Top Management Challenges for 2012

Office of the Inspector General

November 15, 2012
To Dr. France Córdova, Chair, Board of Regents
Cc John McCarter, Chair, Audit and Review Committee, Board of Regents
John Lapiana, Chief of Staff to the Board of Regents
From Scott S. Dahl, Inspector General

Subject Top Management Challenges Report for 2012

The attached report is the Office of the Inspector General’s (OIG) 2012 list of top management challenges facing the Smithsonian Institution. This is the first time that the OIG has issued such a report. The Reports Consolidation Act of 2000, which requires these reports, does not expressly apply to the Smithsonian. However, we have concluded that the report provides valuable insight for our stakeholders.

The Smithsonian's top management challenges are:

• Construction Management
• Collections Stewardship
• Financial Management
• Cash Handling Operations
• Information Systems Security

In the report, we describe each challenge based on work that we have done over the last several years. We also provide a summary of management’s actions to address each challenge and our assessment of these actions. Finally, we include management’s response at the end of the report.

Several challenges are closely related or overlap, such as financial management and cash handling. In addition, a few general themes run through most of the challenges. For example, severe budget constraints have an impact on management’s ability to address each of the challenges. Also, the Smithsonian’s decentralized structure hampers management’s progress on the challenges.

We are encouraged by the continued efforts of management to make progress on these challenges and to improve the Smithsonian. We greatly appreciate the emphasis that the Audit and Review Committee has placed on making these challenges a management priority.

If you have any questions, please contact me at (202) 633-7050.
The Smithsonian Institution’s Office of the Inspector General has identified the following top management challenges for 2012.

**CHALLENGE: CONSTRUCTION MANAGEMENT**

In 2003, Congress established the National Museum of African American History and Culture (NMAAHC). The funding for this $500 million construction project will be split evenly between federal appropriations and private donations. In addition, for the first time, Smithsonian management selected the fast-tracked construction management at-risk (CMR) project delivery method to design and construct this museum. Management believed this was the only method that would enable the Smithsonian to meet its November 2015 opening date. Smithsonian management needs to keep this highly visible project on time and within budget.

In fiscal year (FY) 2012, we conducted the first in a series of audits of the Smithsonian’s management of the NMAAHC construction project. We identified process inefficiencies in the contract modification processes for both the Architect/Engineer (A/E) and the CMR contracts.

In May, we completed our first report on the A/E contract modification process and determined that the Smithsonian needed to streamline and standardize the contract modification process. We found that the Smithsonian: (1) developed independent government estimates for more additional services than federal regulations require and thereby potentially delaying contract modifications and the project schedule; (2) completed these estimates late, making it hard to determine whether the A/E’s fee was fair and reasonable; and (3) forwarded contract modification packages to the contracting office late, delaying the issuance of the modification.

In September, we completed our second report on NMAAHC, this one focusing on the CMR contract modification process. We also determined that the Smithsonian needs to continue to improve the efficiency of awarding and administering construction packages, which are used in the fast-tracked delivery method for accelerating construction in phases. First, we found that the Office of Contracting and Personal Property Management (OCon&PPM) did not authorize the CMR contractor to begin work on construction packages soon after executing the modifications. Second, for one construction package, the Office of Facilities, Engineering, and Operations did not timely provide the price proposal to OCon&PPM and the Office of Equal Employment and Minority Affairs, which delayed their reviews and approvals of the proposal. These are two of many issues that contributed to a 51 day extension of the construction completion date.
The conditions we identified in both reports were primarily due to a lack of written policies and procedures for awarding and administering modifications for both A/E and CMR contracts. Smithsonian management concurred with our findings and recommendations in both reports and has proposed corrective actions that will address the recommendations.

We will continue our ongoing audit oversight of the construction project. In the next phase, we will determine whether (1) management’s funding plans align with the timing of projected expenses and (2) management has a contingency plan should the Smithsonian not receive expected federal appropriations or private donations.
**CHALLENGE: COLLECTIONS STEWARDSHIP**

Collections are at the core of the Smithsonian. The Smithsonian Strategic Plan recognizes that “collections are fundamental to our work,” and that it is the Smithsonian’s responsibility to “preserve them for future generations.”

The challenge for the Smithsonian is that collections are constantly growing, at the same time resources needed to provide proper stewardship remain stagnant or are declining. This condition will affect the Smithsonian’s ability to share its treasures with the public and scholars now and to broaden its reach to future generations through conversion to digitized formats.

