disbursed the amounts shown in Table 6-2 to these students.

Table 6-2
Inappropriate Financial Aid Payments
Fall 1999 Semester

Type of Financial Aid	Federal	State
Unsubsidized Stafford Loan	$15,823	$ 0
Subsidized Stafford Loan	7,870	0
Pell Grant	6,405	0
Supplemental Education Opportunities Grant	500	0
Minnesota Non-AFDC Child Care Grant	0	2,000
Minnesota State Grant	0	680
Total	$30,598	$2,680

Source: Lake Superior College Financial Aid Records.

Lake Superior College incorrectly determined that these students were eligible for financial aid and paid them a total of $33,278. The college's policies require students to make satisfactory academic progress toward a degree or certificate program to remain in good standing. According to Lake Superior College Policy II.9.1, "any student who fails to meet the minimum satisfactory academic requirements for one term will be placed on probation for one term, commencing immediately. A student on probation who fails to meet minimum satisfactory academic progress requirements for that term will be subject to suspension, one term in duration, commencing immediately." The eleven students did not meet the academic standards requirement for the 1999 spring and summer terms. The students should have been placed on probation after the spring term and suspended after the summer term. As a result, they would have been ineligible for financial aid for the fall term.

The college's procedures to determine students who do not meet the satisfactory academic requirements consisted of reviewing MnSCU system generated reports. During the 1999 spring term, the college converted to MnSCU's grade and transcript module. As a result of this conversion, the college had several problems generating adequate reports to determine ineligible students. The college spent time during the summer manually identifying students who fell below the satisfactory academic progress requirements for the spring term. In addition, the college worked laboriously with MnSCU system programmers to generate an adequate report.

Lake Superior College

During the 1999 fall term, the college finally implemented a meaningful report. Because of these problems, the college decided not to review 1999 summer term student records.

Recommendation

- *The college should recover the inappropriate financial aid payments.*

Chapter 7. Enterprise Fund Activities

Chapter Conclusions

Lake Superior College's internal controls provided reasonable assurance that bookstore revenues and expenses were accurately recorded in the accounting records and in compliance with applicable legal provisions and management's authorization. However, the college did not properly analyze and support its calculation of indirect costs allocated to the bookstore. For the items tested, Lake Superior College complied with applicable legal provisions.

Lake Superior College operated three auxiliary activities in the Enterprise Fund during fiscal years 1997 through 1999. The activities including the bookstore, food service, and parking operations were operated mainly for the students. Table 7-1 shows the financial results of the auxiliary activities in the Enterprise Fund for fiscal year 1999.

Table 7-1
Enterprise Fund Activities
Fiscal Year 1999

	Bookstore	Food Service	Parking	Total
Sales and Services	$996,447	$191,110	$124,830	$1,312,387
Cost of Goods Sold	(776,520)	(78,451)	0	(854,971)
Gross Margin	$219,927	$112,659	$124,830	$ 457,416
Operating Expenses:				
Salaries	$ 78,816	$107,570	$ 0	$ 186,386
Purchased Services	0	1,004	38,216	39,220
Supplies	1,522	3,982	0	5,504
Indirect Costs	10,186	0	0	10,186
Depreciation	3,800	0	0	3,800
Total Operating Expenses	$ 94,324	$112,556	$ 38,216	$245,096
Income (Loss) from Operations	$ 125,603	$ 103	$ 86,614	$212,320
Transfers Out	0	0	($87,308)	($ 87,308)
Net Increase (Decrease) to Retained Earnings	$125,603	$ 103	($ 694)	$125,012

Note 1: Auditor's adjustment of $10,186 for indirect costs allocated to the bookstore in fiscal year 2000 for fiscal year 1999 costs.

Note 2: The college transferred money from the Enterprise Fund to the General Fund for purposes of matching state grants for parking lot improvements.

Source: MnSCU Accounting Records adjusted by the Office of the Legislative Auditor.

Lake Superior College

The Enterprise Fund balance as of June 30, 1999, was approximately $771, 000. The college mainly incurred operating costs in the fund from 1997 through 1999. The college had not formalized a plan to use these funds for the benefit of the students or other activities. The college is considering using a portion of this balance to fund facility remodeling.

MnSCU central office is in the process of developing a systemwide indirect cost policy for the Enterprise Fund. Lake Superior College allocated indirect costs of approximately $40,000 to the bookstore in fiscal year 2000, of which $10,186 was related to fiscal year 1999.

