

SEMIANNUAL REPORT TO THE CONGRESS

OCTOBER 1, 2003 – MARCH 31, 2004

OFFICE OF INSPECTOR GENERAL

NATIONAL ENDOWMENT FOR THE ARTS

April 30, 2004

MEMORANDUM

TO: Dana Gioia
Chairman

FROM: Daniel L. Shaw
Inspector General

SUBJECT: **Semiannual Report to the Congress: October 1, 2003 – March 31, 2004**

The Inspector General Act of 1978 (Public Law 95-452), as amended, calls for the preparation of semiannual reports to the Congress summarizing the activities of the Office of Inspector General (OIG) for the six-month periods ending each March 31 and September 30. I am pleased to enclose the report for the period from October 1, 2003 to March 31, 2004.

The Inspector General's report covers audits, investigations and other reviews conducted by the OIG, and indicates the status of management decisions whether to implement or not to implement recommendations made by the OIG. The President's Council on Integrity and Efficiency developed the reporting formats for Tables I and II to ensure consistent presentation by the Federal agencies. The tables provide only summary totals and do not include a breakdown by auditee.

The Act requires that you transmit the report to the appropriate committees of the Congress within 30 days of receipt, together with any comments you may wish to make. Comments that you might offer should be included in your "Report on Final Action," a management report that is required to be submitted along with the Inspector General's report. We will work closely with your staff to assist in the preparation of the management report. The due date for submission of both reports is May 30, 2004.

I appreciate the continuing support we have received from the Chairman's Office and your managers throughout the Agency. Working together, I believe we have taken positive steps to improve Agency programs and operations. We look forward to continuing these efforts.

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NEA PROGRAMS AND OPERATIONS

Since its founding by the U.S. Congress in 1965, the National Endowment for the Arts (NEA) has offered assistance to a wide range of non-profit organizations and individuals that carry out arts programming. The NEA supports exemplary projects in all the artistic disciplines. Grants are awarded to arts, educational, and community organizations for specific projects rather than for general operating or seasonal support. Most NEA grants must be matched by non-federal sources. During FY 2003, NEA incurred obligations of \$117.07 million and employed a staff of about 150. The NEA's FY 2004 appropriation is \$120.97 million.

OIG RESPONSIBILITIES AND RESOURCES

On October 18, 1988, the President signed Public Law 100-504, the Inspector General Act Amendments of 1988. This law amended the Inspector General Act of 1978, Public Law 95-452, and required the establishment of independent Offices of Inspector General (OIG) at several designated Federal entities and establishments, including the National Endowment for the Arts. The Inspector General is appointed by and serves under the general supervision of the NEA's Chairman. The mission of the OIG is to:

- Conduct and supervise independent and objective audits and investigations relating to NEA programs and operations;
- Promote economy, effectiveness and efficiency within the NEA;
- Prevent and detect fraud, waste and abuse in NEA programs and operations;
- Review and make recommendations regarding existing and proposed legislation and regulations relating to NEA programs and operations; and
- Keep the NEA Chairman and the Congress fully and currently informed of problems in Agency programs and operations.

This semiannual report summarizes the OIG's major activities, initiatives and results for the six-month period ending March 31, 2004. During this period, the OIG consisted of two auditors and one program analyst. There is no investigator on the staff. In order to provide a reactive investigative capability, we have signed a Memorandum of Understanding with the Inspector General of the General Services Administration (GSA) whereby the GSA's OIG agrees to provide investigative coverage for us on a reimbursable basis as needed. (No investigative coverage from GSA was needed during the recent six-month period.) We have also signed a Memorandum of Understanding with NEA's Office of General Counsel (OGC) that details procedures to be used for providing the OIG with legal services. An OGC staff member has been assigned to provide such services on an as-needed basis.

SUMMARY OF WORK COMPLETED BY THE OIG

During the six-month period ending March 31, 2004, the OIG conducted the following audits, reviews, investigations and other activities.

