

MINUTES OF THE AUGUST 9, 2012, AUDIT AND REVIEW COMMITTEE MEETING

The Audit and Review Committee (“the Committee”) of the Board of Regents met on August 9, 2012. Participating were Committee Chair John McCarter and Committee members Representative Sam Johnson, Robert Kogod, Senator Jack Reed, and Special Advisor to the Committee Herb Schulken. Member Shirley Ann Jackson was unable to participate. Also participating at the invitation of the Chair were Board of Regents Chair France A. Córdova and Vice Chair Patty Stonesifer.

Participating staff for all or part of the meeting included Chief of Staff to the Secretary Patricia Bartlett; Counsel to the Inspector General Evin Christensen; Inspector General Scott Dahl; Assistant to Representative Johnson David Heil; Under Secretary for Finance and Administration and Chief Financial Officer Albert Horvath; Chief of Staff to the Regents John K. Lapiana; Assistant to Senator Reed Moira Lenehan; General Counsel Judith Leonard; Director of Communications and External Affairs Evelyn Lieberman; Director of Government Relations Nell Payne; Assistant Inspector General for Investigations Michael Pickett; Director for Development Operations and Systems Jerome Posatko; Assistant Inspector General for Audits Michael Sinko; and Comptroller Andrew Zino.

CALL TO ORDER

Mr. McCarter called the meeting to order at 2:05 p.m. He welcomed Executive Committee members Dr. Córdova and Ms. Stonesifer and noted that they would participate in the briefing on the alleged parking fee theft at the National Air and Space Museum’s (NASM) Stephen F. Udvar-Hazy Center.

UDVAR-HAZY CENTER PARKING FEE THEFTS

Mr. Pickett provided an overview on the criminal investigation involving the alleged theft of parking fees by a contractor’s employees at the Udvar-Hazy Center. He noted that the Office of Inspector General’s (OIG) investigation began in October 2011 after the office received a letter alleging that certain employees of PMI, the contractor, were stealing parking fees paid by visitors. Under its contract with the Smithsonian, PMI operates the parking facility at the Udvar-Hazy Center. OIG staff also notified PMI.

In February 2012, the Federal Bureau of Investigation (FBI) contacted OIG staff, informing them that the FBI had received a similar letter. Following that contact, OIG investigators and the FBI conducted a joint and “continuing criminal investigation” into the allegations. Mr. Pickett noted that three PMI employees were arrested on theft charges on August 4, 2012, and described the parallel criminal action against the employees by the United States Attorney (USA) for the Northern District of Virginia. Mr. Dahl added that the OIG will conduct a follow-up internal controls audit of the oversight of certain cash management operations.

In response to a question by Mr. McCarter, Mr. Horvath noted that Smithsonian leadership and the USA's office are reviewing potential remedies and restitution under the provisions of PMI's contract. In addition, efforts were launched to identify and review all significant cash management operations at the Smithsonian.

Mr. Dahl noted that the OIG possess "primary jurisdiction" over allegations that fraud has occurred at the Smithsonian and, in this case, the FBI exercised its own authority to conduct an investigation after receiving the February 2012 letter.

In anticipation of the October 15, 2012, Board meeting, Mr. McCarter asked that he, as Committee Chair, be updated on a regular basis on the investigation's status as well as on continuing reviews of applicable internal cash management controls.

APPROVAL OF THE APRIL 16, 2012 COMMITTEE MINUTES

Mr. McCarter asked for comments or changes on the draft minutes of the April 16, 2012, Committee meeting. The draft minutes were approved without modification.

UPDATE ON IMPLEMENTATION OF THE PAN-INSTITUTIONAL DATABASE FOR ADVANCEMENT

Mr. Horvath explained that the Smithsonian continues to address potential weaknesses in its internal controls, as recommended by the comprehensive governance reforms in 2007. Among the internal control areas identified as "high risk" are the methods by which the Smithsonian accounts for charitable contributions. The most effective way to strengthen these controls, he said, is through automation.

Mr. Posatko said that the Smithsonian will launch the PAN-institutional Database for Advancement (PANDA), which is designed to identify, track, manage, solicit, and steward individual and organizational benefactors.

Mr. Posatko said that core system implementation of PANDA initiative is "on-time, on budget and on-track" for the end of fiscal year (FY) 2013. PANDA will mitigate risk, he explained, in the following five areas:

- chartfield standardization,
- development of policies and procedures,
- design of pan-institutional gift processing workflow,
- consolidation of gift receipting, and
- implementation of an electronic feed to Smithsonian ERP financials.

Mr. Posatko noted that 140 institutions use the same software as PANDA, including the University of Rhode Island, Purdue University, and Stanford University. PANDA will be implemented in three phases, Mr. Posatko said, with Phase I ("Core System Implementation") in late 2013; Phase II ("Unit Migrations") in 2014; and Phase III ("Document Management,

Stewardship and Events”) in 2015.

The development and implementation of PANDA, he said, is an institution-wide effort, adding that he was pleased with the interest and enthusiasm of the participating units.

Mr. Kogod complimented management on making “significant and impressive” progress. In response to questions by Mr. McCarter and Senator Reed, Mr. Posatko said PANDA will help prevent duplicate solicitations and eventually promote stewardship of donors at all giving levels.

REVIEW OF FY 2011 IRS FORM 990 SUBMISSION

Mr. Zino began his presentation by noting that the draft IRS Form 990 was circulated to the Regents in early July 2012 and that no changes had been suggested. He said that many of the suggestions made by Regents on the FY 2010 submission were incorporated into the current draft. [The Smithsonian’s FY 2011 IRS Form 990 is available at http://www.si.edu/Content/Pdf/About/Tax-Filings/SI_Form_990T_FY2011.pdf]

He noted that the Committee’s review is conducted in response to the IRS requirement that nonprofits describe in detail “the process, if any, that the organization uses to review the Form 990” and state whether “a copy of the Form 990 [was] provided to the organization’s governing board before it was filed.” Mr. Zino provided an overview of the staff’s preparation of the draft and thanked Mr. Schulken, advisor to the Committee, for his guidance and expertise.