Lake Superior College operated a cafeteria for students and faculty. The cafeteria provided breakfast, lunch, and snacks. The college also operated a parking activity within the Enterprise Fund. The college charged students a parking fee of $2 per credit and charged faculty a fee depending on their employment status. There was a maximum charge of $30 per semester.

Our audit focused mainly on the bookstore, the largest activity in the Enterprise Fund. Sales for the period July 1, 1996, through June 30, 1999, totaled $3,089,195 and expenses totaled $2,726,975.

Lake Superior College's bookstore sold a variety of books, supplies, and apparel. The bookstore employed two full-time clerks and several work-study students. Bookstore employees recorded sales in a cash register. Students had the option of paying by cash, check, credit card, or charges to financial aid. At the end of each business day, the bookstore employees counted the money in the cash register and reconciled it to the register tape. They then transmitted the money, register tape, and reconciliation to the business office. The accounts receivable clerk also reconciled the register tapes to the cash prior to the deposit. To order supplies, the bookstore prepared a manual purchase order. The purchase order remained in the bookstore until the supplies and the invoice were received. The purchase order was then input into the purchasing module of the ISRS system to encumber funds. When this procedure was completed, the bookstore staff sent the invoice and purchase order to the accounts payable department for payment.

Audit Objectives and Methodology

Our objectives for the bookstore operations were to answer the following questions:

- Did Lake Superior College's internal controls provide reasonable assurance that bookstore revenue collections were accurately recorded in the accounting records and in compliance with applicable legal provisions and management's authorization?

- Did Lake Superior College's internal controls provide reasonable assurance that bookstore expenses were accurately recorded in the accounting records and in compliance with applicable legal provisions and management's authorization?

- For the items tested, did Lake Superior College comply, in all material respects, with the significant finance-related legal provisions concerning bookstore expenditures?

Lake Superior College

To answer these questions, we interviewed bookstore and business office personnel to gain an understanding of the controls in place over bookstore revenues and expenses. We tested transactions to determine if the college had adequate supporting documentation and if amounts had been accurately recorded in the MnSCU accounting system.

Conclusions

Lake Superior College's internal controls provided reasonable assurance that bookstore revenue and expenses were accurately recorded in the accounting records and in compliance with applicable legal provisions and management's authorization. However, the college did not properly analyze and support its calculation of indirect costs allocated to the bookstore. For the items tested, Lake Superior College complied with significant finance-related legal provisions..

8. The college did not properly analyze and support its calculation of indirect costs allocated to the bookstore.

During the audit period, Lake Superior College did not allocate indirect costs to its Enterprise Fund activities. However, in November 1999, the college allocated indirect costs of $40,000 to the bookstore. The charge was intended to represent indirect costs for fiscal years 1997 through 1999. The college did not analyze its total indirect costs in determining the allocation. The college applied a flat rate of $10 per square foot to the bookstore. The college did not maintain support to show how it calculated the indirect costs used in the allocation or the method of determining the square footage for the bookstore.

Enterprise Fund activities should measure the total costs of operations, whether or not those costs are funded from enterprise activities or subsidized by other sources. Therefore, it is important that the college identify all related costs and document its cost allocation decisions.

Recommendation

- *The college should identify the total indirect costs and document the method of allocating indirect costs to the Enterprise Fund activities.*

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Status of Prior Audit Issues
As of April 21, 2000

Most Recent Audits

College Audit

Legislative Audit Report 97-24, issued in May 1997, covered the period July 1, 1995, through December 31, 1996. The audit report cited 17 audit findings related specifically to Lake Superior College. The department implemented 14 of these findings. The remaining issues relate to verifying the accuracy of accounting information and maintaining sufficient collateral for local bank accounts. These areas are carried forward in this report as prior issues partially resolved.

Statewide Audits

Legislative Audit Report 00-11, issued in March 2000, examined MnSCU's activities and programs material to the State of Minnesota's general-purpose financial statements, or the Single Audit, for the year ended June 30, 1999. We audit the federal financial aid programs on an annual basis as part of the Single Audit of the state's federal expenditures. This report contained one finding identifying a financial aid overpayment of $105 under the federal FFEL program at Lake Superior College.