Audits/Reviews

During the recent semiannual period, the OIG issued five reports. Of those, three reports were based on reviews performed by OIG personnel and two reports were the results of OIG desk reviews of audit reports and other materials related to grantee organizations that were required to have audits performed by independent auditors. Overall, our reports contained seven recommendations, all of which were related to systems deficiencies identified during the audit of NEA's financial statements.

Audit Resolution

At the beginning of the six-month period, there was one report awaiting a management decision to allow or disallow questioned costs of \$191,050 with potential refunds of \$50,500. During the period, no reports identified questioned costs or potential refunds.

A management decision was made on the one report to allow \$91,100 in questioned costs and to disallow \$99,950 in questioned costs. Of the \$50,500 in potential refunds, \$20,500 was accepted and the balance of \$30,000 is being sought as a refund. At the end of the period, no reports remained outstanding. (See Table I.)

Investigations

The OIG opened one new allegation case during the recent six-month period. This case will remain open pending further investigation of the evidence. The one open case from the prior period was closed. No criminal investigations were performed during the period.

Indirect Cost Rate Evaluations

Indirect costs are incurred for common or joint objectives, which cannot be readily and specifically identified with a particular project or activity. The costs of operating and maintaining facilities, depreciation or use allowances, and administrative salaries and supplies are typical examples of costs that nonprofit organizations usually consider to be indirect.

Indirect cost rates are established by agreement between a non-Federal organization and a Federal agency (usually the agency that furnishes the preponderance of Federal funding) that acts on behalf of all Federal agencies in approving rates with the organization. During this period, the OIG evaluated four indirect cost rate proposals submitted by NEA grantee organizations.

The OIG also makes use of an Indirect Cost Guide. The Guide answers such questions as: What are direct or indirect costs, what is an indirect cost rate, and does an entity need an indirect cost rate? A copy of the Guide can be found on NEA's web site at www.arts.gov/about/OIG/IndirectCost.html.

Review of Legislation, Rules, Regulations and Other Issuances

The OIG is required to review and comment on proposed legislation and regulations for their potential impact on the Agency and its operations. During this reporting period, the OIG provided analyses and written commentaries on Agency Administrative Directives, and other government publications/reports.

Technical Assistance

The OIG provided technical assistance to NEA grantees and their independent auditors. Our efforts included, for example, clarifying and interpreting the audit requirements of OMB Circular A-133, "*Audits of States, Local Governments, and Non-Profit Organizations*," explaining alternative methods of accounting for indirect costs, and advising some of the first-time and smaller organizations on implementing practical accounting systems and internal controls sufficient to assure compliance with their grant agreements.

The OIG also assisted Agency staff with technical issues related to auditing, accounting and audit followup.

Web Site

The OIG maintains an ongoing Internet presence (www.arts.gov/about/OIG/Contents.html) to assist and inform NEA grantees and Agency employees. The site includes the *Inspectors General Vision Statement*, our two *Financial Management Guides*, our *Indirect Cost Guide*, past *Semiannual Reports to the Congress*, the *OIG Strategic Plan*, information about contacting OIG staff, how to report wrongful acts, information about alternative methods of funding, and answers to frequently asked questions.

Other Activities

During this period, the OIG took part in the activities of the Executive Council on Integrity and Efficiency (ECIE), and allocated resources for responding to information requests from and for the Congress and other agencies. We continued to participate in an advisory capacity in the Agency's implementation of the Federal Information Security Management Act (FISMA). The OIG also provided oversight of the Agency's independent auditors as they prepared and completed the Agency's first financial statement audit for the fiscal year ending September 30, 2003.

SECTIONS OF REPORT

The following sections of this report discuss the 12 areas specifically required to be included according to Section 5(a) of the Act. Table I shows there were no Inspector General issued reports with questioned costs and Table II also shows that there were no Inspector General issued reports with recommendations that funds be put to better use.

