Smithsonian Institution

Office of the Inspector General

March 30, 2011

Audit and Review Committee
Board of Regents
Smithsonian Institution
Washington, D.C. 20560

Dear Members of the Audit and Review Committee:

The Office of the Inspector General (OIG) serves as the Smithsonian's Contracting Officer's Technical Representative for the oversight of the Smithsonian's annual financial statement audits conducted by the independent certified public accounting firm KPMG LLP. This letter presents our observations on the FY 2010 audit process for the Smithsonian's Federal Closing Package (federal appropriations reporting), and the Smithsonian's Financial Statement Audit (combined federal and trust reporting). We also summarize KPMG's FY 2009 audit of the Smithsonian's federal awards, which it performed in accordance with U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations.*

Our review, as differentiated from KPMG's audits, which it conducted in accordance with the American Institute of Certified Public Accountants' (AICPA) generally accepted auditing standards (GAAS) and GAO's *Government Auditing Standards*, was not intended to enable us to express, and we do not express, an opinion on the Smithsonian's financial statements, internal controls, or compliance with laws and regulations. KPMG is responsible for the auditors' reports and the conclusions therein.

We found no instances where KPMG did not comply, in all material respects, with GAAS and *Government Auditing Standards.* We did find that the Smithsonian issued its financial statement a full 5 weeks later than in the past year, a delay that occurred because the Office of the Treasurer (OT) failed to perform key functions in a timely manner. KPMG also encountered problems in the Office of the Comptroller's (OC) financial reporting process. In its audit report, KPMG characterized these problems as a significant deficiency. In addition to that deficiency, we found that the Smithsonian did not make significant progress to resolve internal control deficiencies from the prior year.

In this letter, we begin with an overview of significant findings from KPMG's FY 2010 audits and then turn to our own observations, including the status of prior years' observations from our previous Oversight Letters. In Attachment 1, we describe the status of selected Smithsonian financial management performance measures we have been tracking. In Attachment 2, we summarize KPMG's FY 2010 opinions and findings. We set forth our scope and methodology in Attachment 3.

MRC 524
PO Box 37012
Washington DC 20013-0712
202.633.7050 Telephone
202.633.7079 Fax

Overview of FY 2010

In its independent auditors' report dated March 4, 2011, KPMG issued an unqualified opinion, the highest level of audit assurance on the Smithsonian's FY 2010 financial statements. In conducting its work, KPMG considered the Smithsonian's' internal control over financial reporting. A deficiency in internal control 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 significant deficiency is a deficiency in internal controls that is important enough to merit attention by those charged with governance. We consider the internal control observations described in its report, and discussed below, to be internal control deficiencies, a decision with which KPMG did not disagree.

The Smithsonian issued its FY 2010 audited financial statements five weeks later than the prior year due to delays by the OT in providing necessary supporting information. In addition to the problems encountered in OT, the auditors reported a new significant deficiency in OC. The auditors also reported little progress in resolving two of the three deficiencies from prior years. They did conclude that management had substantially resolved one of the three.

The deficiencies mark a setback in the steady progress the Smithsonian had been making and, in our judgment, reflect insufficient attention to sustained financial management improvement. The Smithsonian has undertaken numerous redesign initiatives pursuant to its strategic plan that should advance financial management. Further, to enhance the influence of the Chief Financial Officer (CFO) within the Institution, the Secretary recently elevated the position organizationally. The CFO will now report directly to the Secretary. We hope that this elevated visibility can fortify the Institution's financial management. We also hope the new CFO does not ignore the need to strengthen core accounting and financial reporting functions, which are essential to any successful redesign efforts. The new CFO the Institution chooses must have the stature and exhibit the necessary leadership to succeed in implementing the necessary financial management improvements.

Fiscal Year 2010 Deficiencies Reported by KPMG

The Institution issued its audited financial statements a full five weeks later than last year, and close to six months after the end of the fiscal year. The independent auditors (KPMG) reported a significant deficiency in the Institution's financial reporting controls. In addition, KPMG reported three additional deficiencies, all of which it had reported in prior year reports. The Institution did not make sufficient progress in resolving these deficiencies in FY 2010. Below, we summarize these deficiencies, which KPMG described in detail in its FY 2010 Management Letter.

- Financial Reporting (Significant Deficiency)

  As noted above, KPMG reported a significant deficiency in the Institution's control environment surrounding its financial reporting process. Problems included: significant reconciling differences among all three of the Institution's financial statements; improper support for major accounts in the Statement of

Cash Flows; and improper support for certain significant footnote disclosures. KPMG recommended that OC consistently apply reporting policies that were developed in prior periods and develop a hierarchy of required review procedures for financial reporting.