Legislative Audit Report 99-19, issued in March 1999, examined MnSCU's activities and programs material to the State of Minnesota's general-purpose financial statements for the year ended June 30, 1998. This report did not include any findings specifically related to Lake Superior College.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. Finance has delegated this responsibility for all Minnesota State Colleges and Universities (MnSCU) audit findings to the MnSCU Office of Internal Auditing. MnSCU's Office of Internal Auditing's process consists of quarterly activity reports documenting the status of audit findings. The follow-up process continues until the Office of Internal Auditing is satisfied that the issues have been resolved.

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Lake Superior College
A Community & Technical College at Duluth

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(218) 733-7600

Office of the President

August 28, 2000

Mr. James Nobles
Legislative Auditor
Centennial Building
658 Cedar St.
St. Paul, MN 55155

Dear Mr. Nobles,

Please find, enclosed, Lake Superior College's response to the findings in your audit report for the period July 1, 1996 through December 31, 1999. On behalf of the college I want to thank you for the valuable information your team provided us during this audit process. We appreciate, especially, the opportunity for open discussion at our exit interview about the findings, their relationships with one another, and our college's actions in regard to them.

We have, as many of our MnSCU consolidated colleges, had enormous challenges to overcome in the transfer of business functions from a school district to a state system and then with the combining of these processes from two state systems into one. The fact that Lake Superior College has done an outstanding job responding to these demands speaks very well of the professionalism and hard work of our Vice President of Finance and Administration, our Accountant, and our business office staff.

We are constantly seeking to improve the quality of all of our college's operations and appreciate this opportunity for your team's feedback and assistance.

Sincerely,

/s/ Kathleen L. Nelson

Dr. Kathleen L. Nelson
President

Enclosures

c: Mr. Richard Halvorson, Vice President of Finance and Administration,
Ms. Wendy Venier, Accountant
Ms. Laura King, Vice Chancellor, Chief Financial Officer, MnSCU
Mr. John Asmussen, Executive Director, Department of Internal Auditing, MnSCU
Ms. Kim McLaughlin, Regional Coordinator, Department of Internal Auditing, MnSCU
The Honorable Andrew Boss, Chair, MnSCU Board of Trustees' Audit Committee

Audit Response - Lake Superior College
August 28, 2000

Finding #1: Lake Superior College did not verify the accuracy of its accounting records.

Response: We agree with this finding with qualifications. The college consistently attempted to reconcile the MnSCU and MAPS accounting systems but was in need of assistance from the MnSCU system office for unresolved differences dating back to 1995 for the federal and general appropriation accounts. As soon as that assistance was available, the college reconciled these systems. All reconciliations were completed before the end of the audit fieldwork.

We do not agree with all of the items presented in Table 2-1:

> <u>Payroll Clearing Account/Agency Fund</u>: The MnSCU system office assisted the college in the recording of the bond proceeds and equipment expenditures in our clearing appropriation in fiscal year 1997. As of March 2000, only $2,498 was remaining in this account. This account has, since then, been cleared.
>
> The MnSCU system office recorded the chargebacks to the general payroll posting errors cost system for fiscal years 1997 and 1998. Colleges were not notified at that time that they needed to move the chargebacks to the correct program codes. For fiscal years 1999 and 2000, instructions were provided to the colleges to move the chargebacks to the correct program codes. Lake Superior College complied..
>
> <u>Private Grants Account/Endowment Fund</u>: The college's Financial Aid office set up a private grant on the MnSCU system incorrectly as a third party award. The receipt of the cash from the grant, therefore, reduced the expenditures. The college receives funds from a local foundation that would be considered a private grant. We have since recorded the financial activity correctly as revenue and expenditures. For fiscal year 2001, we have set up the private grant correctly as a financial aid award, therefore recorded revenue and expenditures will be correctly

recorded.

Implementation Date: Completed.
Responsible Personnel: Vice President of Finance and Administration, Accountant

Finding #2: Lake Superior College did not limit access to its computer systems.

Response: We agree with this finding. The MnSCU system office has agreed to work with the college to determine a system whereby the 11 (of 17 employees) system office staff with access to various accounting modules will be reviewed quarterly for appropriate access. Assistance will also be given by MnSCU to help the college develop security to eliminate, if possible, any incompatible functions. At this time the six Lake Superior College employees with access to various incompatible modules all need such access to complete their position responsibilities. If we are unable to eliminate incompatible functions, we will develop procedures to periodically review employees' work when such incompatibility is evident.