We have issued several audit reports covering collections care issues during the past few years, including at the National Museum of American History, the Cooper-Hewitt, National Design Museum (Cooper-Hewitt), the National Air and Space Museum, and the National Museum of Natural History. Based on this body of work, we have identified a systemic pattern of collections care challenges that the Smithsonian must address on a pan-Institutional level. These challenges fall into the following three areas: (1) improving preservation practices; (2) strengthening inventory controls; and (3) meeting collections security standards.

*Improving Preservation Practices* — Smithsonian policy requires that collecting units develop and implement a comprehensive preservation program for the appropriate stewardship of their objects. However, the Smithsonian has not ensured that its museums implement such programs. For example, one of the museums audited lacked a cohesive program to mitigate the deterioration of its collections.

We found that many of the Smithsonian’s storage areas are substandard and are not conducive to the long-term preservation of the objects. Additionally, museum storage equipment, object housing, and housing practices need significant improvement. For example, at one museum, many storage rooms are overcrowded and have exposed pipes and conduits. Some storage buildings are contaminated with asbestos or lead-containing dust. These conditions threaten to damage or have already damaged collection objects.

To ensure the long-term preservation of collections, we made recommendations to management to develop a prioritized, Smithsonian-wide plan for addressing collections storage needs; establish and implement a preservation program and explore opportunities to maximize storage space; replace substandard storage equipment; and acquire appropriate housing materials for the collections.
Strengthening Inventory Controls — We found in our audits that inventory control measures are not in place or are inadequate. For example, at several museums, collections management staff did not conduct cyclical inventory reviews or maintain complete and accurate inventory records as required by Smithsonian policies. We made recommendations to Smithsonian management to develop a prioritized plan to conduct and document inventories; include measurable goals for record completeness; and revise collections plans to strengthen collections management guidance.

Meeting Collections Security Standards — The Smithsonian has not installed required security devices in all of its collections storage areas, in accordance with Smithsonian security standards. For example, many storage areas had missing or malfunctioning security devices. These issues diminished controls over collections. To improve security controls, we recommended that Smithsonian management implement security policies and procedures. We also recommended that the Smithsonian develop and implement a prioritized plan to bring collections storage areas into compliance with security standards.

In response to our audits, management began to place greater emphasis on collections care and improving security in collections storage areas through pan-Institutional initiatives. These initiatives are led by the Deputy Under Secretary for Collections and Interdisciplinary Support. However, we believe that these initiatives need to include long-term solutions for inventory control and preservation care deficiencies. We will continue to monitor the Smithsonian’s progress through our upcoming 2013 review of these initiatives. We also have an audit planned to determine whether collection objects are transported with the appropriate level of security.
CHALLENGE: FINANCIAL MANAGEMENT

As stated in its strategic plan, the Smithsonian needs to ensure financial strength by enhancing the resources available and strengthening financial management. Based on our work over the last few years, we identified several financial management challenges in the areas of (a) financial statement discrepancies; (b) unit-level financial controls and accuracy of the Enterprise Resource Planning (ERP) system; and (c) ineffective oversight of the travel approving process.

A. Financial Statements Discrepancies

For its fiscal year 2011 financial statements, the Smithsonian has received, as it has in the past, an unqualified opinion from its independent auditor, KPMG, on the federal and trust audits that are conducted under our oversight. However, KPMG reported two comments in its Management Letter: (1) Discrepancies in Contributions Accounting Policies and Procedures, and (2) Improper Recording of Operating Expenses. KPMG encouraged management to strengthen procedures over the application of cash receipts payments to ensure pledge receipts are appropriately applied against existing pledge balances. KPMG also encouraged management to enhance discounting procedures over contributions receivable to ensure organization-wide consistency in policies. In addition, KPMG identified instances where transactions were not recorded in the appropriate fiscal year. We will continue our oversight of the Smithsonian’s annual financial statement audits.

Smithsonian management made financial management improvements by issuing Smithsonian Directive 310, Financial Reporting and Risk Management Internal Controls, which requires the Smithsonian’s unit directors to provide an Assurance Statement in support of the Smithsonian's annual financial statement audit. This directive places the responsibility on all financial managers to attest to their unit’s financial controls and compliance with Smithsonian policies and procedures. During this fiscal year, we will evaluate the effectiveness of the attestation process outlined in this directive.