- Office of the Treasurer (Deficiency)

  KPMG noted that OT failed to perform key functions in a timely manner, creating significant delays in the financial reporting process. One effect of the delay was that $13 million in pooled endowment funds were not invested timely, a lag of 60 to 120 days. KPMG recommended enhancing resources in OT, strengthening controls over cash management, and ensuring investment activities are properly reported in the financial statements.

- Contribution Accounting (Deficiency)

  KPMG noted discrepancies in the accounting and record keeping for contributions, some caused by manual processing and others by the inconsistent application of accounting policies and procedures. KPMG originally reported this deficiency in its management letter on the FY 2007 audits and has reported the matter each year since then. KPMG recommended that the Institution (1) strengthen review procedures over manually prepared schedules, (2) strengthen contemporaneous documentation of all significant communications with donors, and (3) enhance review procedures over past due contributions receivable.

- Sponsored Projects Accounting (Deficiency)

  KPMG noted errors in the calculation of discounts on outstanding contributions receivable and a lack of review and regular report reconciliations. KPMG originally reported this deficiency in its management letter on the FY 2007 audits and each year since then. KPMG recommended (1) consistent application of policy to contribution receivables over $1 million, (2) strengthened reconciliation procedures over manually prepared schedules, and (3) enhanced review procedures to ensure that all unconditional promises to give are recorded as contribution revenue.

During 2010, the Institution resolved one of the deficiencies reported in prior years. In years past, the auditors reported that their reconciliation and analysis of temporarily restricted net asset accounts (TRNA) was manual and involved significant coordination with other departments supplying information. During FY 2010, management reexamined its analysis that supports TRNA balances, obtaining more detailed support for endowment related activities. The auditors consider the deficiency as substantially resolved.

Status of FY 2009 Financial Management Deficiencies

In Attachment II of its FY 2010 Management Letter, KPMG reported on the status of the three deficiencies it had noted in its FY 2009 Management Letter. Two of the deficiencies (see Contribution Accounting and Sponsored Projects Accounting above) continued into FY 2010, with significant work remaining to resolve them.

The third remaining deficiency concerned the reconciliation and analysis of temporarily restricted net asset accounts. KPMG reported that management has substantially resolved the matter, but continued to recommend that management work with the units to supply complete information for disclosure in the appropriate footnote to the financial statements.

OIG Observations on Smithsonian Financial Management

The deficiencies noted this year and in years past, along with observations made in our annual oversight letters, heighten our concern that Smithsonian leaders have not yet sufficiently committed to sustained financial management improvement. The following areas require further management attention and strong leadership:

- Hiring a new CFO
- Resolving internal control deficiencies
- Managing and organizing decentralized accounting and reporting
- Complying with Smithsonian Directives and policies
- Training and supervising employees adequately
- Communicating effectively with central offices and the units
- Preparing timely financial statements
- Addressing employee dissatisfaction

We offer these observations based on our careful examination of the specific problems encountered by the KPMG auditors that gave rise to their conclusions, as well as on our monitoring of the status of corrective actions on ongoing management control problems; developments within the financial management organizational components at the Smithsonian; the status of various financial management reform initiatives; and other financial management audits underway by our office during the year.

As we noted above, the draft financial statements and footnote disclosures provided by OC to the KPMG auditors contained significant reconciling differences and certain footnote disclosures lacked adequate supporting documentation. In our judgment, the inability to prepare draft auditable financial statements resulted from inadequate training and supervision. OC's procedures for preparing the draft financial statements, though fully documented, were not followed by OC personnel responsible for their preparation. The financial reporting duties of the OC were assigned to a new employee whose work products were not examined for basic accuracy, completeness, and reasonableness. It was only after multiple discussions with the independent auditors and the central offices, and numerous revisions to the preliminary draft statements and footnote disclosures, that OC was able to produce a final set of financial statements.

Other financial practices burden the Institution. We are concerned that core accounting and financial functions in the Offices of Sponsored Projects (OSP), Treasurer, and Development (OD) are error-prone and inefficient. Timely recording of transactions; adherence to financial policy; reconciliation and balancing; proper supervisory review; high-level financial analysis; individual accountability; reducing the reliance on time-consuming, error-prone manual entry practices; training;

workload distribution; and documenting the basis for transactions in these units constitute just some of the challenges the Smithsonian continues to face.

