

## **MINUTES OF THE JANUARY 22, 2015, AUDIT AND REVIEW COMMITTEE MEETING**

The Audit and Review Committee (“Committee”) of the Board of Regents of the Smithsonian Institution (“Smithsonian”) met on January 22, 2015. Participating were Committee Chair Robert Kogod and Committee members Representative Sam Johnson\*, Barbara Barrett\*, and Special Advisor to the Committee Herb Schulken\*. Committee member Dr. Shirley Ann Jackson was unable to participate.

Participating staff included Chief of Staff to the Secretary Patricia Bartlett; Chief Information Officer Deron Burba; Office of the Regents Senior Writer-Editor Barbara Feininger (recorder); Director of Finance and Accounting Jean Garvin; Assistant to Representative Johnson Dave Heil; Inspector General Cathy Helm; Acting Under Secretary for Finance and Administration John K. Lapiana; General Counsel Judith Leonard; and Deputy Chief of Staff to the Regents Rachel Parker. Also in attendance were Ellen Harrison, Rennie Henry, and Wendy Lewis, who represented the Smithsonian’s external auditors, KPMG, LLP (“KPMG”).

### **CALL TO ORDER**

Mr. Kogod called the meeting to order at 9:35 a.m.

### **APPROVAL OF THE MINUTES OF THE OCTOBER 1, 2014, COMMITTEE MEETING**

Upon motion duly made and seconded, the draft minutes of the October 1, 2014, Committee meeting were approved without modification.

### **REVIEW OF FISCAL YEAR 2014 FINANCIAL STATEMENTS**

Director of Finance and Accounting Jean Garvin reviewed the fiscal 2014 financial results. The three key areas Ms. Garvin highlighted as opportunities for improvement were coordination between the Office of Finance and Accounting and the Office of Facilities, Engineering, and Operations to gather and review the information used to estimate and track environmental obligations; better education across the Smithsonian on proper period-end cutoff procedures; and work paper presentation to aid identification of errors.

The Smithsonian’s total assets in fiscal year 2014 increased 8.03 percent and totaled \$4.3397 billion. Total cash increased \$22.5 million in fiscal year 2014, primarily due to the November 2013 issuance of \$100 million in external debt. The external debt issuance was offset by increased construction and renovation activity, primarily for the National Museum of African American History and Culture. Investments increased \$131.5 million; Property, Plant and Equipment increased \$164.2 million; Receivables and Advances increased \$23.7 million; and Other Assets increased \$11.6 million, which reflects the Smithsonian’s contribution to the Giant Magellan Telescope.

*\*Participated by telephone*

Liabilities grew \$6.7 million in fiscal year 2014. In November 2013, the Smithsonian issued \$100 million in external debt. The debt issuance was offset by a \$67.9 million decrease in unexpended Federal appropriations and a \$23.9 million decrease in environmental remediation obligations. The decrease in environmental liabilities was caused by lowering fiscal year 2013 estimates underlying the calculation of this amount.

Net operating revenues grew \$70 million. The \$77 million growth in total revenue was offset by a \$7 million growth in expenses. The revenue increase also took into account a \$75 million increase in appropriations, \$41 million of which is attributed to a decrease in unspent appropriations.

Ms. Garvin highlighted an increase of \$8.4 million in Unit Administration. In fiscal year 2013, the Smithsonian received an insurance recovery and had reported additional income. Education, Public Programs and Exhibitions decreased \$4.5 million because the Smithsonian had received an in-kind donation in 2013.

## **REVIEW OF KPMG'S FISCAL YEAR 2013 FINANCIAL AUDIT RESULTS AND MANAGEMENT LETTER**

KMPG Audit Partner Ellen Harrison presented KPMG's audit results. The audited financial statements, KPMG's required communications, and the management letter were included in the meeting materials.

The audit of Smithsonian-wide financial statements (Federal and Trust) resulted in an unmodified opinion issued on January 15, 2015. KPMG issued its audit report on the Federal closing package on November 17, 2014. The audit of the closing package of special-purpose financial statements for Federal Funds resulted in an unmodified opinion. That audit was completed in accordance with Department of Treasury and Office of Management and Budget requirements.

Ms. Harrison reviewed KPMG's required communications with the Committee. She discussed KPMG's responsibilities under professional standards; accounting practices and alternative treatments that are significant to the Smithsonian; and management judgments and accounting estimates.

