

MINUTES OF THE OCTOBER 2, 2012, AUDIT AND REVIEW COMMITTEE MEETING

The Audit and Review Committee (“the Committee”) of the Board of Regents met on October 2, 2012. Participating were Committee Chair John McCarter and Committee members Shirley Ann Jackson, Representative Sam Johnson, Robert Kogod, and Senator Jack Reed. Special Advisor to the Committee Herb Schulken also participated.

Participating staff for all or part of the meeting included Chief of Staff to the Secretary Patricia Bartlett; 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-Razzuri; General Counsel Judith Leonard; Director of Communications and External Affairs Evelyn Lieberman; Director of Government Relations Nell Payne; Assistant Inspector General for Audits Michael Sinko; Deputy Comptroller Stephen Wills; and Comptroller Andrew Zino. Also in attendance were Joanna Friedman, Ellen Harrison, and Wendy Lewis, who represented the Smithsonian’s external auditors, KPMG LLP (“KPMG”).

CALL TO ORDER

Mr. McCarter called the meeting to order at 2:05 p.m.

APPROVAL OF THE AUGUST 9, 2012, COMMITTEE MINUTES

The Committee approved the draft minutes of the August 9, 2012, meeting without modification.

REVIEW OF KPMG FISCAL YEAR 2012 AUDIT PLAN AND 2011 A-133 AUDIT RESULTS

Fiscal Year (FY) 2012 Audit Plan. KPMG Senior Partner Ellen Harrison opened KPMG’s presentation by describing the proposed engagement team. She noted there will be “plenty of continuity” in light of the number of returning team members, some of whom will switch roles for the FY2012 audits. Ms. Harrison provided an overview of the audit scope for the three audits KPMG will conduct: (1) consolidated financial statements; (2) special purpose financial statements filed with the Department of Treasury (“Federal closing package”); and (3) Federal awards compliance audit (“OMB Circular A-133 audit”).

Ms. Lewis described for the Committee the standard audit objectives, the definition of “materiality” of information in the audit process, and KPMG’s and Smithsonian management’s responsibilities. In reviewing the Federal closing package and consolidated financial statements, audit emphasis will be on certain recurring transactions (*e.g.*, compliance with terms of Federal appropriations, management of cash receipts, satisfaction of donor restriction); non-routine transactions (*e.g.*, Endowment payout, national campaign expenses, debt financing); and key accounting estimates (*e.g.*, valuation of marketable securities and non-

marketable investments, tax matters, allocation of functional expenses). She outlined KPMG's anticipated relationship with the Office of Inspector General (OIG) as the contracting officer's technical representatives.

FY 2011 OMB Circular A-133 Audit. Ms. Harrison described KPMG's coordinated A-133 audit approach with the Defense Contracting Audit Agency (DCAA). KPMG issued an unqualified opinion on compliance for Mall-Based awards; however, Ms. Harrison noted, KPMG did report an instance of non-compliance related to cash management of a travel reimbursement. She added that DCAA issued an unqualified opinion on the Smithsonian's Chesapeake, Maryland, and Boston, Massachusetts, research and development programs. In those audits, DCAA cited two non-material control deficiencies and an instance of non-compliance related to the late submission of an indirect cost proposal. Both Ms. Harrison and Mr. Zino characterized the control deficiencies identified by DCAA as "not serious." Mr. Zino added that procedures have been refined to avoid their reoccurrence. Ms. Harrison said that she did not believe that the theft of parking fees by a contractor's employees at the National Air and Space Museum's (NASM) Udvar-Hazy Center appeared to constitute a "major deficiency."

INSPECTOR GENERAL UPDATE

Udvar-Hazy Parking Fees Theft. Mr. Dahl reported that on September 27, 2012, an employee of a Smithsonian contractor (PMI Parking) pled guilty to stealing at least \$400,000 in parking fees from the Udvar-Hazy Center. Another employee is expected to enter a similar plea soon. The civil and criminal investigations are continuing, he said. Mr. Dahl also explained the timing of the arrests and the scope of the investigations. Mr. Kogod described his meeting with a pro bono outside parking consultant, Paul Edenbaum; Mr. Horvath; and members of Mr. Horvath's staff. The purpose of the meeting was to identify oversight and internal control improvements for Smithsonian parking operations. Mr. Horvath said that he is working with NASM management to "get out of the business of handling cash" for parking at the Udvar-Hazy Center. He added that the Smithsonian is renegotiating the Smithsonian's relationship with PMI.

Mr. Kogod noted that he has had business interactions with PMI and that he would recuse himself from future discussions involving PMI to avoid any appearance of a conflict of interest.

Mr. Dahl stated that he expects that the Smithsonian "will be made whole" by PMI for the actual losses incurred by the thefts and applicable penalties. Mr. McCarter urged that the Smithsonian be very aggressive in identifying and recovering revenues lost due to the thefts.

