

## **MINUTES OF THE SEPTEMBER 7, 2010, AUDIT AND REVIEW COMMITTEE MEETING**

On September 7, 2010, the Regents' Audit and Review Committee ("the Committee") met in the Regents' Room of the Smithsonian Castle. Participating were Acting Chair Robert Kogod and Committee members Shirley Ann Jackson\* and Sam Johnson\*; Committee chair John McCarter was unable to participate. Also participating were Assistant to Congressman Sam Johnson David Heil\* and Committee Advisor Herb Schulken\*. Participating staff included Secretary G. Wayne Clough; Chief of Staff to the Secretary Patricia Bartlett; Assistant Inspector General for Audits Dan Devlin; 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\*; and Comptroller Andrew Zino. Also in attendance were Joanna Biegler, Ellen Harrison, and Wendy Lewis, who represented the Institution's external auditors, KPMG LLP. Minutes were taken by Special Assistant to the CFO Susan Block.

Acting Chair Robert Kogod called the meeting to order at 2:00 p.m.

### **Review of KPMG Fiscal Year 2010 Audit Plan and Fiscal Year 2009 A-133 Audit Results**

KPMG LLP Senior Partner Ellen Harrison reviewed the audit plan for fiscal year 2010. Ms. Harrison will be the lead audit partner on all aspects of the financial statement audit, including the Federal closing audit and A-133 audit. The audit scope is consistent with the fiscal year 2009 audit with the exception that there will be no standalone audit of Smithsonian Enterprises (SE). KPMG will conduct an audit of the consolidated financial statements of the Smithsonian for the year ending September 30, 2010; audit the special-purpose financial statements that will be filed with the Department of Treasury (Federal Closing Package); and conduct the OMB Circular A-133 audit. KPMG will ensure that the Smithsonian's financial statements meet U.S. generally accepted accounting principles (GAAP), and KPMG will follow the auditing standards issued by the Auditing Standards Board of the American Institute of Certified Public Accountants, as well as the government auditing standards imposed by OMB Circular A-133 and OMB Bulletin No. 07-04, in conducting their audits.

Wendy Lewis 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. She reviewed both KPMG's and management's responsibilities during the audit, as well as the concept of materiality. Joanna Biegler outlined key issues the audit will emphasize, including recurring transactions, nonroutine transactions, and key accounting estimates.

Member Shirley Ann Jackson asked about the Smithsonian's application of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) on the financial statements with regard to the handling of expenditures against the Endowment in terms of gains on assets. The District of Columbia has adopted UPMIFA and, although the Institution is not required to follow it, the Smithsonian has in practice managed its Endowment following standards consistent with UPMIFA. For example, the Smithsonian manages the portfolio as a whole and diversifies its

\* participated by teleconference

investments. General Counsel Leonard said she would provide an explanatory chart about UPMIFA to the full Board prior to its September 2010 meeting, when it will vote on the formal adoption of UPMIFA standards as guidance.

Ms. Biegler informed the Committee that the Smithsonian is adopting Accounting Standards Codification (ASC) Update No. 2009-12 for the first time, which will require expanded disclosure requirements under FASB ASC topic 820 for those investments which were reported using net asset value per share as a practical expedient. These expanded disclosures include redemption frequency, notice periods, and unfunded commitments by fund type.

KPMG's fraud risk responsibilities 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. KPMG also works closely with the Office of the Inspector General (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 2010 audit timetable is consistent with those for prior audits. The Federal Closing Package is due November 15, 2010, after which the Smithsonian-wide audit will begin, with completion on January 15, 2011. 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, 2011.

Ms. Harrison reported the results of the fiscal year 2009 A-133 Audit. With respect to the Mall-based awards audited by KPMG, KPMG issued an unqualified opinion on compliance with one significant deficiency that was considered immaterial noncompliance. It related to Allowability, Reporting, and Cash Management. 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 one deficiency that was also considered immaterial noncompliance. It related to the transfer of \$231,426 of unallocable costs from a non-Federal department to a Federal department and an immaterial instance of noncompliance related to the timely filing of no-cost extensions.

### **Approval of the Minutes**

A motion was made and seconded, and the minutes of the Committee's April 7 and August 9, 2010, meetings were approved. Acting Chair Kogod reminded Committee members to fill out their Committee self-assessments and return them to the Office of the Regents.

### **Inspector General's Update**

IG Ryan informed the Committee that the Inspector General Act was modified by the Dodd-Frank Consumer Protection Act to require that IGs who report to a board can only be removed by a written concurrence of two-thirds majority of the board.