SECTION 1 – Significant Problems, Abuses and Deficiencies

Audits and other reviews conducted by OIG personnel during the current and prior periods have disclosed a few instances of deficient financial management practices in some organizations that received NEA grants. Among these were:

- Reported grant project costs did not agree with the accounting records, i.e., financial status reports were not prepared directly from the general ledger or subsidiary ledgers or from worksheets reconciled to the accounts;
- Personnel costs charged to grant projects were not supported by adequate documentation, i.e., personnel activity reports were not maintained to support allocations of personnel costs to NEA projects;
- The amount allocated to grant projects for common (indirect) costs which benefited all projects and activities of the organization was not supported by adequate documentation; and
- Grantees needed to improve internal controls, such as ensuring a proper separation of duties to safeguard resources and including procedures for comparing actual costs with the budget.

SECTION 2 – Recommendations for Corrective Action

To assist grantees in correcting or avoiding the deficiencies identified in Section 1, the OIG has prepared two "*Financial Management Guides*," one for non-profit organizations and the other for state and local governments. The guides are not offered as complete manuals of procedures; rather, they are intended to provide practical information on what is expected from grantees in terms of fiscal accountability. The guides are available on the NEA's web site.

The guides discuss accountability standards in the areas of financial management, internal controls, audit and reporting. The guides also contain sections on unallowable costs and shortcomings to avoid. In addition, the guides include short lists of useful references and some sample documentation forms.

SECTION 3 – Recommendations in Previous Reports on Which Corrective Action Has Not Been Implemented

There were no significant recommendations in previous reports on which corrective action has not been implemented.

SECTION 4 – Matters Referred to Prosecuting Authorities

No matters were referred to prosecuting authorities during this reporting period.

SECTION 5 – Denials of Access to Records

No denials of access to records occurred during this reporting period.

SECTION 6 – Listing of Reports Issued

<u>REPORT NUMBER</u>	<u>TITLE</u>	<u>DATE OF REPORT</u>
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Oversight Audit Agency Review Reports

OAA-04-01	Metropolitan Opera Association, Inc.	10/24/03
OAA-04-02	Dept. of Accounting and General Services/State of Hawaii.....	01/29/04

Limited Scope Audit

LS-04-01	Association for Cultural Equity, Inc.	12/22/03
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Technical Assistance Report

TA-04-01	Nickolais/Lewis Foundation for Dance, Inc.	12/11/04
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Special Review Report

A-04-01	National Endowment for the Arts Financial Statements.....	01/20/04
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TOTAL REPORTS – 5

SECTION 7 – Listing of Particularly Significant Reports

There were no particularly significant reports during the reporting period.

SECTION 8 – Statistical Tables Showing Total Number of Audit Reports and the Dollar Value of Questioned Costs

Table I of this report presents the statistical information showing the total number of audit reports and the total dollar value of questioned costs.

SECTION 9 – Statistical Tables Showing Total Number of Audit Reports and the Dollar Value of Recommendations that Funds be Put to Better Use by Management

As shown on Table II, there were no audit reports with recommendations that funds be put to better use by management.

SECTION 10 – Audit Reports Issued Before the Commencement of the Reporting Period for Which No Management Decision Has Been Made by the End of the Reporting Period

There were no audit reports issued before the commencement of the reporting period for which no management decision has been made by the end of the reporting period.

SECTION 11 – Significant Revised Management Decisions Made During the Period

No significant revised management decisions were made during the reporting period.

SECTION 12 – Significant Management Decisions With Which the Inspector General Disagrees

There were no significant management decisions that the Inspector General disagreed with during the reporting period.

