

MINUTES OF THE SEPTEMBER 14, 2011, AUDIT AND REVIEW COMMITTEE MEETING

On September 14, 2011, 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 Sam Johnson* and Robert Kogod; Committee member Shirley Ann Jackson was unable to participate. Also participating were Assistant to Congressman Johnson Dave Heil and Committee Advisor Herb Schulken. Participating staff included Secretary G. Wayne Clough; Chief of Staff to the Secretary Patricia Bartlett; Acting Chief Financial Officer (CFO) Bruce Dauer; Assistant Inspector General for Audits Dan Devlin; Chief of Staff to the Regents John K. Lapiana; General Counsel Judith Leonard; Under Secretary for Finance and Administration Alison McNally; Deputy Under Secretary for Collections and Interdisciplinary Support Scott Miller; Director of Government Relations Nell Payne; Inspector General (IG) Sprightley Ryan; National Collections Coordinator William Tompkins; and Comptroller Andrew Zino. Also in attendance were Joanna Friedman, Ellen Harrison, and Wendy Lewis, who represented the Institution's external auditors, KPMG LLP. Minutes were taken by Deputy Comptroller Stephen Wills.

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

Strengthening Collections Progress Report

In response to a series of IG reports on the state of collections care, Dr. Scott Miller, Deputy Under Secretary for Collections and Interdisciplinary Support, provided an overview of Smithsonian collections stewardship and recent progress in improving the care and accessibility of collections. Within this report, Dr. Miller mentioned the Collections Space Plan, which is a pan-institutional initiative to develop a Smithsonian collections space plan with near-term, intermediate, and long-term recommendations for addressing current and projected Smithsonian-wide collections storage requirements. The Collections Space Planning Initiative complements processes already under way in collections care assessment and planning, as well as digitization planning, to form a comprehensive planning resource for enhancing collections stewardship. Dr. Miller also provided an update on the status of a series of Office of the Inspector General (OIG) reports commenting on the adequacy of security and other safeguards over collections and related inventory controls.

The Chair asked about the level of accession and deaccession activities for the 137 million–some objects and specimens that comprise the total Smithsonian collections. Dr. Miller noted that better information on this activity can be reported to the Committee and that both the accession and deaccession of collections are important activities in collections management. Mr. Tompkins stated that the Chair's recommendation for additional information on this topic will be included in future presentations to the Committee.

The Chair noted that this report, excluding the last page (audit status), will be made public. Dr. Miller concurred that the report will be included in the Regent's presentation materials and will

**participated by teleconference*

be made public.

The Chair asked about the welfare of the collections after the recent earthquake. Dr. Miller reported that, from a collections care and facilities standpoint, the collections at the Museum Support Center fared very well and that previous procedures put in place were effective in preventing damage that otherwise might have occurred. Issues involving some shelving collapse as well as sprinkler head failure in some collections support center areas were noted. Damage was minimized in a number of areas due to recent building renovations. Overall, the investment in preventive care for collections items proved valuable in avoiding significant damage to the collections.

The Chair asked about the search for the new Director of the National Museum of American History (NMAH) and asked if the job description adequately details collections stewardship. Dr. Miller reported that the search committee had been formed but a job description had not been formalized. However, the search committee will be adequately represented with individuals who have extensive collections experience. Furthermore, Dr. Miller reported that management has redirected \$253,000 in additional funds to NMAH from central fiscal year 2011 collections care funding to further the museum's efforts in collections management.

Approval of Minutes

The Chair next called for the approval of the August 2011 meeting minutes. A motion was made and seconded, and the minutes of the Committee's August 2, 2011, meeting were approved. The Chair asked Andrew Zino to improve the timeliness, transparency, and clarity of future Income Tax Review 990s. He also asked that the Committee meet earlier to review the draft 990. Comptroller Zino indicated that, based upon management's review of the previous year's tax return, there may be some limitations in making all of the suggested changes but that he will do his best to address the issues noted by management. The Chair reemphasized his request, saying that the Office of the Comptroller must not try but will in fact complete the 990 on schedule.

Review of Findings of Audit Report "Stewardship of the Collections at Cooper-Hewitt, National Design Museum"

Assistant Inspector General for Audits Dan Devlin briefed the Committee on an audit of collections stewardship at Cooper-Hewitt, National Design Museum (CHNDM). The CHNDM audit focused on the adequacy of physical security to safeguard the collections, the functionality and adequacy of current inventory controls, and the adequacy of controls over the preservation of collections.

Mr. Devlin noted that CHNDM controls over inventory, physical security, and preservation were generally adequate. He reported that the audit did identify some opportunities to strengthen the management of inventory and security.

