MINUTES OF THE JANUARY 13, 2010, AUDIT AND REVIEW COMMITTEE MEETING

On January 13, 2010, the Regents' Audit and Review Committee ("the Committee") met in the Regents' Room of the Smithsonian Castle. Participating were Committee Chair John McCarter* and Committee members Shirley Ann Jackson*, Congressman Sam Johnson*, and Robert Kogod. Also participating was Committee Advisor Herb Schulken. Participating staff included Secretary G. Wayne Clough; Treasurer Sudeep Anand; Chief of Staff to the Secretary Patricia Bartlett; Director of External Affairs Virginia Clark; Assistant Inspector General for Audits Daniel Devlin; Director of Development Services, Office of Development Zully Dorr; Associate General Counsel Lauryn Guttenplan; Chief of Staff to the Board of Regents John K. Lapiana; General Counsel Judith Leonard; Chief Financial Officer (CFO) Alice Maroni; Under Secretary for Finance and Administration Alison McNally*; Director of Government Relations Nell Payne; Inspector General (IG) Sprightley Ryan; Chief Information Officer Ann Speyer*; Deputy Comptroller Stella Whitsell; and Comptroller Andy Zino. Also in attendance were Rebecca Horton and John Keenan, who represented the Institution's auditors, KPMG LLP. Minutes were taken by Susan Block, Special Assistant to the CFO.

Chairman John McCarter called the meeting to order at 2:00 p.m.

Approval of the Minutes

A motion was made and seconded and the minutes of the September 8, 2009, Committee meeting were approved.

KPMG Fiscal Year 2009 Audit Update, Including the Federal Closing Package

KPMG LLP Senior Partner John Keenan presented a status report to the Committee. He informed the Committee that work on the audits of the Smithsonian-wide financial statements and Smithsonian Enterprises statement of "net gain" were in progress and proceeding in accordance with the audit plan that was discussed with the Committee in September 2009. He noted that there had been some slippage in the schedule in some areas that might cause the completion date of the audit to move back to February 5, 2010; however, he stated that management and KPMG were working to get through the open areas as quickly as practical and still hoped to complete the audits by the end of January 2010. He informed the Committee that the audit of the Federal closing package special purpose financial statements had been completed in accordance with Department of Treasury and OMB requirements, as well as a few days prior to their scheduled due date. He then turned the presentation over to Rebecca Horton to discuss the findings of that audit.

Ms. Horton fulfilled the required communications to the Committee on the audit of the Federal closing package. She stated that there had been very good cooperation with management during this audit and that no major issues arose during the course of the audit. There were a few audit differences in the areas of property and equipment; expense accruals; conditional asset retirement obligations; and imputed costs. She reported that these differences were not recorded in the financial statements as they were determined by management to be immaterial and that KPMG agreed with that assessment. She informed the Committee that there were no

** participated by teleconference*

material weaknesses noted and that there were no current year observations. She told the Committee that the prior year comment on Accounting Resources and Staff Capacity was no longer considered a significant deficiency. With regard to the other two audits, the Smithsonian-wide financial statements and the Smithsonian Enterprises special-purpose statement of "net gain," there were no material weaknesses noted to date.

Internal Controls: Charitable Contributions Improvement Plan

Chief Financial Officer Alice Maroni reminded the Committee that its previous review of the internal controls associated with key financial processes had left for later consideration the assessment of internal controls associated with charitable contributions. As work on the national campaign has progressed, she reported that the Office of External Affairs could now present a remediation plan to address the deficiencies identified in the charitable contributions process. Ms. Maroni then introduced Zully Dorr to make the presentation.

Zully Dorr, Director of Development Services in the Office of External Affair's Office of Development, informed the Committee that the review of the financial processes related to accounting for charitable contributions considered the way contributions were recorded in both the financial system and the donor system and were not about cash management, the controls for which were reviewed separately. She explained that the issue under review concerned how gifts are coded and recorded so that the restrictions are accurate and represent the purpose and intent of the donor. Ms. Dorr said that when the charitable contributions process was assessed for risk, the following aspects were reviewed: what is good governance in an organization like the Smithsonian; what is entailed in the proper segregation of duties; is there appropriate duty segregation; is there enough system integration or other internal controls to mitigate human error; and how do other organizations process charitable contributions.

Ms. Dorr said that the current process by which contributions information is recorded by the Institution uses a parallel work flow between the donor system and the ERP financial management system. Although checks and balances occur throughout each parallel process, the systems are not integrated and there is no automated data transfer between them. As a result, gifts may be recorded in the ERP system by the Office of the Comptroller (OC) in advance of any review for accuracy by the Office of Development (OD). If an error is discovered, OD notifies OC and contacts the unit to request correction. Ms. Dorr said that an excessive amount of manual reconciliation has to occur to ensure that data is accurately reflected in both systems, since the processes are not integrated to support each other.

She said that the implementation of a new donor system, and its integration with ERP, will address the majority of the issues identified in the risk assessment. She added that, since the implementation of a new system will take a number of years, OD is pursuing a number of key efforts that will considerably enhance internal controls in advance of a new system.

