Los Angeles Community College District

Report on Audited Basic Financial Statements

June 30, 2010
Independent Auditors' Report on Internal Control over Financial Reporting  
and on Compliance and Other Matters Based on an Audit of Financial  
Statements Performed in Accordance with Government Auditing Standards

The Honorable Board of Trustees  
Los Angeles Community College District  
Los Angeles, California:

We have audited the basic financial statements of the Los Angeles Community College District (the District) as of and for the year ended June 30, 2010, and have issued our report thereon dated April 26, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the District’s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District’s internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses, and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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. We consider the deficiency in the District’s internal control over financial reporting described in the accompanying schedule of findings and questioned costs as item FS-10-01 to be a material weakness.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as items FS-10-02 through FS-10-04 to be significant deficiencies in internal control over financial reporting.
In our opinion, the Los Angeles Community College District compiled, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs identified in the accompanying schedule of findings and questioned costs for the year ended June 30, 2010.

However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133, and which are described in the accompanying schedule of findings and questioned costs as findings F-10-01 through F-10-12.

**Internal Control over Compliance**

The management of the District is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the District’s internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the District’s internal control over compliance.

Requirements governing maintaining contact with and billing borrowers and processing deferment and cancellation requests and payments in the Student Financial Assistance Cluster: Federal Perkins Loan Program as described in the Compliance Supplement are performed by ACS. Internal control over compliance related to such functions for the year ended June 30, 2010 was reported on by other accountants in accordance with the U.S. Department of Education’s Audit Guide. Our report does not include the results of the other accountants’ testing of ACS’s internal control over compliance related to such functions.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the entity's internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be *material weaknesses*, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies as described in the accompanying schedule of findings and questioned costs as findings F-10-01 to F-10-12. A *significant deficiency in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

The District’s responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the District’s responses, and accordingly, we express no opinion on the responses.
(1) Summary of Auditors’ Results

Basic Financial Statements

(a) The type of report issued on the basic financial statements: Unqualified.

(b) Internal control over financial reporting:
   - Material weakness(es) identified: Yes. See item FS-10-01
   - Significant deficiencies identified that are not considered to be material weaknesses: Yes. See items FS-10-02 through FS-10-04.

(c) Noncompliance, which is material to the basic financial statements: No.

Federal Awards

(d) Internal control over major programs:
   - Material weakness(es) identified: No.
   - Significant deficiencies identified that are not considered to be material weaknesses: Yes. See items F-10-01 through F-10-12.

(e) The type of report issued on compliance for major programs:
   - Student Financial Assistance Cluster – Unqualified.
   - TRIO Cluster – Unqualified.
   - Career and Technical Education (CTE) Basic Grants to States (Perkins IV) – Unqualified.
   - Higher Education Institutional Aid – Unqualified.
   - State Fiscal Stabilization Fund – Education Stabilization Funds – Unqualified.

(f) Any audit finding which are required to be reported under Section 0.510(a) of OMB Circular A-133: Yes.

(g) Dollar threshold used to distinguish between Type A and Type B programs: $3,000,000.

(h) Major programs:
   - U.S. Department of Education
LOS ANGELES COMMUNITY COLLEGE DISTRICT
Schedule of Findings and Questioned Costs
Year ended June 30, 2010

- Student Financial Assistance Cluster:
  CFDA 84.007 Federal Supplemental Educational Opportunity Grants (FSEOG)
  CFDA 84.032 Federal Family Education Loans (FFEL)
  CFDA 84.033 Federal Work-Study Program (FWS)
  CFDA 84.038 Federal Perkins Loans (FPL)
  CFDA 84.063 Federal Pell Grant Program (PELL)
  CFDA 84.268 Federal Direct Student Loans (DIRECT LOAN)
  CFDA 84.375 Academic Competitive Grant (ACG)

- Higher Education Institutional Aid – CFDA 84.031
- TRIO Cluster
  CFDA 84.042 Student Support Services
  CFDA 84.044 Talent Search
  CFDA 84.047 Upward Bound
  CFDA 84.066 Educational Opportunity Centers

- CTE Basic Grants to States (Perkins IV) – CFDA 84.048
- State Fiscal Stabilization Fund – Education Stabilization Funds – CFDA 84.394

(i) Auditee qualified as a low-risk auditee under Section 0.530 of OMB Circular A-133: No.