Implementation Date: December 31, 2000
Responsible Personnel: Accountant, Director of Information Technology, Registrar, Director of Human Resources

Finding #3: Lake Superior College did not maintain collateral for its local bank accounts.

Response: We agree with this finding. The college is now able to monitor the bank balance electronically on a daily basis and will obtain collateral as necessary.

Implementation Date: Completed
Responsible Personnel: Vice President of Finance and Administration, Accountant

Finding #4: The college did not maximize its investment earnings for funds in its local bank account.

Response: We agree with this finding. Lake Superior College's bank has just recently organized a governmental banking unit. We became aware of this change in June, 2000. We have, since that date, changed our account to a municipal checking account with interest, which, from January to June of 2000, earned interest rates between 2.9% and 3.05%. We will, as well, investigate other types of investing options available to use to determine which would best suit our needs.

Implementation Date: October 31, 2000
Responsible Personnel: Vice President of Finance and Administration

Finding #5: The college did not adequately monitor the status of the child-care contract.

Response: We agree with this finding. The college has developed a database with all of its current contracts, the expiration dates, and other terms of the contracts. The college has since renewed the contract with the child-care provider and has obtained a copy of the insurance certificate as required by the contract.

Implementation Date: Completed.
Responsible Personnel: Vice President of Finance and Administration

Finding #6: Lake Superior College did not monitor the input of hours worked for the payroll clerk.

Response: We agree with this finding. While the college has had two individuals verifying time in the past, its management decided to shift job responsibilities in the business office to more efficiently use its limited human resources. During this period of time the payroll clerk has had no one verify her hours worked or her leave balances, and the audit team found no exceptions in their testing. The college has developed a system, however, that will provide for an independent verification, on a quarterly basis, of the hours worked and leave taken for the payroll clerk.

Implementation Date: Completed
Responsible Personnel: Vice President of Finance and Administration, Accountant

Finding #7: The college did not properly monitor academic progress for recipients of financial aid resulting in overpayments to eleven students.

Response: We agree with this finding with qualifications. While the audit

report clearly identifies both the problems the college faced with conversion to the new MnSCU financial aid system and the intensely laborious work undertaken by the college's staff to handle both corrupted data and reports, it does not adequately reflect the college's rationale for its management decision to not run a report for the 1999 summer term students, the college's full policy regarding the awarding of financial aid, nor the college's historical achievements in successfully handling its probation and suspension policies.
The college has never failed to run a meaningful report to assist in determining students' probation and suspension status until its decision to not run a report following summer session, 1999. During the conversion to a new MnSCU system, as described in the report, the college's management made a decision not to delay the awarding of financial aid to nearly 2000 students in the fall of 1999 by running a report on summer probation and suspension containing errors and requiring intensive manual labor for adjustments prior to distributing financial aid awards in the fall term. Due to the difficulties with the MnSCU system already identified in the report, the eleven students mentioned in the report and all other college students who were placed on probation following the spring term, did not receive probation letters until July of 1999. These letters stated that they would be placed on probation for the fall term. The eleven students had already either completed summer courses at this time, were nearing completion of the summer term or had withdrawn from the summer term. The college felt it was unfair to notify students at this point that they were on probation for the summer term and of the conditions they would need to achieve in order to remain in good academic standing.

Under normal circumstances these eleven students would have been suspended after summer term, 1999. However, due to the computer conversion problems, the students were instead carried forward on their probation status. What the college's management failed to do was to grant students administrative appeals to continue in such status. The college's policy allows students to appeal any suspension status. Since the students were never informed (late in the summer) that they were actually on probation for the summer term, they did not know of the opportunity to appeal a suspension. The college's administration, however, should have officially made and granted this appeal to each of these students caught in the system conversion trap. The college's administration has officially notified all of these eleven students that they were officially reinstated for the fall term, 1999.

Implementation Date: Completed
Responsible Personnel: Accountant, Director of Financial Aid, Registrar

Finding #8: The college did not properly analyze and support its

calculation of indirect costs allocated to the bookstore.

Response: We agree with this finding. While the college did calculate the cost per square foot based on a standard local rate for such rental, it did not complete an in-depth analysis of all costs associated with the use of this space. MnSCU is currently discussing policy implementation regarding such calculations. A more careful analysis of these costs will be undertaken with assistance from MnSCU staff.

Implementation Date: December 31, 2000
Responsible Personnel: Vice President of Finance and Administration