These problems have consequences beyond the delay of the financial statements – although we note that delay itself cost the Institution $37,000 in additional fees to KPMG. OT's delay in investing $13 million in endowment funds, for example, represents a lost investment opportunity. More troubling, though, is the appearance that OT is not acting promptly to honor the expectations of donors.

One fundamental cause for the inadequacies noted above, in our judgment, is the Smithsonian's under-appreciation for the importance of financial management. During much of the year, key positions within the Office of the Chief Financial Officer (OCFO) remained vacant, including the CFO and the Director of the Office of Contracting. The Secretary announced the departure of the CFO in September 2010, but only published the announcement to replace the CFO in late March, 2011. We recognize that the Institution has taken important steps to hire a qualified CFO including increasing the potential compensation for the position and engaging the services of a professional search firm. All the same, we note that much of the audit work took place without the senior financial officer in place. Central to improving financial management is the urgent need to fill key positions with individuals with leadership and technical competence, starting with the position of the CFO, and then empowering those individuals to make the necessary changes.

The attitudes of some senior leadership, and the low employee morale in OC, the central financial unit, illustrate the low regard in which the Institution holds the role of sound financial management. At a recent post-audit meeting, for example, the Acting CFO complimented the many individuals who had been involved in preparing the financial statements, stating that he recognized that such duties were over and above their regular duties. That he characterized accounting and reporting functions as secondary – as an add-on to their other duties – shows a lack of understanding of the importance of financial reporting. The morale in OC seems to reflect the attitudes as well: OC was rated the lowest of all units in the 2010 Smithsonian employee perspectives survey.

At the same time, the frustrations encountered by OC in collecting financial information from the units outside its control to prepare the financial statements revealed the inherent difficulties of decentralization and distributed accountability across the Institution. For example, OC's dependence on other units for such functions as accounting for contributions, grants, and contracts – functions outside of its control – hampers its ability to influence timely and accurate financial reporting. The limited financial management leadership and functional fragmentation across the units once again constrained the financial reporting process this year. The Institution must address the partnership between the central financial functions and the units with effective leadership and communication. The Institution must address the partnership between the central financial functions and the units.

The problems that contributed to the untimely issuance of the FY 2010 financial statements and deficiencies in control are noteworthy in that the Smithsonian had been making steady progress to resolve them and to improve its reporting and

control processes. In our FY 2009 oversight letter, we complimented the Smithsonian for issuing its financial statements two weeks earlier than the prior year. We credited the efficiency to improvements in communications among OC, other central offices, and the units. We also reported that the OCFO addressed deficiencies relating to staff resources and capabilities. And, we noted then that the Smithsonian had improved its accounting for contributions and sponsored projects, and made progress in implementing the internal control recommendations in the Regents' Governance Report.

The Smithsonian did not sustain this progress in FY 2010. The delay in the issuance of the financial statements and the addition of the significant deficiency in the auditor's report reflect poorly on the Institution. These developments come at a time when the need to build confidence is paramount as the Smithsonian rolls out its ambitious capital campaign. Indeed, the campaign will rely heavily on the Institution's financial management function to provide reliable and transparent financial data and instill confidence in donors and taxpayers.

We recognize that the Smithsonian is attending to many of these concerns through ambitious reforms undertaken in implementing its Strategic Plan, where the Institution committed to pursuing excellence and accountability in financial management by enhancing financial controls, adopting best practices, and improving its core financial functions. We commend the Institution for these far-sighted initiatives. Six redesign teams representing stakeholders from across the Institution are working to assess the current environment and best practices to accomplish the strategic goals. The teams are organized around the following functions:

- Procurement
- Metrics
- Goal-Setting and Budget Development
- Finance
- Exhibition Services
- Federal Hiring

The OIG continues to meet with representatives of the redesign teams to share our institutional understanding and to capitalize on their leadership to carry forward many long standing OIG recommendations for improved accountability. The evolution of each redesign team varies from team to team as does the current state of each team's conclusions and results. We are encouraged by the energy, emphasis, and expertise of the redesign members. We will continue to monitor the status of their work and seek opportunities to inform their analysis and plan future audits in response to their results.

All the same, we believe that, in addition to strategic reforms, the Smithsonian must focus more on improving its core accounting and financial functions. As we have previously cautioned in congressional testimony, the Smithsonian cannot sustain the quality of its programs or fully realize its strategic plan without improving its financial discipline.