(2) **Findings Relating to the Financial Statements Reported in Accordance with Government Auditing Standards**

*FS-10-01: Capital Assets and General Obligation Bond Program*

*Condition and Context*

The Los Angeles Community College District (the District) has contracted with a program management firm to manage the District’s General Obligation (G.O.) Bond Construction Projects (Proposition A, Proposition AA and Measure J) known as BuildLACCD (the Program Manager). The District also utilizes the County of Los Angeles to levy *ad valorem* property taxes on the District’s behalf to fund the debt service payments on the G.O. Bonds. The following issues were noted during our testwork:

- The District does not currently have adequate policies and procedures in place that allow them to identify and record capital asset expenses in the proper period in accordance with U.S. Generally Accepted Accounting Principles (GAAP). Exceptions were noted during our capital asset testwork, which required additional analysis by management.
- The District does not currently reconcile furniture and equipment purchased with bond proceeds to the actual equipment received and tagged.
- The District requires all employees designated in the Los Angeles Community College District Administrative Regulations as C-5 Categories and C-6 Designated Positions as having procurement
oversight responsibility to annually submit a California Fair Political Practices Commission Statement of Economic Interests (Form 700) and the Board of Trustees Rule XIV, Conflict of Interest Code for the Los Angeles Community College District. However, we noted that there does not appear to be adequate controls in place to reconcile the information included in these forms with vendors or subcontractors utilized by the District.

Cause and Effect

Effective July, 2007, the District’s board of trustees approved the Program Manager to oversee all bond-funded capital improvements. The Program Manager is responsible for maintenance of the master schedule of work performed, program budgets, accounting, contracting, and development. The Program Manager performs cutoff procedures during the District’s closing process; however, the Program Manager did not perform adequate cutoff procedures related to expenditures paid for in the current year that related to the previous fiscal year. Additionally, there do not appear to be adequate controls in place over the receipt of goods and the related reconciliation to accounting records. Lack of formal cutoff procedures can impact the completeness of fixed asset records and the period in which expenses are reflected in the District’s accounting records.

In 2010, the District contracted with a new asset management firm, Annams Systems Corporation, to record and track furniture and equipment purchases funded through bond proceeds as well as furniture and equipment disposals. Although the District has properly capitalized the furniture and equipment purchases made during the year, since the assets were not reconciled with BuildLACCD records, the District did not record this furniture and equipment into its Asset Management system. Lack of updating the inventory records into the District’s Asset Management system will have an impact on possible loss and misuse of assets.

The lack of controls to reconcile the information included in California Fair Political Practices Commission Statement of Economic Interests (Form 700) and the Board of Trustees Rule XIV, Conflict of Interest Code for the Los Angeles Community College District to the vendors and subcontractors employed as part of the District’s bond program appears to be due to resource limitations and the lack of controls in place at the District. Perceived or actual conflicts of interest can exist if this information is not reconciled and reviewed in a timely manner.

Criteria

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We believe the control deficiencies described above in aggregate represent a material weakness in internal control.
Recommendation

We recommend that the District work with the Program Manager to design and implement internal controls to ensure that capital assets are being tracked and recorded in a timely manner, reconciled to accounting records and reported in accordance with U.S. GAAP for governmental organization. Additionally, we recommend the District strengthen its controls related to the reporting and tracking of potential conflicts of interest. These procedures could include expanding the representations made by vendors and subcontractors to require self-reporting of potential conflicts of interest. Finally, we also recommend that management implement processes and controls to determine that expenses, revenues, and accruals are recorded and disclosed in accordance with U.S. GAAP.

Views of Responsible Officials and Planned Corrective Action

The District continues to work with the Program Manager (BuildLACCD) to implement controls and processes to ensure capital assets are recorded and reconciled in a timely manner. The Program Manager implemented additional controls through a two-part accruals review after fiscal year-end of June 30, 2010. The District continues to work with the Program Manager to improve the process of reconciling furniture and equipment (FF&E) purchased with bond proceeds to the actual equipment received and tagged. In August 2010, the Program Manager went live using the District’s accounting system (SAP) for recording all new FF&E purchases. Annam’s Systems Corporation was selected and contracted on January 28, 2010 to be the Asset Management service to provide the following items: Phase 1 – Strategic Planning, Phase 2 – Technology Solution and Implementation, and Phase 3 – a Baseline Inventory. Currently the Program Manager is performing Phase 2 and expects to start Phase 3 in the next eight to twelve months. After completion of this work and a complete reconciliation is performed between the various systems, this completed inventory will be reflected in the District’s Asset Management system in SAP. The District will strengthen its processes and controls in the review of the Form 700 for potential conflicts of interest related to the use of bond funds by the vendors and subcontractors employed as part of the District’s bond program.