Ms. Dorr then outlined four processes that have been identified for improvement, three of which will be implemented in fiscal year 2010. The first control improvement to be implemented will be the consolidation of the gift receipting process. The second control improvement relates to the establishment of new accounts. Currently, Ms. Dorr explained, new accounts are established upfront by the OC and the unit. She said that OC has agreed to coordinate with OD to confirm, based on donor intent and restrictions on gifts, the accuracy of the accounts established. The third control improvement will further refine the guidelines used by the units for coding gifts, as there is a need for the Institution to standardize how the codes are used and to improve consistency. The fourth control improvement, which will be implemented in fiscal years 2011–2012, relates to merging the current parallel workflow into a single process, placing OD at the front of the cycle to assist with accurate recording of gifts in ERP. The plan is to pilot this process revision with a small group of units in fiscal years 2011 and 2012. The test will occur through a fiscal year-end closing to evaluate the revised process's impact on staff resources and year-end closing processes. Ms. Dorr said that management is hopeful that the process realignment will coincide with the installation of a new donor management system, which is projected to begin in fiscal year 2013.

Because Committee members Jackson and Johnson expressed a need to leave the meeting early, the Chairman adjourned the meeting at 2:30 p.m. on an interim basis to include them in an executive session with the Inspector General and the Secretary.

Following the conclusion of the executive session, the meeting resumed at 2:45 p.m.

Insurance Overview

Treasurer Sudeep Anand updated the Committee on the Institution's insurance program. He informed the Committee that the Institution's insurance program is structured around the Federal immunities and self-insurance program, and that all property purchased with Federal appropriations is self-insured. Consequently, the Institution only buys insurance for its Trust-funded properties and activities. Mr. Anand explained that the Institution has three types of policies: property policies, which cover real and personal property against physical loss or damage; liability policies, which cover the Smithsonian, Regents, employees, and volunteers for legal liabilities and provide defense against claims for alleged errors, omissions, negligence, or other wrongful acts; and special purpose policies, which are used for special activities and situations. He told the Committee that collections are insured only when they are off of the Smithsonian's premises (in storage or in transit) or on loan to the Smithsonian from others.

Mr. Anand informed the Committee that the Trust-related insurance program is designed to protect against serious or catastrophic loss while maintaining as low a premium as possible and continuing to improve coverage. He said that if there were a major loss the Smithsonian would have to seek a supplemental appropriation from Congress to cover that loss, which has never been done. He said that there is also protection under the Federal Tort Claims Act whereby the Department of Justice would provide defense and funding for certain actions brought to litigation; he added that Federal sovereign immunities exist when not waived by statute.

He informed the Committee that the Institution has insurance through seven companies and that the policies are put out for bid every three to five years. He told the Committee that, in order to maintain low premiums, his office tries to educate insurance providers on understanding that their exposure is limited because of Smithsonian Federal protections. He also said that other museums are contacted every three years to ensure that the Smithsonian's policies are comparable to those of peer organizations.

The Chair asked when the Committee had last conducted a review of the Smithsonian's insurance program and was informed that the previous insurance review had occurred 18 months prior to this meeting. The Chair stated that he would like the Committee to review the Smithsonian's insurance program on an annual basis, starting with the Committee's April 2010 meeting. It also was suggested that a major university should be added to the benchmark comparison and the Treasurer responded that he would do so.

Inspector General Update

Inspector General (IG) Sprightley Ryan said that she was pleased to report that the Office of the Inspector General is now fully staffed. She noted that all of the significant items reported in the Semi-Annual Report, which had been provided in advance of the meeting, had already been discussed with the Committee. She reported that her office had completed a peer review of the Inspector General's office of the Federal Trade Commission and then updated the Committee on completed audit work, the status of prior recommendations, and ongoing audit work.

With regard to completed audit work, Ms. Ryan reported that the personal property accountability audit had concluded, as had a report on the travel expenses of the Board of Regents. She said that, aside from recommending that the Office of the Regents document in writing its policy on travel expenses, the latter report essentially did not report any findings and that the Office of the Regents had subsequently provided documentation of its travel expenses policy.

Regarding prior recommendations, Ms. Ryan informed the Committee that her office had closed five of the recommendations from the Facilities and Maintenance Funds audit; one recommendation from the Personal Property Accountability audit; and the oldest outstanding recommendation from a September 2006 audit of Collections Security and Inventory at the National Museum of Natural History. She said that there were not any outstanding open recommendations that are more than two years old.

Ms. Ryan reported that ongoing audit work included a number of projects. She said that her office is working on a Collections Security and Inventory Control audit at the National Air and Space Museum. She said that the formal draft report was issued in late November 2009 and that her office was awaiting a formal response from management. The Chair requested, and the IG agreed, that a future executive session with the Inspector General include a discussion of the different levels of security on the most valuable objects of the collections.