She reported that her office was about to issue the discussion draft of its audit on Smithsonian acquisition workforce training. Although it was not within the scope of the audit, the review

revealed a problem regarding the segregation of duties for purchase orders. Auditors discovered that, for about 6 percent of purchase orders under \$100,000, only one person enters, approves, and budget-checks purchase orders, which violates the principle of segregation of duties. KPMG also noted this violation in 2009 and discussed it with the Office of the Chief Information Officer (OCIO), which implemented a custom form change policy. Although that policy stated that duties must be segregated, there were no automated means to prevent the segregation of duties or to detect individual non-compliance. The OIG subsequently issued an advisory. Management agreed with its findings and will revise policies regarding ERP permissions. The IG reported that her office will likely release the final audit by the end of September 2010.

The OIG will issue a report on the review of the architecture/engineering of the National Museum of African American History and Culture. Auditors found that, in general, proposed costs are fair and reasonable, although about \$1.4 million, or 2 percent, of the costs will receive additional review.

The IG updated the Committee on the OIG Hotline. She discussed how the hotline is publicized and how complaints are received. Most complaints are received through an e-mail hotline and phone calls to OIG agents. About one-third of the complaints are referred elsewhere in the Institution, while the remainder are investigated by OIG special agents. Investigators often determine that there is no merit to an allegation and close the file. If they determine that a crime has been committed, the IG Act requires investigators to report it to the Department of Justice. If the Department of Justice declines to prosecute, the OIG conducts a noncriminal investigation and presents a report to the individual's supervisor, who can use it to support disciplinary action.

### **Inspector General's Fiscal Year 2011 Audit Plan**

The IG presented the fiscal year 2011 audit plan and noted it will be published on the OIG Web site. The OIG discussed proposed topics with stakeholders before putting the topics on the list. The OIG also issued an announcement letter for the audit on SE financial operations, which is included in the fiscal year 2011 audit plan.

### **Chief Financial Officer's Issues Update**

CFO Maroni informed the Committee that the Institution's tax return (IRS Form 990) was filed on time and posted on the Smithsonian's Web site, and that there have been no inquiries about the tax return. Acting Chair Kogod thanked both Committee Advisor Schulken and Comptroller Zino and his staff for the excellent preparation of the tax return.

Progress continues in efforts to address internal financial control deficiencies. Although some interim milestones have been missed, it is expected that overall goals will be achieved. Progress on procurement and contracting has slipped, as more time is needed to finalize the development of policies. A fall 2010 Continuing Resolution also would jeopardize the Institution's ability to hire the staff required to conduct a procurement policy compliance review.

The fiscal year 2012 Federal budget request sent to the Office of Management and Budget (OMB) includes a funding request to upgrade to the Institution's IT firewall. The firewall will strengthen information security and support the internal controls critical to information security.

The 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, so additional critical areas to monitor were added. Review areas for the coming 12-month period were outlined. The areas were selected because of their financial impact or significance to the Institution.

The Committee was updated on the continuing implementation of the financial system, which is part of the Institution's Enterprise Resource Planning (ERP) system. The Institution has made significant progress in the development of its financial system and the ability to support the Institution's changing needs. The staged implementation of the system has mitigated some of the considerable work load associated with both the implementation and the reengineering of individual processes. The system was launched in 2003 and upgraded in 2009, and another system upgrade is planned for 2014.

The Institution's travel system was upgraded in June 2010 and over 500 staff have received training on the upgrade. The improved navigation of the system has been well-received by users. In response to the Governance recommendations adopted by the Regents in 2007, the Committee requested that the CFO's office prepare quarterly reports on senior executive travel expenses. The CFO noted that 100 percent of senior executive travel is now reviewed and is typically well-documented. In general, there is little of note to report. Most travel cardholders use their travel cards properly and make payments as required. The Committee asked to continue receiving these reports. Committee member Jackson asked how many staff have travel cards. The CFO subsequently confirmed that there were 2775 travel cardholders at the end of fiscal year 2010.

With regard to resources for the Office of the Chief Financial Officer, the CFO reported that staffing continues to improve. Fiscal year 2011 Trust funds have been approved to support efforts to comply with payment card industry data security standards. This effort will protect the credit card numbers of Smithsonian customers. As previously noted, the fiscal year 2012 Federal funding request includes a request for a firewall replacement that is critical for information security and financial reporting. Following a discussion of financial management staff vacancies, the Committee expressed some concern about the vacancies in the Office of the Comptroller and was informed that the Institution's accounting staff vacancy rate remains a critical issue for the Comptroller but is nevertheless well below that experienced elsewhere in the Federal government.

The meeting was adjourned at 3:15 p.m. The Committee then conducted separate executive sessions with KPMG, the Inspector General, the General Counsel, and the Chief Financial Officer, after which it met alone.

Respectfully submitted,  
Robert Kogod, Acting Chair