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INDEPENDENT STATE AUDITOR'S REPORT ON
CERTAIN ACTIVITIES OF THE
HOLYOKE COMMUNITY COLLEGE
JULY 1, 2005 TO JUNE 30, 2006

OFFICIAL AUDIT
REPORT
JANUARY 26, 2007

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Holyoke Community College (HCC) is authorized by Chapter 15A, Section 5, of the Massachusetts General Laws, and operates under the oversight of the Board of Higher Education. A Board of Trustees appointed by the Governor of the Commonwealth controls its operations, and HCC's President is responsible for implementing the policies set by the Board of Trustees, in accordance with the policies and procedures established by the Board of Higher Education.

We have conducted a review of HCC's federal student financial assistance programs funded through the United States Department of Education (DOE) for the period July 1, 2005 to June 30, 2006. Our review was conducted in conjunction with the Single Audit of the Commonwealth of Massachusetts for the fiscal year June 30, 2006.

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Our review of 59 student canceled checks and endorsements totaling \$8,782.00 for the February 18, 2006 Federal-Work Study (FWS) payroll disclosed that a student endorsed his paycheck to his supervisor, who subsequently cashed it. Our expanded testing for that student for the period July 1, 2005 to June 30, 2006 disclosed that 15 (60%) of the 25 checks issued were also endorsed to his supervisor. This practice is not in compliance with adequate internal control procedures regarding segregation of duties. Moreover, our review of this student's timesheets contained a number of work-study hours that conflicted with the student's class schedule. HCC officials indicated that standard practice makes it difficult to implement every internal control suggested by the American Institute of Certified Public Accountants (AICPA). HCC believes that there were sufficient internal control procedures in place to mitigate the necessity to ban supervisors from cashing checks for their work-study students. However, in accordance with 34 Code of Federal Regulations (CFR) 668.16(c) (1) and (2), the HCC should have adequate checks and balances and segregation of duties in its internal control structure. The HCC, in taking corrective action, has drafted an updated payroll distribution and check cashing policy that became effective October 20, 2006, which includes a provision that supervisors are prohibited from cashing employee paychecks.

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INTRODUCTION

Background

Holyoke Community College (HCC) is part of the system of public institutions of higher education as promulgated by Chapter 15A, Section 5, of the Massachusetts General Laws. It was founded in 1961, and is one of fifteen community colleges in Massachusetts. A Board of Trustees appointed by the Governor governs HCC and establishes the College's administrative policies. HCC's President is responsible for implementing the policies set by the Board of Trustees, in accordance with the policies and guidelines established by the Board of Higher Education.

Audit Scope, Objectives, and Methodology

In accordance with Chapter 11, Section 12, of the General Laws, we conducted a review of HCC's federal student financial assistance programs funded through the United States Department of Education (DOE) for the period July 1, 2005 through June 30, 2006. We conducted our review in conjunction with the Single Audit of the Commonwealth of Massachusetts for the fiscal year ended June 30, 2006. Our report is an abstract from the Commonwealth's Single Audit Report for the fiscal year ended June 30, 2006 and solely represents the Office of the State Auditor's audit results of the College. The Commonwealth's Fiscal Year 2006 Single Audit Report consists of the following volumes:

- Statutory Basis Financial Report
- Comprehensive Annual Financial Report
- Reports on Compliance and Internal Controls in Accordance with Governmental Auditing Standards and Requirements of the Office of Management and Budget (OMB) Circular A-133 and the Schedule of Expenditures of Federal Awards

Our review was conducted in accordance with applicable generally accepted auditing standards and standards set fourth in OMB Circular A-133, revised June 27, 2003, and the American Institute of Certified Public Accountants' (AICPA) Audit and Accounting Guide, Audits of State and Local Governments. Additionally, our review evaluated HCC's compliance with the Office of the Comptroller (OSC) policies and procedures, Massachusetts General Laws, and the other applicable laws, rules, and regulations.

In performing our review of HCC's activities, we referred to the OMB Circular A-133, March 2006 Compliance Supplement to determine the compliance requirements that must be considered in an audit conducted under OMB Circular A-133. Based upon our review, we determined specific requirements applicable to federal student financial assistance programs and designed appropriate tests to determine HCC's compliance with those requirements. Specifically, our objectives were to:

- Assess the internal controls in place at HCC during our review period: and
- Assess and evaluate the programs for compliance with the requirements of the Supplement and DOE and the OSC.
- Follow-up on prior audit results, if any.