TABLE I
INSPECTOR GENERAL ISSUED REPORTS WITH QUESTIONED COSTS

	<u>NUMBER</u>	<u>QUESTIONED COSTS</u>	<u>UNSUPPORTED COSTS</u>	<u>POTENTIAL REFUNDS¹</u>
A. For which no management decision has been made by the commencement of the reporting period	<u>1</u>	<u>191,050</u>	<u>(191,050)</u>	<u>50,500</u>
B. Which were issued during the reporting period	<u>0</u>	<u>0</u>	<u>(0)</u>	<u>0</u>
Subtotals (A + B)	<u>1</u>	<u>191,050</u>	<u>(191,050)</u>	<u>50,500</u>
C. For which a management decision was made during the reporting period	<u>1</u>	<u>191,050</u>	<u>(191,050)</u>	<u>50,500</u>
(i) Dollar value of disallowed costs	<u>1</u> ²	<u>99,950</u>	<u>(99,950)</u>	<u>30,000</u>
(ii) Dollar value of costs not disallowed	<u>1</u> ²	<u>91,100</u>	<u>(91,100)</u>	<u>20,500</u>
D. For which no management decision has been made by the end of the reporting period	<u>0</u>	<u>0</u>	<u>(0)</u>	<u>0</u>
Reports for which no management decision was made within six months of issuance	<u>0</u>	<u>0</u>	<u>(0)</u>	<u>0</u>

^{1/} The potential refund amount usually will not equal the questioned costs amount because matching requirements must be considered and the grantee may be either under or over matched. In addition, historically, the potential refund generally is reduced significantly as a result of the audit followup process, which includes examination of documentation submitted by the grantee.

^{2/} Includes one grantee that had both costs disallowed (i) and cost not disallowed (ii) by management.

TABLE II

INSPECTOR GENERAL ISSUED REPORTS

WITH RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE

	<u>NUMBER</u>	<u>DOLLAR VALUE</u>
A. For which no management decision has been made by the commencement of the reporting period	0	0
B. Which were issued during the reporting period	0	0
Subtotals (A + B)	0	0
C. For which a management decision was made during the reporting period	0	0
(i) dollar value of recommendations that were agreed to by management	0	0
- based on proposed management action	0	0
- based on proposed legislative action	0	0
(ii) dollar value of recommendations that were not agreed to by management	0	0
D. For which no management decision has been made by the end of the reporting period	0	0
Reports for which no management decision was made within six months of issuance	0	0

DEFINITIONS OF TERMS USED

The following definitions apply to terms used in reporting audit statistics:

Questioned Cost	A cost that the Office of Inspector General (OIG) questioned because of alleged violation with a provision of a law, regulation, contract, or other agreement or document governing the expenditure of funds; such cost is not supported by adequate documentation; or the expenditure of funds for the intended purpose is unnecessary or unreasonable.
Unsupported Cost	A cost which the OIG questioned because the cost was not supported by adequate documentation at the time of the audit.
Disallowed Cost	A questioned cost that management has sustained or agreed should not be charged to the NEA grant or cooperative agreement.
Funds Be Put To Better Use	A recommendation made by the OIG that funds could be used more efficiently if management took actions to implement and complete the recommendation.
Management Decision	Management's evaluation of the findings and recommendations contained in the audit report and the issuance of management's final decision, including actions to be taken. Interim decisions and actions are not considered final management decisions for the purpose of the tables in this report.
Final Action	The completion of all actions that management has concluded in its management decision with respect to audit findings and recommendations. If management concluded that no actions were necessary, final action occurs when a management decision was made.

REPORTING WRONGFUL ACTS

Anyone, including Agency employees, who learns about or has reason to suspect the occurrence of any unlawful or improper activity related to NEA operations or programs, should contact the OIG immediately. A complaint/referral may be made by visiting the OIG office, calling the OIG at 202-682-5402, emailing at oig@arts.endow.gov or writing to the Office of Inspector General, Room 601, 1100 Pennsylvania Avenue, NW, Washington, DC 20506.

When contacting the OIG, it will help if you have answers to the following questions:

- Who are the parties involved (names, addresses and phone numbers if possible);
- What is the suspected activity (specific facts of the wrongdoing);
- When and where did the wrongdoing occur;
- How did you learn about the activity (from a third party, actual observation, conclusion drawn from observing or performing different activities, etc.); and
- Where can you be contacted or when will you contact us again.

The OIG will not disclose the identity of a complainant or informant without consent, unless the Inspector General determines that such disclosure is unavoidable during the course of the investigation. You may remain anonymous, if you choose. Federal employees are protected against reprisal for disclosing information to the Inspector General unless such disclosure was knowingly false.