B. Unit-Level Financial Controls and ERP Accuracy

The Smithsonian’s financial management operates in a decentralized environment, which means, for example, that the Comptroller has no direct supervisory authority over financial managers in the units. This structure is not optimal for effective financial oversight of the units.

To ensure the accuracy and completeness of the Smithsonian’s official accounting records (ERP), unit-level financial management controls need to be in place and work as intended. Over the past 2 years, we have addressed this issue in our audits.
of the financial management operations at the Center for Folklife and Cultural Heritage (CFCH) and Smithsonian Enterprises (SE).

**Center for Folklife and Cultural Heritage** — We found several financial controls were either not in place or were not working as intended in CFCH’s primary activities, the Smithsonian Folklife Festival (Festival) and Smithsonian Folkways Recordings (Folkways). The Folkways’ inventory and accounts receivable records were inaccurate. As a result, Folkways’ profit and loss statement generated from ERP was not an accurate representation of Folkways’ profitability, jeopardizing the accuracy of ERP and Smithsonian’s financial reporting. Additionally, the Folkways’ system did not effectively maintain subsidiary records, and neither inventory nor accounts receivable reconciled to ERP. Finally, CFCH needed to improve management of the Festival point of sale system and to improve segregation of duties and cross-train staff to perform key financial tasks.

Smithsonian management concurred with our recommendations and has taken or will take action to address them. Also, during the course of our audit and at our suggestion, CFCH hired a firm that had financial expertise for independent record labels. This firm will assist Folkways in the inventory and accounts receivable valuations.

**Smithsonian Enterprises** — We found that SE’s Retail and Corporate offices did not work collaboratively; financial roles and responsibilities were unclear to some staff; financial information was not transparent to all museums; and the allocation methodology used by SE to distribute shared expenses to each museum’s profit and loss statement was not equitable. SE has implemented most of our recommendations and agreed to use a new allocation methodology that recognizes individual museum retail units based on their “4-wall” profitability. In addition, management informed us that, because of this change, a new revenue-share methodology was developed with central administration and will be effective in FY 2013. SE management continues to work with its stakeholders to improve transparency of financial information.

We will continue our reviews of unit-level financial management in FY 2013. We plan to review select financial management operations at the Smithsonian Tropical Research Institute (STRI). We will also examine financial operations at Friends of the National Zoo (FONZ) and review the Smithsonian’s management of the government purchase card program. Further, we will assess the effectiveness of the programs for identifying opportunities to reduce costs relating to leased office space. Finally, as we mentioned earlier, we will continue our ongoing audit oversight of the NMAAHC building project.
C. Ineffective Oversight of the Travel Approving Process

In March, we completed an audit of Non-Senior Staff Travel and reported on ineffective oversight of the travel approving process. We found systemic problems with voucher approvals and oversight of approvers. Unit travel approvers were not effectively reviewing the vouchers, and supervisors were not effectively overseeing approvers’ work. Ineffective approval and inadequate oversight of the travel process weaken internal controls and may result in reimbursement for unauthorized expenses.

Management concurred with our recommendations and has revised the Travel Handbook to require approvers to follow-up with the travelers and travelers’ supervisors, if necessary, if they find voucher problems. Also, management has committed to mandatory training for approvers with a high volume of trip reviews or problems. We continue to monitor Smithsonian’s travel program, as we near the completion of our audit of senior executive travel.
CHALLENGE: CASH HANDLING OPERATIONS

Whenever cash handling is a part of a Smithsonian operation, the risk of loss and reputational harm increases. We have found, through a series of audits and investigations, that the Smithsonian needs significant improvement in this area.

_Udvar-Hazy Center (Theft of Parking Fees by Contractor Employees)_ — We are conducting a joint criminal investigation with the FBI’s Washington Field Office regarding visitor parking fees stolen by contractor parking lot attendants at the Udvar-Hazy Center. Three individuals were arrested in August, two of whom have already pled guilty to each stealing over $400,000.

_Cooper-Hewitt (Admission-Related Cash Receipts)_ — In 2011, we investigated a museum employee’s theft of at least $55,173 in admission receipts. We investigated this criminal matter and arrested the employee. In addition to the criminal investigation of the employee, we conducted a review to analyze the weaknesses in the museum’s internal controls over admission-related cash receipts. We found that the museum did not timely detect the theft due to an organizational restructuring, a lack of written procedures within the museum’s Operations Department, and inadequate procedures within the Finance Department. As a result of the review, the museum reverted to its original division of responsibilities for cash handling and improved the supervision of staff in both the museum’s Operations and Finance departments. We further recommended, and the museum implemented, stronger controls over admission-related cash receipts.