Prior Year OIG Observations on Smithsonian Financial Management

In addition to the above findings, as reported by KPMG, over the past few years we have reported on the following four issues, and we continue to view them as concerns. To sustain the progress it has made, the Smithsonian needs to follow through on its commitment to improve in these areas.

- Improve Contribution Accounting (first reported in OIG's FY 2009 Oversight Letter)

  In January 2009, in response to recommendation 23 of the June 2007 Report of the Regents' Governance Committee, the OCFO presented to the Audit and Review Committee its *A Plan for the Strengthening Internal Controls* (the Plan), which identifies "Charitable Contributions" as a high-risk area. According to the January 2011 update to the Audit and Review Committee, the improvement plans for the area of Charitable Contributions are "on track" except for identifying a funding a source for system acquisition and implementation. We are skeptical that any system development effort can stay on track when funding for acquiring and implementing the system has not yet been identified. Nevertheless, the Institution has some time, as transition year to the new system is planned for FY 2013.

- Staff Resources and Capabilities (first reported in OIG's FY 2009 Oversight Letter)

  OC resolved the significant deficiency first identified in the FY 2007 audit regarding its accounting resources and staff capacity, a significant achievement for OC and for the Institution as a whole. We noted in early FY 2010 that the Deputy Comptroller resigned. Given the Deputy Comptroller's critical role as both a technical expert and the primary facilitator for all the parties involved in the audit, we advised the OCFO to act quickly to fill the role to ensure that gains made in coordinating the audit and improving the understanding and communication among the many SI units and offices would continue.

  Unfortunately, the potential risks we mentioned in our FY 2009 Oversight Report regarding the hiring of a Deputy Comptroller came to pass. Inadequate supervision and insufficient analysis in OC of the work products from the operations of the Deputy Comptroller led to discrepancies and errors in the preparation of the financial statements and related disclosures.

  Further, the audit process revealed considerable stress among key staff engaged in year-end financial reporting, including intensive reliance on select individuals to accomplish essential functions. In our judgment, the staffing constraints are not in keeping with the organizational maturity of the Smithsonian's accounting and financial management functions. OC's poor results in the 2010 Smithsonian employee survey underscore concerns about their workload management, training, and supervision.

- Develop a Plan for Closing Accounts and Producing Financial Statements Quarterly (first reported in OIG's FY 2007 Oversight Letter)

  The OCFO achieved little progress in refining its closing process and issuing quarterly financial statements during the year. Although we understand that quarterly reporting is a long-term goal, we believe that the Smithsonian should strive to achieve that goal as soon as possible. Quarterly reporting is standard practice in many organizations because it produces additional analytical data for senior management; increases the reliability of financial data; helps to make financial management more of an Institution-wide priority; and achieves greater discipline in the Institution's financial reporting process through identifying errors, omissions, unusual transactions, changes in accounting procedures, and breakdowns in controls.

  We acknowledge the high cost of producing Institution-wide quarterly statements in accordance with professional accounting standards. However, we believe that the Smithsonian can produce meaningful statements on a modified basis that would yield some of the benefits mentioned in the above paragraph. We continue to recommend that the OCFO develop a plan for modified quarterly reporting that presents an approach for producing credible and useful quarterly financial statements.

- The Institution's Comprehensive Plan for Internal Controls (first reported in OIG's FY 2008 Oversight Letter)

  As of September 30, 2010, the OCFO made progress in addressing the 23 internal control processes fundamental to the Institution, with an emphasis on the five high-risk areas:

  - Personal Property Management. The Office of Contracting and Personal Property Management (OCON) hired property accounting specialists and issued policy directive and an implementation manual in fiscal year 2011.
  - Procurement, Contracting and Leasing, and Purchase Card Use. OCON issued 3 of 7 policy manuals in fiscal year 2011. OCON expects to issue the remaining manuals in late 2011. OCON initially planned to issue the manuals, in their entirety, no later than FY 2010. OCON also requested additional compliance positions in the FY 2011 budget.
  - Capital Projects. The Office of the Chief Information Officer (OCIO) delayed implementing the project costing module in the Institution's financial system (ERP), which was originally due no later than 2010, but expects to deliver the module later in FY 2011.
  - Charitable Contributions. OD hired a Gift Registrar and began to centralize the process for receiving gifts in FY 2011. OD completed documentation for the IT infrastructure requirements for the development system, which it expects to be delivered in FY 2013. As we noted above, however, OD has not identified the funding source for the system.
  - Use of Funds Restrictions. OPMB hired a financial policy analyst for policy development and training support. OPMB expects to complete the Use of

Funds Handbook in mid-FY2011, approximately a year beyond the date it promised last year.