There were no major changes in the Smithsonian's accounting policies in fiscal year 2014 and no unusual transactions. KPMG agreed that the major assumptions used by management in making accounting estimates in the completion of the financial statements were reasonable. Key areas of focus for the audit included the valuation of long term investments; valuation of contributions receivables; classification of net assets; and calculation of environmental remediation obligations.

Audit adjustments and uncorrected audit differences were reviewed. Four adjustments were identified by KPMG and recorded by management. All four differences were immaterial.

The report highlighted that there were no disagreements with management; management cooperated fully with KPMG; and management provided complete access to the books and records.

Ms. Harrison reviewed the management letter with the Committee noting that no material weaknesses or significant deficiencies were identified. Some suggested areas to improve control processes include (1) strengthening the controls around the environmental remediation liability calculation; (2) developing and applying a more systematic approach to the temporarily restricted net assets accounting process and strengthening the review of temporarily restricted activities; (3) strengthening year-end cutoff procedures; (4) strengthening the review of inter-unit activity; and (5) reviewing network access for separated contractors and employees.

Smithsonian management concurred with all of the recommendations and reported to the Committee on some of the steps that have been taken to improve control processes in light of the recommendations.

## **INTEGRATED RISK MANAGEMENT**

Chief Information Officer Deron Burba presented an update on information technology (“IT”) security. Mr. Burba stated that the main goal of the IT security program was to facilitate cost-effective programs, which support the Smithsonian’s mission, image, and operations while ensuring compliance with applicable information security regulations and standards. His office performs continuous assessments of and updates to policies and procedures, training and awareness, incident management, risk management, vulnerability management, enterprise security architecture, and governance and reporting. Some of the Fiscal Year 2015 initiatives Mr. Burba highlighted were updating security-related Smithsonian Directives and Technical Notes; replacing new user and annual on-line security training; performing periodic training on, and testing of, incident response processes; and updating procedures for assessing and managing security risks.

Following Mr. Burba’s presentation Committee Chair Robert Kogod encouraged the Committee to relay the significance of the subject to the full Board of Regents and seek feedback and suggestions from the Board on the topic.

## **OVERSIGHT OF TRAVEL EXPENDITURES**

Acting Under Secretary for Finance and Administration John K. Lapiana reported on the oversight of travel expenditures. He explained that the Smithsonian audits the travel of 71 senior executives on a quarterly basis. Mr. Lapiana reviewed the actions Smithsonian management had undertaken to address the concerns the Committee had raised with the number of violations of the travel policy.

Mr. Lapiana reported that of the 19 policy violations cited during the fourth quarter of fiscal year 2014, 18 were corrected within 30 days. Violations of the policy decreased from 124 violations three quarters ago to 19 violations this quarter.

#### **INSPECTOR GENERAL'S UPDATE**

Inspector General Cathy Helm discussed the Office of the Inspector General ("OIG") report, which had been completed since the last meeting of the Committee. That report concluded that the Smithsonian had effective controls over unliquidated obligations for federal capital contracts.

Ms. Helm reviewed seven ongoing OIG audits. The audits in progress include pan-institutional initiatives addressing collections care; national zoological park animal care and safety; deferred maintenance program; Smithsonian's Information Security Program; review of travel expenses of the Board of Regents; controls over purchase orders; and financial statement audits. Ms. Helm reported that OIG plans to begin an audit of privacy controls in the next quarter.

She also reported that OIG closed six recommendations during the quarter and is in the process of closing the remaining recommendations.

#### **COMMITTEE CHARTER AMENDMENTS**

During its October 2014 meeting, the Board voted to recommend that each Regent committee revise its charter before January 2014 to reflect changes to committee term limits. Recommended changes include extending term limits for Regent committee members to 12 years, maintaining term limits for non-Regent members at six years, and maintaining term limits for all other non-Regent and Regent emeritus committee members at three years.

Upon motion duly made and seconded, the following motion was approved for recommendation to the Governance and Nominating Committee:

**VOTED** that the Audit and Review Committee recommends that the Governance and Nominating Committee recommend to the Board of Regents the approval of the proposed amendments to the Audit and Review Committee Charter.

#### **EXECUTIVE SESSION**

The Committee adjourned its open session at approximately 10:55 a.m. to conduct executive sessions with KPMG, the Inspector General, and the Chief Financial Officer followed by a member-only session. The meeting was adjourned at approximately 11:30 a.m.

Respectfully submitted,  
Robert Kogod, Chair