National Zoological Park Parking Fee Thefts. Mr. McCarter asked that the Committee be briefed on the recent discovery of similar thefts at the National Zoo by employees of the Friends of the National Zoo (FONZ). FONZ is a 501(c)(3) organization established to support the Zoo and operate certain business activities (e.g., parking, retail, and restaurants) on the Zoo's behalf. According to Mr. Dahl, approximately \$500 in parking fees appears to have been stolen and the responsible attendants have been fired. In response, he noted, FONZ officials have

implemented testing procedures to better detect fraudulent activity. In the process of conducting its investigation of the parking fee theft, Mr. Dahl said FONZ alerted OIG of possible thefts at Zoo merchandise kiosks, which OIG will also investigate.

Mr. Horvath said that an outside consultant, Booz Allen Hamilton, will assist in reviewing the Smithsonian's controls and oversight over activities that include large cash transactions on a regular basis (e.g., parking concessions, Folk Life Festival, museum stores). The Booz Allen Hamilton report is expected to be issued in November 2012.

Financial Statement Audit Contract. Mr. Dahl updated the Committee on the status of the financial statement audit contract award process. Five bids have been received and will be evaluated by a panel by the end of November 2012. The contract will be awarded in mid-December 2012.

OIG Audit Reports. Mr. Dahl noted that three OIG audit reports were issued since the Committee's August 9, 2012, meeting and asked Mr. Sinko to highlight the first two of those audits' findings and recommendations:

- **Management Advisory Regarding ARTLAB+ Stolen Laptops (September 14, 2012).** Mr. Sinko said that Hirshhorn management has taken corrective measures to solidify controls over museum laptops as well as other assets. A property custodian has been appointed; serial numbers are now assigned for laptop borrowing; and the borrowing process has been strengthened.
- **Accounting Information Systems at the Center for Folklife and Cultural Heritage (September 28, 2012).** Mr. Sinko said that OIG found a "disconnect" — since reconciled — between inventory management and accounts receivable records on the ERP system. Two other issues were related to the 2011 Folklife Festival on the National Mall: (1) The point-of-sale system used was inaccurate and (2) daily cash deposits were withheld for up to 12 days before actual deposit. Mr. Sinko said that OIG is satisfied with the actions management has taken in response to the audit report.
- **National Museum of African American History and Culture Building Project Contract Modification Process (September 28, 2012).** Mr. McCarter asked that discussion of this audit be conducted later on the agenda, along with Mr. Dahl's presentation of the draft FY 2013 annual audit plan.

OIG Strategic Plan and Performance Metrics. Mr. McCarter directed the Committee to the OIG Strategic Plan FY 2013 – FY 2015 and OIG Performance Metrics contained in the meeting materials. Mr. Dahl noted that he thought it important that OIG "take the medication that we prescribe for others." Mr. McCarter said the plan and metrics were "terrific."

OIG Audit Plan for FY 2013. Mr. Sinko briefly reviewed the draft audit plan for FY 2013. He

noted that the plan reflected responses to the OIG risk assessment survey of management, in which senior staff were asked to identify the greatest risks to the Smithsonian.

The plan contains four mandatory audits and seven discretionary audits:

MANDATORY:

- Oversight of the FY 2013 Financial Statements Audit
- Oversight of the FY 2013 Federal Information Security Management Act Program Evaluations
- Travel Expenses for the Members of the Board of Regents
- External Peer Review

DISCRETIONARY:

- National Museum of African American History and Culture (NMAAHC): Funding, Budget, and Construction Issues
- Selected Operations of the Smithsonian Tropical Research Institute
- Friends of the National Zoo Financial Operations
- Management of Leased Office Space
- Accountability and Maintenance of the Institution's Fleet
- Collections Stewardship: Security of Transporting High Value Objects
- Financial Reporting and Risk Management Internal Controls: Annual Assurance Letter Process
- Developing a Pan-Institutional Approach to Collections: Care and Security

Mr. McCarter expressed concern regarding the findings contained in the recently completed audit of the NMAAHC building contract modification process, particularly the OIG finding that 51 days of the contingency period have already been used for a project the Smithsonian has committed itself to completing by November 2015. Mr. Kogod, who also serves as the Regents' Facilities Committee chair, said he is closely monitoring progress and is consulting with Secretary Clough as well as the Smithsonian's construction oversight team on a regular basis.

Mr. Horvath added that the construction is "very complex," but is "going very well." He noted that enough contingency remains to complete the project on time and within budget, despite the aggressive timeline. Dr. Jackson cautioned that the OIG audit should clearly distinguish those factors the Smithsonian can control from those it cannot (*e.g.*, Federal appropriations). Mr. Dahl concurred, stating that OIG staff "is trying to constrain ourselves to those issues that are within the Smithsonian's control."

OIG Initiatives. Mr. Dahl noted that the OIG will conduct post-audit surveys to measure satisfaction with the audit process. He then outlined the status of OIG recommendations with management as of September 14, 2012, and congratulated Mr. Horvath on progressing toward resolving many outstanding recommendations. Next, Mr. Dahl presented a draft outline of the

“Smithsonian’s Top Management Challenges.” The five areas cited, he said, pose the greatest risk to the Smithsonian’s mission or reputation. He anticipates that a report based on these challenges will be issued in November 2012.

EXECUTIVE SESSION

The Committee then conducted an executive session.

The meeting was adjourned at approximately 4:35 p.m.

Respectfully submitted,

John McCarter, Chair