The criteria for our review was drawn from OMB Circular A-133, the Compliance Supplement, the Code of Federal Regulations, and the OSC's Internal Control Guide. Those criteria dealt with the College's responsibility for the administration and operation of the federal student financial assistance programs and for compliance with the laws and regulations governing:

- Activities Allowed or Unallowed
- Cash Management
- Eligibility
- Matching, Level of Effort, and Earmarking
- Period of Availability of Federal Funds
- Program Income
- Reporting
- Special Tests and Provisions

We examined, on a test basis, evidence regarding HCC's compliance with the applicable requirements and performed other procedures as we considered necessary under the circumstances. Based on these tests, except as disclosed in the Audit Results section of this report, we concluded that HCC had adequate internal controls in place; complied with the requirements of the United States DOE, OMB Circular A-133 and the Compliance Supplement; and complied with the OSC's

policies and procedures, the Massachusetts General Laws, and other applicable laws, rules, and regulations, for the areas tested.

AUDIT RESULT

1. IMPROVEMENTS NEEDED IN FEDERAL WORK-STUDY PAYROLL PROCESSING

Holyoke Community College (HCC) received \$180,556 in Federal Work-Study (FWS) Funds for the period July 1, 2005 through June 30, 2006. Approximately 468 students participated in the FWS program for this period.

Our review of the FWS program included gathering information on the procedures for determining the needs of the HCC for FWS jobs, communicating availability of these positions to interested qualified students, awarding FWS funds, describing and verifying work performed, testing of the payments made to a sample of students participating in the program, analyzing the paychecks issued, and reviewing the HCC's payment procedure.

Our review of 59 student canceled checks and endorsements totaling \$8,782.00 for the February 18, 2006 FWS payroll disclosed that a student endorsed his paycheck to his supervisor, who subsequently cashed it. Our expanded testing for that student for the period July 1, 2005 to June 30, 2006 disclosed that 15 (60%) of the 25 checks issued were also endorsed to his supervisor. This practice is not in compliance with adequate internal control procedures regarding segregation of duties. Employees who participate in the authorization and payroll approval process should not distribute or have custody of payroll checks. The cashing of FWS checks by departments, unless specifically authorized, should be strictly prohibited under any circumstances, in compliance with the sound internal control principle requiring segregation of duties. By approving the student's work time and signing his timesheets, the supervisor substantially participated in the authorization and approval process. Subsequently, by accepting custody of the student checks within the payroll process, the supervisor and the HCC did not appropriately segregate the duties to ensure adequate internal control procedures were in place.

The supervisor, in obtaining the student's checks, became a holder in due course, which upon receiving the student's endorsed checks allows him to legally endorse and cash the checks. This practice, to obtain custody of a student's check during the payroll process, is allowed by an existing HCC financial aid departmental memorandum. This memorandum, which is issued annually, allows the practice of having FWS supervisors distribute checks to students directly. Under this memorandum entitled *Supervisors Responsibilities-Federal Work - Study Program*, the section on paychecks indicates that the supervisor is "responsible for distributing paychecks to

your work-study student(s)”. However, this practice is contrary to internal procedures and applications established by both HCC policy and federal regulation. Specifically, the HCC’s Financial Aid Office Internal Control Policy Section 2 states:

There shall be a separation of duties between the office awarding the financial aid funds and the office disbursing the financial aid funds.

The HCC is also required by DOE Bluebook Chapter 12 Financial Management Systems – Internal Control- A System of Checks and Balances, which states, in part:

Control Activities important to managing FSA funds. To participate in federally funded student financial aid programs, a school must demonstrate that adequate checks and balances are in place – separating the functions of authorizing and awarding FSA aid and disbursing of FSA...

The HCC must have administrative capabilities that address 34 Code of Federal Regulations (CFR) Sec. 668.16 (c) (1) & (2), which states:

(1) Administers Title IV, HEA programs with adequate checks and balances in its system of internal controls; and

(2) Divides the functions of authorizing payments and disbursing or delivering funds so that no office has responsibility for both functions with respect to any particular student aided under the programs. For example, the functions of authorizing payments and disbursing or delivering funds must be divided so that for any particular student aided under the programs, the two functions are carried out by at least two organizationally independent individuals who are not members of the same family, as defined in Sec. 668.15, or who do not together exercise substantial control.

Our audit disclosed that the HCC utilizes the Commonwealth’s Human Resources Compensation Management System (HR-CMS) to account for FWS payroll activities, including the processing of payroll checks. The Office of State Treasurer (OST) and respective banking entities use a process of “truncation”. “Truncation” is the retention of cancelled checks by the bank. The American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide for Audits of State and Local Government Units, Section 7.04 states, in part, that:

Because the Uniform Commercial Code (UCC-406 (1)) provides that a bank is under no obligation to return cancelled checks to a customer if it makes such checks available to customers in “a reasonable manner,” many banks have developed the practice of not returning cancelled checks, called check truncation. The management of a governmental unit is responsible for maintaining sufficient internal control to compensate for the absence of returned cancelled checks.