_Smithsonian Enterprises (Collection of Cash from Donation Boxes)_ — We also investigated a Smithsonian Enterprise employee for embezzling Smithsonian funds and for not complying with Smithsonian policies for cash donation collection. The employee provided some financial restitution for the embezzlement, and we recommended that management regularly remind employees of the Smithsonian’s two-person policy for collecting and counting cash donations. Employees routinely collected the cash by themselves, which increased the risk of theft or loss and diminished accountability. We also recommended that management develop alternative procedures when two individuals are unavailable to collect the cash donations.

As a result of the theft of parking fees at the Udvar-Hazy Center and other problems, Smithsonian management has engaged a consultant to review third-party cash activities throughout the Smithsonian. We are actively working with Smithsonian management to reduce cash handling abuse throughout the organization. Furthermore, in our 2013 audit plan, we will address this issue with audits of FONZ and STRI financial operations.
CHALLENGE: INFORMATION SYSTEMS SECURITY

The Smithsonian faces several information security challenges in balancing public access with essential information systems safeguards. The information security challenges are evident in the Smithsonian’s ongoing efforts to (a) comply with government and industry standards for protecting information systems, and (b) establish an effective privacy program that will protect sensitive personally identifiable information (PII).

A. Federal Information Security Management Act

Every year since 2005, we have conducted or overseen reviews of select Smithsonian information systems pursuant to the Federal Information Systems Management Act (FISMA). Although FISMA does not expressly apply to the Smithsonian as a trust instrumentality, the Smithsonian nevertheless seeks to comply with the requirements as providing best practices. In these reviews, we found that the Smithsonian was not consistently implementing these best practices. For example, the Smithsonian was not enforcing the use of standard configuration baselines and had not included all of its major and minor systems in system security plans. In our 2011 FISMA review, we determined that during the previous year, the Smithsonian made improvements to strengthen the information security program, including proactively reviewing security controls and identifying areas to enhance the program.

In addition, the Smithsonian has taken a considerable length of time to implement and enforce many of these standards. However, management recently provided evidence that they have implemented a number of our oldest recommendations. We are reviewing the steps that management has taken, and we have started a review of the Smithsonian’s FY 2012 information security program.

B. Smithsonian’s Privacy Program

In a 2008 audit, we determined that most elements of a privacy program were not in place at the Smithsonian. In October of 2010, the Smithsonian hired a Privacy Officer (PO) and started to develop a formal privacy program. The PO made some improvements and began the task of developing a program, but the PO left before completely establishing the program. The PO position remains vacant.

The Under Secretary for Finance and Administration is spearheading the effort to implement the privacy program. However, over three years after we issued our report with the privacy recommendations, many of the actions management agreed to take remain incomplete. As a result, the Smithsonian remains vulnerable to
unnecessary or excessive privacy-related risks, such as that sensitive PII could be inappropriately collected or disclosed.

Throughout the coming year, we will continue to monitor management’s progress towards securing the Smithsonian against privacy-related risk. Additionally, we have identified PII safeguards as a potential audit beyond FY 2013.
November 14, 2012

Scott Dahl, Inspector General
Smithsonian Institution

Re: Management’s Response to Top Management Challenges for 2012

Dear Mr. Dahl:

The Smithsonian Institution remains committed to the pursuit of its mission, The Increase and Diffusion of Knowledge, and is mindful of its responsibility to its stakeholders—the citizens of the United States. My leadership team and I work daily to ensure that all of our activities reflect a desire to be the very best in all that we do.

Guiding a complex organization such as the Smithsonian inevitably presents challenges, including those presented in your document. We recognize the five challenges highlighted in your report and have worked hard to address them, along with other areas of risk outside of those in the report. For example, significant management attention has been devoted to our financial and internal control environment over the past five years, leading to a more effective framework in which to operate. Also, tremendous progress has been made to tighten security over our IT systems in a technology environment that constantly changes. Our commitment is underscored throughout our strategic plans in priorities such as organizational excellence, strengthening collections and measuring performance.

I will share your observations with senior leadership and am confident that they, along with their staff, share a commitment to continuous improvement in stewarding our resources and excellence in carrying out all facets of the Smithsonian’s mission.

G. Wayne Clough
Secretary