CHNDM is in the process of redesigning its interior space to increase its exhibition space. This

reconstruction project will close the operating space for two years, beginning in mid-2011. As a result, the museum has leased long-term storage space in Newark, New Jersey, to house the bulk of its permanent collections. At the time of the audit, most of the CHNDM collections were placed in temporary storage awaiting the completion of renovations to the museum's permanent storage space. The audit recommended that CHNDM strengthen its physical access controls at the Newark facility by controlling access to combined collection storage areas and ensuring that the Office of Protection Services obtains and reviews security reports, as well as oversees the management of the physical keys used to secure certain high-value collections storage areas. Finally, the audit also recommended CHNDM prevent staff members from having unrestricted access to both collection objects and related collections records for those objects.

The Chair emphasized the importance of segregation of duties in maintaining the security of collections.

Review of the Audit Results and Management Letter

KPMG LLC Senior Partner Ellen Harrison reviewed the audit plan for fiscal year 2011. Ms. Harrison will be the lead audit partner on all aspects of the financial audit, including the Federal closing audit and A-133 audit. The audit scope is consistent with the fiscal year 2010 audit. KPMG will conduct an audit of the consolidated financial statements of the Smithsonian for the year ending September 30, 2011; audit the special-purpose financial statements that will be filed with the Department of Treasury (Federal Closing Package); and conduct the Office of Management and Budget (OMB) Circular A-133 audit. KPMG will ensure that the Smithsonian's financial statements meet U.S. generally accepted accounting principles (GAAP). KPMG also will conduct their audits in accordance to auditing standards issued by the Auditing Standards Board of the American Institute of Certified Public Accountants and the government audit standards imposed by OMB Circular A-133 and OMB Bulletin 07-04.

Ms. Harrison discussed the objectives of the audit. The opinion of the audit will note if the financial statements are prepared, in all material aspects, in accordance with GAAP and if the statements are free from material misstatement. Joanna Friedman reviewed both KPMG's and management's responsibilities during the audit, as well as the concept of materiality. She outlined key issues the audit will emphasize, including recurring transactions, non-routine transactions, and key accounting estimates.

Ms. Friedman reported to the Committee that the Smithsonian is adopting Accounting Standards Codification (ASC) Update No. 2010-06 for the first time, which will require expanded disclosure under Financial Accounting Standards Board (FASB) ASC 820 for investments. These expanded disclosures include transfers, disaggregation by transaction type, class level, and inputs and valuation techniques.

Wendy Lewis outlined KPMG's fraud risk responsibilities, which include examining management's procedures to prevent and deter fraud, as well as incentives and pressures, the attitude of management, and any known or suspected fraud. Additionally, KPMG works closely

with the OIG to document its role as the contracting officer's technical representative. KPMG will participate in weekly status meetings with the OIG during the audit fieldwork, review selected OIG reports, and share perspectives on accounting and internal control matters.

The fiscal year 2011 audit timetable is similar to prior audits. The Federal Closing Package is due November 15, 2011, after which the Smithsonian-wide audit will begin, with completion scheduled by February 28, 2012. The A-133 audit is coordinated with the Defense Contract Audit Agency (DCAA). Because DCAA observes a different audit schedule, the A-133 audit will not be completed until June 30, 2012.

Ms. Harrison reported the results of the fiscal year 2010 A-133 Audit. With respect to the Mall-based awards audited by KPMG, KPMG issued an unqualified opinion on compliance with two instances of immaterial noncompliance related to Allowability, Reporting, Cash Management, and related costs of \$460. With respect to the Research and Development program compliance requirements audited by DCAA Chesapeake and DCAA Boston, DCAA issued an unqualified opinion on compliance with a deficiency that was also considered immaterial noncompliance. It related to the proper documentation supporting all inter-unit transactions, including copies of agreements between departments regarding services performed and related detailed expense breakdowns of costs incurred.

Inspector General's Update

IG Ryan informed the Committee that the audit reports "Smithsonian Enterprises Financial Management" and "Collections Stewardship at the Cooper-Hewitt, National Design Museum" would be issued by the end of the month and, as is always the case with OIG audits, they will be published on the OIG website.

The IG updated the Committee on the report on Smithsonian Enterprises' (SE) financial management. Auditors found that the Corporate and Retail divisions of SE do not effectively collaborate with each other during the budgeting process or while executing capital projects, have unclear roles and responsibilities, and could improve their transparency to museums with regard to financial information. Further, the auditors determined that SE's allocation methodology may not fairly distribute costs. Management concurred with all OIG recommendations except for the allocation methodology proposal.