In this regard, our audit tests disclosed that the HCC does not have copies of cancelled checks and has not developed an internal control procedure that addresses “truncation”. Alternative or

sufficient internal controls, which ensure, in the absence of receiving the checks, that cancelled checks and check endorsements are reviewed by the HCC as an integral part of internal control procedures, were not in place. The HCC should have established internal control procedures to review checks for comparison to appropriate signatures on file. Management should make this review independent of the HCC's payroll department.

During our audit we interviewed both the FWS student and the HCC Supervisor separately. They disclosed that the primary reason for the supervisor endorsing the student's checks was because the student did not have a local bank depository account and could not readily cash his checks. The supervisor as a matter of convenience, endorsed and cashed each check, and according to both parties, remitted the cash to the student. The student has subsequently opened a local bank account into which his FWS checks are now directly deposited. The HCC does not have a mechanism in place for students to cash payroll checks on campus.

In conjunction with our review of these instances, we further noted conditions that warrant the attention of the HCC. The timesheets processed by the HCC for this student contained a number of work-study times that conflicted with the student's class schedule. We found 26 instances of work hours recorded on the student's timesheets where the registrar's records indicated he was scheduled for classes. An example of these conflicts are noted below:

<u>Date</u>	<u>Scheduled Class Time</u>	<u>Recorded Timesheet Time</u>
09/27/05	8:00 am to 10:30 am	9:00 am to 11:00 am
11/22/05	8:00 am to 10:30 am	8:30 am to 10:30 am
12/01/05	9:00 am to 9:50 am and 10:00 am to 10:50 am	8:00 am to 2:00 pm

In this regard, the HCC's Director of Financial Aid had annually prepared a memorandum distributed to all FWS program students entitled *Student Employee Responsibilities- Federal Work Study* that prohibits students from working during scheduled class time. This memorandum states, in part, as follows:

Working During Class Schedule - You are not allowed to work during time periods when you are scheduled to be in class except in the event of a special circumstance (i.e., class cancellation).

Changes in Work Schedules - If you need time off from work, give your supervisor sufficient notice. Requests for such adjustment of hours should be made only when there is a serious reason. Frequent adjustments in working hours are not usually appropriate.

Contrary to these requirements, the student's timesheets indicated 26 instances where he was working during scheduled class time. No notations were found on timesheets to indicate released time or class cancellations. Our audit tests found no other instances of non-compliance with this directive, or other instances of questionable endorsements on all other student checks and timesheets reviewed.

By not establishing proper internal controls regarding the disbursement of FWS funds to students, it is possible for supervisors to receive funds that they are not entitled to. The absence of adequate internal controls over the FWS payroll process makes the HCC vulnerable to potential theft or abuse of FWS funds.

Recommendation

The HCC needs to review and update its existing internal controls and the applications of these controls in the FWS payroll areas cited. Upon completion of the review, all updates and changes to internal controls must be extended throughout all HCC departments participating in the FWS program, and procedures must be put into place to ensure that internal controls are functioning as intended. The update should include assurances that segregation of duties occur in a manner that does not allow any employee to participate in all phases of the FWS payroll process. The HCC should include in its internal control manual language discouraging FWS student employees from endorsing their checks to their supervisors. The HCC should also consider providing a mechanism for FWS students either to cash their paychecks at the HCC or by making arrangements at local banking institutions. The HCC should ensure that HCC staff independent of the payroll process review truncated cancelled checks periodically. The HCC should resolve conflicts between written controls and departmental memoranda ensuring that all memoranda are in compliance with the HCC's stated controls. The HCC should also review timesheet procedures and provide ongoing oversight to prevent conditions cited from recurring. All HCC staff should be advised annually of their responsibilities with regard to payroll procedures and student employee practices.

Auditee's Response

Standard practice dictates that it is impractical, albeit impossible, to implement every internal control suggested by the AICPA. Holyoke Community College believes that there were sufficient internal control procedures in place to mitigate the necessity to ban supervisors from cashing checks for their work-study students. The financial aid office awarded the funds, individual departments recorded and approved hours worked, the payroll office processed the payroll. Supervisors then distributed checks but the financial aid office then reconciled all pay distributed to the award recipient after the payroll was complete which would have brought to light any irregularity. The college will review the one piece of this process that the auditor is questioning and will implement alternative procedures keeping in mind the cost benefit of each control. The college's policy of prohibiting students from work during their scheduled classroom hours will be followed up with additional procedures to verify that the policy is being enforced. In addition, the college has drafted an updated payroll distribution and check cashing policy.