Finally, Smithsonian Directive 310, *Financial Reporting and Risk Management Internal Control*, which was last issued in 1996, remains under review by the Directives management group. Because it forms the basis for the Institution's overall control structure, we encourage the Smithsonian to issue it promptly. The group expects to issue the directive in the third quarter of FY 2011.

We are encouraged by the progress made on the Plan during the past year. We believe the design of the above policies and procedures and the related implementation reflect progress in establishing an effective control structure at the Institution. We would like to emphasize, however, that to improve internal controls in these high-risk areas, the Smithsonian must add new compliance positions, identify a stable funding source to finance the development system, and issue the Use of Funds Handbooks and the directive on management controls.

Recommendations

The challenges facing the Smithsonian demand that the new Chief Financial Officer bring to the position leadership and competence sufficient to energize and sustain financial management improvement at the Smithsonian. The initial finance redesign team appears to have a firm understanding of the challenges. We are encouraged by their earnest efforts to effect needed change and believe that the new CFO will be well served by the directions their reforms efforts are headed.

1. We recommend that the new CFO examine the organizational staff within OCFO to identify opportunities to improve the training, supervision, work load distribution, and professional development of its cadre of accounting and financial reporting personnel.

2. We recommend that the OCFO develop a plan for modified quarterly reporting that presents an approach for producing credible and useful quarterly financial statements.

* * * * *

If you have any questions, please do not hesitate to contact Daniel Devlin, Assistant Inspector General for Audits, or Bruce Gallus, Financial Audit and Quality Control Manager, on 202.633.7050.

Very truly yours,

A. Sprightley Ryan
Inspector General

Attachment 1

Status of Selected Smithsonian Financial Management Performance Measures

For the last four years we have reported on selected performance measures related to the Smithsonian's accounting and financial reporting processes. These measures include: (1) the number and type of deficiencies in the Institution's accounting and reporting controls as reported by the Institution's independent auditor; (2) the number of recommendations stemming from the deficiencies and how many of those recommendations the Institution has resolved, and (3) the number and amount of year-end audit adjustments the independent auditor required the Institution to make as well as the amount and number of uncorrected differences (i.e., not necessary for the Institution to record due to their immaterial impact on the financial statements).

As noted in our Oversight Letter above, there are problems with the Institution's accounting and reporting controls as well as organizational and communication problems with respect to financial management. While the following measures show a positive trend, the Smithsonian will need to maintain its commitment to their resolution.

The following tables set forth the above three measures over a 5-year period between FY 2006 – FY 2010. We will continue to track these measures, and eventually others, to monitor the effectiveness of the Institution's accounting and reporting controls.

Table 1
Material Weaknesses, Deficiencies, and Other Observations in the Smithsonian's Accounting and Financial Reporting Process

Year	Other Observations **(Low Risk)**	Deficiencies **(Moderate Risk)**	Material Weaknesses **(High Risk)**
FY 2006	None	11[1]	None
FY 2007	2	7	None
FY 2008	2	3	None
FY 2009	3	None	None
FY 2010	4	1	None

In the last five years, KPMG has not reported any material weaknesses in the Institution's financial reporting process, indicating the process is fundamentally sound, that financial information is basically reliable, and that the likelihood of a material error in its financial reports is unlikely. While this seems to be reassuring, in fact, the size of the Smithsonian's investment balances and its federal appropriation are so large that any significant undetected errors or control problems in all other

[1] The 11 findings in FY 2006 consisted of two reportable conditions and 9 other deficiencies. Due to a change in terminology adopted in FY 2007, the auditors now report reportable conditions, as well as other deficiencies, as significant deficiencies.

accounts would likely hide the fact that a problems or risks exist.

As seen above, KPMG reported no deficiencies in FY 2009, but in FY 2010 it reported one along with 4 additional observations. As we discussed earlier, we believe that three of the observations constitute internal control deficiencies. The continuing nature of these deficiencies represents a reversal from progress made in recent years.

Table 2 – Open and Resolved Recommendations Smithsonian Institution Financial Statement Audit						
Year	2006	2007	2008	2009	2010	Total
Recommendations	23	19	8	7	13	70
Resolved	23	19	5	0	-0-	47
Open	0	0	3	7	13	23

The three deficiencies and two other observations KPMG reported in FY 2010 resulted in 13 recommendations, bringing the number of recommendations over the past 5-year period to 70, an average of 14 per year, reflecting each year a significant number of areas requiring improvement. To its credit, OC has made significant progress in resolving the recommendations but, even so, significant work remains.

