

GALLAGHER & ASSOCIATES CPAs, PLC

ACCOUNTING ▲ TAX ▲ BUSINESS VALUATION ▲ LITIGATION SUPPORT

September 8, 2006

Ms. Beverly Baligad
Baligad & Hirsbrunner, PLC
4515 W. Saginaw Hwy, Suite 205
Lansing, MI 48917

RE: Lansing Community College Ad Hoc Committee Consulting Services

Dear Ms. Baligad,

In follow-up to our meeting today with you and Trustee Brannan, the following is a summary of the status of our consulting services and the observations we have made to date. This letter is intended to be a brief summary, as I plan to attend the September 18, 2006 Board meeting to field any questions or speak on any of these matters in more detail.

Summary of Services and Objectives

We were engaged in January 2006 to consult with you and the Chair of the Ad Hoc Committee, Tom Rasmusson, regarding the following:

- FY2004 and FY2005 Audit Reports and Internal Control Letters;
- FY2004 and FY2005 Adjustments, Reconciliations, Work papers, Etc.;
- Budget Adjustments and Transfers;
- 2005 Agreed Upon Procedure Reports;
- 2005 Student Financial Aid Risk and Vulnerability Assessment Report; and
- Various 2005 reports from then President, Paula Cunningham, to the Board related to Budgeting, Financial Aid, and Oracle matters.

Our overall objective was to help the Ad Hoc Committee understand the nature of these reports and the data within. In performing our services, we also interviewed the current Director of Accounting and Payroll for the College, Catherine A. Fisher.

Observations

For the time period we reviewed, it appears the internal control structure of the accounting, payroll, budgeting/purchasing and IT departments of the College were malfunctioning at multiple levels.

It appears the breakdown in the internal control structure resulted primarily from the following, which were occurring all at once:

- High turnover in accounting department management;
- Implementation of new Oracle software;
- Lack of understanding by the IT department regarding various accounting system matters and internal controls; and
- Lack of understanding and required knowledge by the Administration and Senior Management.

We did not specifically look for any indications of misuse of funds or the system, but with the lack of internal controls in place, it is feasible that anyone in a management position could have abused the system.

Some notable items we observed, in no particular order, are summarized below:

1. There were 16 adjusting entries made by the auditors in FY2004 and 15 in FY2005. This number of adjustments at the audit level seems high. Notable adjustments included:
 - a. Over \$2.5 million to various clearing accounts in FY2004;
 - b. Over \$4.6 million to accounts payable in FY2004. Apparently, the auditors had to recreate accounts payable by sending vendor confirmations. An additional \$2.8 million in accounts payable was recorded based on their findings;
 - c. An adjustment of approximately \$284,000 in FY2004 was not made and the reason cited in the supporting document by the auditor was "Not adjusted – below material misstatement level". However many adjustments were made for amounts significantly under this amount. It is unclear why this adjustment was not made, while others of smaller amounts were made.
 - d. Prior year adjustments were made in FY2005 because beginning fund balances did not reconcile to prior year financial statements.
 - e. Many entries were made in both years to "Due to/Due from" accounts within the various Funds. The number of adjustments to these accounts would likely indicate that they are not reconciled or cleared out on any kind of regular basis.
2. The auditing firm was performing significant accounting and reconciliation services. This raises a question about the whether the auditing firm was performing management functions or making management decisions and whether they were able to maintain their independence as required by professional standards.
3. The College has been using the same auditing firm for a number of years. Some non-profits require a change every 3 to 5 years.

4. Various "clearing" accounts were set up in the general ledger by accounting and/or IT personnel.
5. The IT department created many "re-works and work-arounds" for accounting transactions.
6. Account reconciliations were not done on a timely basis, including bank accounts. Many accounts are still only reconciled annually at the time of the Audit because that is the procedure established by past management.
7. The 2005 Student Financial Aid Risk and Vulnerability Assessment report by Plante & Moran, PLLC appears to have been revised before it was ultimately submitted to the Board. We reviewed copies of the final draft dated October 17, 2005 and the final issued report dated October 18, 2005 and there were revisions and omissions in the final report that appeared to be material. We were told such revisions and omissions were requested by the Administration and Plante & Moran complied. The Administration should not be in a position to request that material items be revised and omitted from a report before submitting it to the Board. Further, it seems unusual that the accounting firm was willing to comply with the request. Although, in their own right, they may have deemed the revisions and omissions to be immaterial.
8. Specific internal control recommendations have been made by the auditors for several years and still are not yet implemented.
9. The previous CFO and Administration did not appear to have the required knowledge to understand the severity of the internal control problems and/or the message from the auditors in their Material Weaknesses letters.
10. The College has healthy cash and investment balances and there appears to be a sense of casualness about accounting and finance matters because of it. For example, it is common for entities with small to moderate liquid assets or tight cash flow to constantly monitor financial and accounting matters and highly prioritize such. When the opposite is true, it may not be watched as closely and/or prioritized as highly.
11. Significant turnover of accounting department management has likely created a level of independence among staff that may not be appropriate and has contributed to the malfunctioning of the internal control structure. They have become used to managing themselves and relying on procedures by past management, whether right or wrong.
12. The accounting department manages the balance sheet side of the financial statements and the budget/business office manages the income and expense side. The two departments do not seem to interact or be concerned with what the other is doing. The two departments must work together to ensure the entire financial statements are accurately reported.

Moving Forward

The Board has a fiduciary responsibility regarding the financial statements and financial condition of the College, and should take this responsibility seriously. Recognizing Board Members are elected and not necessarily finance or accounting experts, they need to be able to rely upon the expertise of the CFO and his or her ability to manage the Accounting Department, the Budget/Business Office and all aspects of the financial and accounting systems at the College.

We understand the Board has already made positive changes by replacing the Accounting Department Director with a qualified individual and adding an internal auditor position in the accounting department. We understand the Board is also currently searching for permanent replacements for the CFO and President positions. We would highly encourage the Board to fill the CFO position with an individual having significant knowledge in accounting and a strong enough personality to see through cultural changes that are needed, as discussed later.

For two years in a row, the College has received Material Weakness reports from the auditors in regards to the internal control structure. This is a serious issue and could lead to a qualification of the Audit. Suggestions have been made by the auditors and a new internal auditor position has been established. The Board may want to consider hiring an independent consultant to work with the internal auditor and the new CFO to review the current internal controls and the suggested changes from the auditors and ultimately develop a solid internal control system that this, and future Boards can rely on.


Current staff appear to be well-qualified, however they have become accustomed to independently managing themselves and doing things a certain way because it has always been done that way. A cultural change and the importance of internal controls will need to be instituted and will need to come from the CFO, the Administration, Department Directors and even the Board.

As the College reinstalls the Banner software program, we would advise that the internal auditor and CFO be involved in the development and implementation of all accounting and payroll related modules. This will ensure proper internal controls are set up from the start and no "work arounds" be allowed.

We hope this summary letter is sufficient for your needs at this time.

Sincerely,

Gallagher & Associates CPAs, PLC



Michelle F. Gallagher, CPA/ABV