FS-10-02: Employee Benefits

Condition and Context

During our current year testwork, we noted the following related to the District’s accounting for employee benefits:

- There did not appear to be adequate controls in place to ensure that supporting documentation for check requisitions for medical-related employee benefit payments (i.e., payments made to Blue Shield, Kaiser Foundation, Safeguard Dental, and VSP) were reviewed and approved prior to payments. We noted that the supporting documentation was not included in one of the months selected for testwork.

- There did not appear to be adequate controls in place to ensure that the reconciliation of the SAP Workbench reports of employee benefits expenses (e.g., medical-related benefits, retirement-related benefits, and other employee benefits) according to the payroll register agrees to the general ledger in a timely manner. During our testwork, we noted that the information related to medical-related employee benefits that is transferred to the workbench files was not always complete and/or accurate. Errors are sometimes internally detected through a manual review of the data; however,
due to the large volume of data, the District's staff are unable to manually review the entire report. Errors are also sometimes detected by either the District's health provider if they are either over or underpaid or by employees if they realize their medical claims are not being paid.

- There do not appear to be adequate controls in place to ensure that social security payments are made for all student workers and that all employees that work in excess of 1,000 hours are enrolled in CalPERS and Social Security. During fiscal year 2010, the District identified approximately 100 non-LACCD student workers where the District had not paid Social Security payments. The District also identified approximately 200 employees where it had not enrolled the employees into CalPERS and Social Security in a timely manner. Additionally, we noted exceptions in our testwork related to Social Security payments (both over and understatements).

Cause and Effect

The control deficiencies noted above appear to be due to missing reconciliations, reliance of work done by others without requiring documentation to support benefit payments, and missing controls related to the employment of student workers and certain employees. Given the control exceptions noted, there is a risk that benefit expenses will not be recorded correctly and in accordance with U.S. GAAP.

Criteria

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We believe the control deficiencies described above in aggregate represent a significant deficiency in internal control.

Recommendation

We recommend that management strengthen its procedures and internal controls to ensure the following:

- Supporting documentation for benefit payments is reviewed prior to making disbursements.
- Reconciliations are performed of employee benefit data to SAP workbench reports.
- Controls are strengthened to ensure new student workers or employees of the District are timely enrolled in Social Security and the District’s various benefit plans.

Views of Responsible Officials and Planned Corrective Action

The District will continue to strengthen its procedures and controls to ensure the proper review of employee benefits is performed on a monthly basis. The supporting documentation is reviewed for reasonableness of premium payment amount before approval of disbursement by management. Payments for Delta Dental and VSP (vision) are not based upon the workbench because these are self-insured plans, which are based on the actual expenses submitted by employees and already paid by the provider. We have
implemented a monthly reconciliation of the employee benefit data to SAP workbench and will continue to review our process to ensure that all employee benefit payments are reconciled.

The District has strengthened controls to ensure that social security and retirement deductions are made from all eligible employees pay on a timely basis. We recently implemented the following: during the Fall of 2009, the Retirement Unit working with InfoTech created several reports that are now part of our business process to ensure that employees are enrolled in Social Security and the CalPERS retirement system on a timely basis. One report tracks employees’ hours and notifies the colleges and district senior staff on a monthly basis when employees are approaching 1000 hours worked in a fiscal year. Once the 1000-hour threshold is reached, Retirement Unit staff enrolls the employees into CalPERS and Social Security. In September 2010, the job classes in which non-LACCD student workers may be employed were identified by Human Resources and assigned a new status code that must be used for current and new assignments. Attached to the new status code is the requirement that Medicare and PARS be a mandatory deduction. These students are now enrolled in PARS and Medicare.

**FS-10-03: Risk Management**

*Condition and Context*

During our current year testwork, we noted the following related to the District’s workers’ compensation and general liabilities:

- There do not appear to be adequate controls in place to ensure that the accuracy of the data that is submitted to the actuary used by the District to calculate the estimated workers’ compensation and general liability accruals.