Mr. Kogod expressed his surprise at the findings in the report and asked that both the Committee and the Board of Regents examine SE financial operations at an upcoming meeting.

The IG briefed the Committee on the audit report "Collections Stewardship of the National Collections at the National Museum of American History." The auditors found that NMAH could strengthen inventory controls to improve stewardship and broaden access to the collections. Additionally, the auditors reported that the museum has not developed resource and succession plans for collections management operations. The Chair asked that the Secretary prepare a response to the audit.

The IG reported on its audit of social media use at the Smithsonian. The auditors found that the Smithsonian is using media responsibly and manages user content well. The Smithsonian has published its social media policy, which was aided by the OIG. Concerns beyond the policy raised by the OIG include the (1) lack of a new web and media leader and (2) lack of media metrics.

The IG briefed the Committee on the results of a triannual peer review of its activities by the OIG from the Federal Deposit Insurance Corporation (FDIC). The FDIC found that the Institution's OIG processes and procedures are adequate. It also made suggested recommendations for improvement.

Inspector General's Fiscal Year 2012 Audit Plan

The IG presented the fiscal year 2012 audit plan and noted that it will be published on the OIG website. IG Ryan reported that she and Mr. Devlin will be leaving the OIG in November 2011.

Chief Financial Officer's Issues Update

Acting CFO Dauer informed the Committee that the Institution's fiscal year 2010 A-133 audit was completed on time in June 2011 with a clean audit opinion. Additionally, the Acting CFO reported that the fiscal year 2011 interim audit work was completed successfully in July 2011, that the financial statement audit is scheduled for completion by February 28, 2012, and that the Institution's tax returns (Internal Revenue Service Forms 990 and 990-T) were filed on time.

The Acting CFO informed the Committee of the publication of Smithsonian Directive (SD) 310: Financial Reporting and Risk Management Internal Controls. In that directive, the Smithsonian requires unit directors to sign an attestation that they have adequate internal controls in place, and that they have confidence and reasonable assurance that the financial reporting of their units is accurate to the best of their knowledge. The Chair asked that the Committee be given copies of SD 310.

Progress continues in the Smithsonian's efforts to address the one remaining internal control deficiency. All five high-risk areas are on track. Significant progress has been made in procurement and contracting with all seven policy manuals completed this year. Additionally, Use of Funds has transitioned to green status with the issuance of the Use of Funds Handbook in the second quarter of fiscal year 2011. A second internal control area on Capital Projects also transitioned to green status during the year, and the Personal Property Management and the Procurement and Contracting internal control areas have transitioned to yellow or moderate status during fiscal year 2011.

The Acting CFO reported on the status of compliance reviews conducted by the Office of the Comptroller over the past year. The objectives of the plan were exceeded during the fiscal year, with the addition of two additional compliance reviews. The Compliance Review Plan for the coming 12-month period also was presented to the Committee. The areas selected for compliance review were selected because of their financial impact or significance to the

Smithsonian.

The Committee was updated on the continuing implementation of the financial systems within the Smithsonian's Enterprise Resource Planning (ERP) system. The Project Costing module for Capital Projects was implemented on May 23, 2011, and the Grants module was implemented on June 20, 2011. Further improvements include continuing the migration of units to new bank accounts using enhanced bank account structure, and implementing the system changes necessary to support the revised program code structure. Finally, significant efforts are under way to meet new Federal reporting requirements under Government Treasury Account Symbol, which are scheduled to begin in the third quarter of fiscal year 2012.

The Smithsonian's current travel system contract, managed by the General Services Administration (GSA), will expire in November 2013. GSA will re-compete the contract prior to that timeframe, which will in turn require the Smithsonian to adopt a new travel system. The Committee also was informed of the review processes for travel card compliance. It was noted that a large portion of Institution's cardholders use their travel cards properly and make payments as required.

The Acting CFO updated the Committee on the processing of endowment financials. The Smithsonian will be migrating its endowment processing to a commercial off-the-shelf product in fiscal year 2012. The driving purpose behind this migration is the fact that the in-house contractor supporting the current system is retiring, and other required changes to the current system are necessary to support expanding reporting requirements. The Smithsonian has narrowed the selection of a new vendor to two systems, with the final selection to be made in the next couple of weeks.

Update on the Annual Financial Disclosure Process

General Counsel Leonard updated the Committee on the Annual Financial Disclosure Process.

The meeting was adjourned at 3:55 p.m. The Committee then conducted separate executive sessions with KPMG and the Inspector General. The Acting CFO did not require a session with the Committee. The Committee concluded its business with a meeting of the Committee alone.

Respectfully submitted,

John McCarter, Chair