Table 3 – Smithsonian Institution Financial Statement Audit Recorded Audit Adjustments and Uncorrected Audit Differences					
YEAR	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Number of Recorded Audit Adjustments	9	15	3	None	1
Number of Uncorrected Audit Differences	24	31	13	12	11

In FY 2010, KPMG proposed one audit adjustment (in the amount of $13 million) that the Smithsonian recorded in its general ledger in preparing its FY 2010 financial statements. The single adjustment is in keeping with the last couple of years and appears to reflect to some degree a functional, but tenuous, reporting process.

In FY 2010, KPMG also reported 11 uncorrected audit differences (i.e., the differences between the Smithsonian's figures and KPMG's audit results that the Smithsonian chose not to record based on materiality). The nature of some of the uncorrected differences reflects continuing differences between the Institution and the auditors in the use of certain accounting principles but which both consider immaterial. Therefore one would expect, as indicated in the table above, some consistency in the number of such differences.

Attachment 2

Federal Closing Package of the Smithsonian's Special-Purpose Financial Statements

In its independent auditors' report dated November 15, 2010, KPMG issued an unqualified opinion (the highest level of audit assurance) on the FY 2010 Federal special-purpose financial statements. KPMG reported no matters involving internal control that it considered to be material weaknesses, significant deficiencies, or other observations. The Smithsonian's special-purpose financial statements are used in the consolidation of the annual Financial Report of the U.S. Government.

Smithsonian Institution Financial Statements

On March 4, 2011, KPMG issued an unqualified opinion on the Smithsonian's financial statements for FY 2010 and found no matters involving internal control that it considered to be material weaknesses. KPMG did, however, identify one significant deficiency in this year's audit related to Financial Reporting, three deficiencies related to Contribution Accounting, Sponsored Projects Accounting, and the Office of Treasurer. One observation was made regarding the Office of the Chief Information Officer. KPMG also reported that a prior year finding related to accounting for Restricted Net Assets was substantially resolved and that two continuing prior year findings, one related to contribution accounting and the other two sponsored projects accounting, were still in the process of being resolved. Further information on these matters can be found in KPMG's FY 2010 Management Letter, dated March 4, 2011.

Smithsonian's OMB A-133 Audit of Federal Awards

The Smithsonian's OMB Circular A-133 audit process is a coordinated effort between KPMG and the Defense Contract Audit Agency (DCAA). Generally, KPMG audits the direct costs of the Smithsonian's Washington, D.C.-based activities, while DCAA audits the direct costs of the Smithsonian's Astrophysical Observatory in Cambridge, MA, as well as the indirect costs of the Smithsonian as a whole.

OMB Circular A-133 audit reports are not published until approximately 9 months after the Smithsonian's fiscal year end. As a result, current year (FY 2010) results are unavailable. However, in FY 2009, KPMG gave the Smithsonian an unqualified opinion on its Supplementary Schedules of Expenditures of Federal Awards. In addition, KPMG concluded that the Smithsonian had complied, in all material respects, with OMB Circular A-133 requirements applicable to its major federal program for the year ended September 30, 2009. KPMG reported one finding (with questioned costs for $643) related to the allowability and reporting of federal expenditures. Further information on these matters can be found in KPMG's FY 2009 Audit of Federal Awards Performed in Accordance with U.S. Office of Management and Budget Circular A-133.

Attachment 3

Scope and Methodology

The scope of our oversight review included KPMG's FY 2010 audits of the Institution's special-purpose federal financial statements, the Institution's entity-wide financial statements, and the OMB A-133 audit of the Institution's federal awards for FY 2009.

We reviewed (i) planning documents, including risk assessments, materiality calculations, audit programs, internal control evaluations, and sampling plans; (ii) tests of account balances and transactions; (iii) other selected work papers; and (iv) financial reporting procedures. In addition, we held discussions with KPMG auditors and managers, representatives from the Office of the Chief Financial Officer, and representatives from selected central offices. For the OMB A-133 audit, we reviewed the workpapers and report and discussed the audit results with KPMG.

We performed our oversight review from July 2010 to March 2011 and designed our procedures to comply in all material respects with the audit program and guidance developed by the Council of Inspectors General on Integrity and Efficiency for OIG oversight of independent public accountants.

We provided KPMG and the CFO with a draft of this report. Based on their comments, we made changes to the report to the extent we deemed appropriate.