Ms. Ryan also informed the Committee that her office's next big project will be the Capital Project Oversight, which is a follow-up review of previously conducted audits that identified numerous problems. Her office is also doing an audit on the Contractor Price Proposal to provide architect and contracting services for the Arts and Industries Building Revitalization Project. In addition, she informed the Committee that her office is also doing another audit of collections stewardship, and in particular storage conditions, at the National Museum of American History. Her office also has started an audit on acquisition workforce training, which will look at the training of contracting personnel. Ms. Ryan added that is anticipated that this audit will dovetail with Governance Recommendation #23 regarding improving contracting processes.

In closing her report, Ms. Ryan reminded the Committee that she and the Secretary had testified before the House Subcommittee in December 2009 and subsequently provided answers to questions for the record.

Chief Financial Officer's Update

CFO Alice Maroni updated the Committee on the activities of the Office of the Chief Financial Officer. She informed the Committee that it is anticipated that the annual financial statement audit will be done by early February 2010, after which work will begin immediately on the A-133 audit, which will be completed in June 2010.

She then updated the Committee on the status of efforts to improve internal controls and reported that progress continues to be made with respect to the five high-risk areas. Of particular note, the Institution's appropriation for fiscal year 2010 includes requested funding for internal controls positions.

Ms. Maroni expressed concern about resource constraints going forward. She said that some of the process owners responsible for processes rated moderate risk had based their remediation plans on the assumption they would get additional staff. She said that, because it was unclear if all of the required funds will be received, those process owners were reevaluating their plans to assess what they can do to strengthen controls in the absence of additional staff resources. She also informed the Committee that the Institution's fiscal year 2011 Federal budget request to be submitted to Congress in February 2010 includes funds for improving internal controls. The Chair asked the CFO to provide updated and previous versions of the red, green, and yellow chart at future Committee meetings, noting that the chart tracks efforts to improve internal controls and supports the Committee's efforts to monitor progress on these initiatives. The CFO stated she would do so.

The CFO was asked whether the 10 positions received in the fiscal year 2010 appropriation were the same as or different from the 10 audit positions previously authorized. She clarified that the Institution originally identified the need for 10 new positions to support the conduct of the audit in response to a significant deficiency regarding inadequate staff capacity that was reported by KPMG in the financial statement audit for fiscal year 2007. She said that all 10 positions have been funded and that seven of the 10 have been hired. She said that the requirement for additional staff was identified in the review of internal controls briefed to the Committee in January 2009. To strengthen internal controls largely in the financial processes deemed high-risk, Congress subsequently approved funding for 10 additional positions in the fiscal year 2010 appropriation; the Institution also is requesting funding for four more positions in its fiscal year 2011 Federal budget request.

Ms. Maroni updated the Committee on asset management and the Institution's personal property inventory. In 2006, when the Institution was preparing to deploy the financial system's asset management module, it conducted the first Institution-wide inventory to ensure that the data put into the system was accurate. Since that time, the Institution has made excellent progress: it conducts annually an inventory that covers one-third of the Institution's personal property, and has implemented policies and procedural standards.

Ms. Maroni said that efforts to emphasize the importance of asset management are paying off. In 2009, the inventory found that the value of the assets either missing or unrecorded totaled $2.1 million or 2.5 percent of the total inventoried. This is consistent with industry standards, which consider an organization to be at low risk if no more than 2 percent of inventory asset value is identified as missing or unrecorded. She stated that the IG's recent audit confirmed that improvements have been made, and that management agreed with the recommendations about the need for more training, the use of property accountability forms as required in the policy, and some policy clarifications to strengthen personal accountability. She said that preparations were under way for the spring 2010 inventory.

With regard to governance reform, Ms. Maroni informed the Committee that processes have been strengthened and new processes have been implemented in some cases to monitor spending. She said that the focus has been on travel, expense reimbursement, and procurement, noting that there is now a quarterly review of all senior executive travel vouchers and a monthly review of travel card and purchase card transactions. She also noted that, starting this year, policy compliance reviews of special event activity and purchase orders will be conducted.

Ms. Maroni reminded the Committee that the Institution is committed to complying with the best practice standards of not-for-profit organizations with regard to the Sarbanes-Oxley Act. She said that included a commitment to provide the Committee with an annual attestation letter at the conclusion of the financial statement audit, similar to the one that is currently provided to KPMG. She stated that the draft letter was in the review process and that the final letter would be delivered at the April 2010 meeting of the Committee.

The CFO stated for the record some of the decisions that have been made regarding the IRS Form 990 and 990-T. She said that the Chair and Committee Advisor Herb Schulken would soon begin receiving portions of the tax return to review in April or May 2010. The Comptroller requested, and received approval for, a meeting with the Chair and Mr. Schulken around the time of the April 7, 2010, Committee meeting in order to begin discussions on the Form 990 tax return. The Committee also agreed that it will meet on August 9, 2010, to discuss and approve the Institution's tax return.

The meeting was adjourned at 3:35 p.m. The Committee then conducted an executive session with KPMG, after which it met alone.

Respectfully submitted,
John McCarter, Chair