Mr. Zino then directed the Committee’s attention to the major sections of the draft form and highlighted changes from the FY 2010 submission. He stressed that the financial data included had been reconciled with the audited financial statements.

Mr. McCarter commended Mr. Zino and his team for both the timeliness of the draft and the attention given to incorporating Regents’ comments regarding the narrative portion of the form.

SARBANES-OXLEY UPDATE

Mr. McCarter reminded the Committee that, as a nonprofit, the Smithsonian is not subject to the reporting requirements of the Sarbanes-Oxley Act. As a matter of good governance, however, the Board and the Committee have encouraged that Smithsonian operations follow the Act’s provisions as applicable.

Mr. Zino observed that Smithsonian operations were in compliance with all relevant provisions contained in the Act, as follows:

- Title II (“Auditor Independence”)
- Title III, Section 301 (“Independent and Competent Audit Committee”)

- Title III, Section 302 (“Certified Financial Statements”)
- Title IV, Section 402 (“Insider Transactions and Conflicts of Interest”)
- Title VIII, Section 802 (“Document Destruction”)
- Title VII, Section 806 (“Whistle-Blower Protection”)

He added that, while Section 404 of Title IV (“Internal Control Audits”) of the Act was not applicable to nonprofits, the Smithsonian has nevertheless documented its core financial internal control processes as part of its comprehensive governance reform initiative.

INSPECTOR GENERAL UPDATE

Financial Statement Audit Contract. Mr. Sinko updated the Committee on the status of the financial statement audit contract award process. A request for quotes was distributed to eight auditing firms on August 8, 2012, and the OIG expects a contract award on or before December 14, 2012.

Audit Reports and Memoranda Updates. Mr. Dahl first noted that the OIG is expediting its communication of audit findings and recommendations through “management advisories.” This practice will allow management to react in “real time” before the program or activity being audited is completed.

Mr. Sinko briefed the Committee on the draft audit report entitled “The Smithsonian Should Streamline and Standardize its Architect/Engineer Contract Modification Process.” Among other things, the OIG found that the contract modification process was causing avoidable delays in the National Museum of African American History and Culture construction project. Both Mr. McCarter and Mr. Kogod expressed concern that the 2015 opening date for the new museum may be at risk, and asked that the Committee be advised on the project’s progress and management’s response to the draft audit.

OIG Audit Recommendations. Mr. Dahl directed the Committee’s attention to the July 3, 2012, Quarterly Report on the Status of OIG Recommendations, and noted that he expects to make the report a routine item in his Committee presentations. He highlighted long-outstanding privacy-related recommendations and said that “real progress” is being made between the OIG and management to resolve them.

Mr. Dahl said he was concerned that management not get too far behind on addressing critical collections-related recommendations. Resolving collections-based deficiencies need to be elevated to a Smithsonian-wide, rather than unit-level, priority. He said that the OIG is encouraging Deputy Secretary for Collections and Interdisciplinary Support Scott Miller to develop a standardized way to apply more pan-institutional improvements developed in response to audit recommendations.

Mr. McCarter stressed that collection stewardship be “the first topic on the [orientation] agenda” of the new directors at major Smithsonian museums (e.g., the National Museum of

American History and the National Museum of Natural History).

OIG Risk Assessment. Mr. Dahl and Mr. Sinko described the OIG risk assessment survey currently under way and how its results, along with other stakeholder input, will be used to help develop the annual audit plan.

Mr. Dahl added that his office plans to follow the lead of other Federal agency OIGs and publish a “Top Management Challenges” paper that will identify for management areas of high risk as seen from the perspective of OIG’s “oversight perch.” He expects the first memorandum to be published in the first quarter of FY 2013.

ANNUAL FINANCIAL DISCLOSURE AND CONFLICT OF INTEREST REVIEW

Ms. Leonard reported on the annual financial disclosure and conflict of interest review conducted by the Office of General Counsel. The review covers both members of the Board of Regents and senior executives.

With regard to the Regents and non-Regent committee members, she noted that two Regents disclosed financial interests in vendors doing business with the Smithsonian. They have been advised that they may not take official action on behalf of the Smithsonian with these entities and may need to recuse themselves should an issue involving these entities and the Smithsonian be presented to the Board.

She added there were no reportable issues or additional actions necessary in response to the information reported by senior executives.

REPORT OF THE CHIEF FINANCIAL OFFICER

OIG Audit Responses. Mr. Horvath began his report by noting that his staff is working with the OIG to address long-standing open audit recommendations in the areas of privacy and information technology. He predicted that all privacy-related audit recommendations will be closed by December 31, 2012. Several outstanding information technology recommendations will be closed in the near future. He said that the Office of the Chief Information Officer has a “renewed focus to stay on top of these issues” and to communicate better with OIG and was optimistic that significant and continue progress is being achieved.

Financial Reporting. A team is being formed to address and enhance quarterly financial reporting. With the Smithsonian strategic plan envisioning broader revenue sources, he underscored that the Smithsonian requires a system that can provide accurate, reliable, and timely financial reports.

Enterprise Risk Management. Mr. Horvath provided a brief update on the “nascent” enterprise risk management program. He said a team has been assembled and is developing a work plan and that a more substantive update will be presented to the Committee later in the

year.

EXECUTIVE SESSION

The Committee then conducted an executive session.

The meeting was adjourned at approximately 5:15 p.m.

Respectfully submitted,

John McCarter, Chair