Auditor's Reply

HCC's implementation of an updated payroll distribution and check cashing policy would ensure that HCC has adequate checks and balances and a proper segregation of duties within its internal control structure in accordance with 34 Code of Federal Regulations (CFR) 668.16 (c)(1) and (2).

APPENDIX

Chapter 647, Acts of 1989, An Act Relative to Improving the Internal Controls within State Agencies

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Chapter 647

THE COMMONWEALTH OF MASSACHUSETTS

In the Year One Thousand Nine Hundred and Eighty-nine

AN ACT RELATIVE TO IMPROVING THE INTERNAL CONTROLS WITHIN STATE AGENCIES.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

Notwithstanding any general or special law to the contrary, the following internal control standards shall define the minimum level of quality acceptable for internal control systems in operation throughout the various state agencies and departments and shall constitute the criteria against which such internal control systems will be evaluated. Internal control systems for the various state agencies and departments of the commonwealth shall be developed in accordance with internal control guidelines established by the office of the comptroller.

(A) Internal control systems of the agency are to be clearly documented and readily available for examination. Objectives for each of these standards are to be identified or developed for each agency activity and are to be logical, applicable and complete. Documentation of the agency's internal control systems should include (1) internal control procedures, (2) internal control accountability systems and (3), identification of the operating cycles. Documentation of the agency's internal control systems should appear in management directives, administrative policy, and accounting policies, procedures and manuals.

(B) All transactions and other significant events are to be promptly recorded, clearly documented and properly classified. Documentation of a transaction or event should include the entire process or life cycle of the transaction or event, including (1) the initiation or authorization of the transaction or event, (2) all aspects of the transaction while in process and (3), the final classification in summary records.

(C) Transactions and other significant events are to be authorized and executed only by persons acting within the scope of their authority. Authorizations should be clearly communicated to managers and employees and should

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include the specific conditions and terms under which authorizations are to be made.

(D) Key duties and responsibilities including (1) authorizing, approving, and recording transactions, (2) issuing and receiving assets, (3) making payments and (4), reviewing or auditing transactions, should be assigned systematically to a number of individuals to ensure that effective checks and balances exist.

(E) Qualified and continuous supervision is to be provided to ensure that internal control objectives are achieved. The duties of the supervisor in carrying out this responsibility shall include (1) clearly communicating the duties, responsibilities and accountabilities assigned to each staff member, (2) systematically reviewing each member's work to the extent necessary and (3), approving work at critical points to ensure that work flows as intended.

(F) Access to resources and records is to be limited to authorized individuals as determined by the agency head. Restrictions on access to resources will depend upon the vulnerability of the resource and the perceived risk of loss, both of which shall be periodically assessed. The agency head shall be responsible for maintaining accountability for the custody and use of resources and shall assign qualified individuals for that purpose. Periodic comparison shall be made between the resources and the recorded accountability of the resources to reduce the risk of unauthorized use or loss and protect against waste and wrongful acts. The vulnerability and value of the agency resources shall determine the frequency of this comparison.

Within each agency there shall be an official, equivalent in title or rank to an assistant or deputy to the department head, whose responsibility, in addition to his regularly assigned duties, shall be to ensure that the agency has written documentation of its internal accounting and administrative control system on file. Said official shall, annually, or more often as conditions warrant, evaluate the effectiveness of the agency's internal control system and establish and implement changes necessary to ensure the continued integrity of the system. Said official shall in the performance of his duties ensure that: (1) the documentation of all internal control systems is readily available for examination by the comptroller, the secretary of administration and finance and the state auditor, (2) the results of audits and recommendations to improve departmental internal controls are promptly evaluated by the agency management, (3) timely and appropriate corrective actions are effected

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by the agency management in response to an audit and (4), all actions determined by the agency management as necessary to correct or otherwise resolve matters will be addressed by the agency in their budgetary request to the general court.

All unaccounted for variances, losses, shortages or thefts of funds or property shall be immediately reported to the state auditor's office, who shall review the matter to determine the amount involved which shall be reported to appropriate management and law enforcement officials. Said auditor shall also determine the internal control weaknesses that contributed to or caused the condition. Said auditor shall then make recommendations to the agency official overseeing the internal control system and other appropriate management officials. The recommendations of said auditor shall address the correction of the conditions found and the necessary internal control policies and procedures that must be modified. The agency oversight official and the appropriate management officials shall immediately implement policies and procedures necessary to prevent a recurrence of the problems identified.

House of Representatives, December 21, 1989.

Passed to be enacted, *George Luvaan*, Speaker.

In Senate, December 22, 1989.

Passed to be enacted, *William W. Budge*, President.

January 3, 1990.

Approved, *Richard K. Hahn*, Governor.