- There do not appear to be adequate controls in place to ensure that the firm utilized by the District to process general liability claims is updated in a timely manner related to the status of pending cases related to claims the firm is processing.

- There do not appear to be adequate controls in place over the retention of supporting documentation related to claims being processed by the District’s third-party servicer. During our current year testwork, we noted two cases where the District was unable to provide supporting documentation of the information provided to its third-party servicer for open cases.

*Cause and Effect*

The control deficiencies noted above appear to be due to a lack of review and updating of data submitted to third-party servicers used by the District. Given the control exceptions noted, there is a risk that expenses and related risk management accruals will not be recorded correctly and in accordance with U.S. GAAP.

*Criteria*

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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. A significant deficiency is a deficiency, or combination of
deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We believe the control deficiencies described above in aggregate represent a significant deficiency in internal control.

Recommendation

We recommend that management strengthen its procedures and internal controls as follows:

- The District should implement controls to review the data provided by the third-party servicers for completeness and accuracy before it is provided to the District’s actuary. Additionally, the District should strengthen its controls over the retention of documentation that supports open claims and cases so that information will be available for reference to validate the claim information before it is forwarded to the District’s actuary.

- The District should strengthen its controls over the updating of case information to its general liability third-party servicer.

Views of Responsible Officials and Planned Corrective Action

The District will strengthen its procedures and controls related to the District’s workers’ compensation and general liabilities to ensure proper reporting to the District’s actuary and the general liability third-party servicer. Management will implement a plan to sample the data provided by the third-party servicers for discrepancies in completeness and accuracy before providing this data to the District’s actuary. Forms are being designed to assist the colleges in reporting information in a timely manner and updating Risk Management with additional information about claims so that the pending general liability claims can be accurate and up-to-date.

**FS-10-04: Information Technology**

**Condition and Context**

During our review of the District’s information technology controls during the fiscal year 2007 audit, we identified control weaknesses in the areas of security and change management. These included the sharing of user accounts, extensive superuser access, and informal change management processes. These issues were determined to be significant deficiencies in the District’s system of internal controls. During the fiscal year 2010 audit, we evaluated the progress of the controls implemented to remediate the weaknesses identified during the fiscal year 2007 audit.

The District has made progress in remediating the previously identified issues; however, control weaknesses have not been remediated to a level where general internal controls can be relied upon for audit purposes and the significant deficiencies continued to exist during fiscal year 2010.

**Cause and Effect**

During 2006-07, the District completed postimplementation activities for a new Enterprise Resource Planning System (SAP). At that time, management indicated that certain access controls were not fully implemented and certain duties needed to be shared. While not ideal from a control standpoint, this also is not unusual for organizations that must continue to support business operations as complex systems implementations are being completed. However, weaknesses in the IT controls can significantly
compromise both the security and accuracy of the data within a system and it is important that adequate controls are implemented.

With regard to change management, once a system is operational, further changes to the system are usually required to meet the business’ developing needs. Such changes should be subjected to controls as formal as those used in the development or implementation of a new system. If there are weaknesses in managing system changes, the benefits originally gained by controlling the system’s implementation can be quickly lost as subsequent changes are made.

Criteria

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We believe the control deficiencies described above in aggregate represent a significant deficiency in internal control.

Recommendation

We recommend that management continue to implement the planned modules of Security Weaver and create an overall project plan that lays out the roadmap from complete tool implementation, security issue remediation, and implementation of an effective monthly monitoring control. Additionally, management should strengthen the use of the Mercury Quality Center to have all changes to the production environment appropriately documented, approved, and migrated to production. We recommend that these control improvements be completed as soon as possible.

Views of Responsible Officials and Planned Corrective Action

The SAP IT Team as part of its continuous improvement philosophy, and as was already implementing preaudit has completed moving IT support access to Security Weaver. HP Quality Center has and remains the key change management tool for tracking configuration and program changes. Workflow notifications regarding staff changes (new hires, terminations, etc.) are now part of the change management process. HP Quality Center continues to capture change management requests and activities as required. Super User Access has been removed where appropriate. SAP IT has embarked on a process to staff a full-time SAP HP Quality Assurance Position that will further emphasize its commitment to change management controls and processes.