

AUDIT REPORT

**SMITHSONIAN INSTITUTION ORGANIZATIONAL
CHECKING ACCOUNTS**

Number A-02-10

April 16, 2003

SUMMARY

The Office of the Inspector General audited Smithsonian Institution bank accounts. The purpose of the audit was to assess whether bank account internal controls were functioning effectively. Our audit was limited to 11 organizational checking accounts.

Generally, internal controls and safeguards over organizational checking accounts were inadequate to reduce the risks of loss or unauthorized use of Smithsonian funds to an acceptable level. Although our audit disclosed no instances of defalcation, we believe that reasonable alternatives for most transactions currently accomplished through organizational checking accounts exist. Consequently, we made seven recommendations to improve Smithsonian bank account management. In summary, the recommendations are as follows:

- Perform re-certifications of all checking accounts and close those accounts deemed unnecessary;
- Revise, update, and issue policies and procedures that relate to organizational checking accounts and purchase cards; and
- Perform periodic compliance reviews to ensure that controls are operating effectively.

The Institution Comptroller concurred with the audit recommendations. Overall, we believe that the corrective actions taken and planned are responsive to the recommendations.

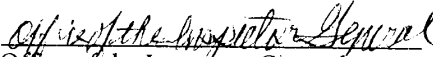

Office of the Inspector General

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ABBREVIATIONS AND ACRONYMS

CFO	Chief Financial Officer
OC	Office of the Comptroller

INTRODUCTION

A. Purpose

The purpose of the audit was to evaluate Institution internal controls for organizational checking accounts.

B. Scope and Methodology

Our audit was conducted from August 5, 2002, to February 28, 2003, in accordance with generally accepted government auditing standards. We reviewed 11 of 14 Institution checking accounts. Our methodology included the following:

- identifying and reviewing applicable policies and procedures related to financial accounting and organizational checking accounts, and
- evaluating organizational checking account transactions.

We reviewed financial and procurement policies, procedures, and controls. As part of our review, we interviewed staff from at least 12 Smithsonian units:

- Office of the Comptroller (OC);
- Office of Contracting;
- Office of the Treasurer;
- Center for Folklife and Cultural Heritage;
- Smithsonian Marine Station at Fort Pierce;
- Smithsonian National Museum of Natural History Arctic Studies Center;
- Smithsonian Environmental Research Center;
- Smithsonian Tropical Research Institute;
- Smithsonian Astrophysical Observatory;
- The Smithsonian Associates;
- National Zoological Park; and
- Cooper-Hewitt, National Design Museum.

Through interviews and transaction reviews, we gained an understanding of the controls and practices employed concerning organizational checking accounts.

The following points were considered throughout our audit: Adequate separation of duties between individuals authorized to write, reconcile, and request check transactions, and the availability and use of alternatives to checking accounts. We conducted interviews to determine current check writing and account reconciliation processes, as well as the processes involved in establishing and re-certifying accounts. Through interviews, we gained an understanding of existing internal controls associated with the Institution's bank accounts.

C. Background

The Chief Financial Officer (CFO) issued a 2002-2006 Strategic Plan dated March 15, 2002 that identifies the CFO as responsible for the financial integrity of the Institution. The CFO is responsible for establishing financial policies and standards for the Institution to ensure fiscal discipline. The OC is responsible for preparing and maintaining the Institution's official accounting and financial records, reports, and financial statements.

The first strategic goal is to set financial management standards, take responsibility, and share commitment. This goal articulates the CFO's responsibility as steward of the Institution's resources to set financial management standards through policies and procedures for the entire Institution, to take responsibility for Institutional compliance with policies and procedures, and to promote financial and contracting best practices. The goal will ensure fiscal discipline, strong internal controls, and compliance with policies and procedures.

RESULTS OF AUDIT

Institution Organizational Checking Accounts

The Institution could improve its oversight and internal controls of organizational checking accounts. Specifically, weaknesses exist in organizational checking accounts concerning:

- lack of segregation of duties;
- no supporting documents maintained;
- unaccountable checks;
- transaction records incomplete;
- improper and not up-to-date signatories;
- bank accounts exist without OC knowledge; and
- transactions could be paid by purchase card.

This occurred because the Comptroller's office has not critically reviewed the need for units to maintain organizational checking accounts and check writing transactions. As a result, accounts were maintained that may not be necessary, were not used for intended purposes, and were used without authority.

Background

The scope of our review consisted of reviewing 11 of 14 organizational checking accounts focusing on internal controls. We evaluated organizational checking accounts transactions for the bank statement for one year: August 2001 through August 2002.

Smithsonian Directive 115, ***Management Controls***, revised July 23, 1996, lists standards that shall apply to Institution units. In particular, the directive requires managers to take systematic and proactive actions to develop and implement appropriate, cost effective management controls. It also requires that controls established shall provide reasonable assurance that assets are safeguarded against waste, loss, unauthorized use, and misappropriation.

Smithsonian Directive 302, ***Financial Management: Payments, Policies, Systems and Procedures***, April 7, 1992, states that it is Smithsonian policy as well as sound business practice to pay for goods and services that are supported by proper invoices and other approved documents. Source documents are required to be maintained in a secure and readily accessible location for audit. Requests for organizational checking accounts must be in writing and specifically identify the circumstances that make it impracticable to use the Smithsonian's central purchasing system and payment systems. Directors are responsible for ensuring that checking accounts comply with operational procedures and requirements. The OC is responsible for recertifying checking accounts periodically. The OC

and our office conduct reviews and audits when necessary. Operational procedures require the separation of duties: Separate employees should be assigned to authorize purchases, approve the receipt of goods or services, and approve disbursements. Each organization must support each disbursement with an original invoice, purchase authorization, evidence of receipt for goods and services, and the tax identification numbers for independent contractors providing services. Organizations must maintain a daily check register and account for both used and unused checks.

Records should contain the check number, date issued, payee, amount, purpose, fund code, and account code. Banks should send bank statements to the Comptroller's office. Organizations must not use organizational checking accounts for:

- salary;
- travel;
- equipment or construction services;
- establishment or replenishment of petty cash; or
- reimbursement of employees.

Micro-purchases are purchases up to \$2,500 for routine or occasional supplies and services. Purchase card usage is limited to the micro-purchase threshold. A petty cash purchase is a method of making purchases under \$500 from local vendors. Petty cash use is limited to emergency situations where the normal purchasing procedures will not result in timely payment.

Smithsonian Directive 309, ***Merchant Credit Cards***, September 6, 2002, states that the OC is responsible for establishing merchant credit card accounts, recording revenues, and monitoring Smithsonian Institution merchant credit card account activity. Smithsonian units may not establish merchant credit card accounts except through the OC.

Smithsonian Staff Handbook 314, ***Requisitioning – Purchase of Supplies, Equipment and Services***, March 1993, provides policies and procedures for offices to acquire supplies, equipment, and services. Offices have the following purchase methods available: petty cash, purchase cards, purchase order system, and blanket purchase order system. Petty cash is available for advancing cash or reimbursing employees for small purchases of supplies and services in the local area. A purchase order permits offices to purchase goods or services directly from suppliers. A blanket purchase agreement is a simplified method of filling anticipated repetitive needs for supplies or services by establishing “charge accounts” with qualified sources of supply.

Result of Review

We evaluated internal controls for Institution organizational checking accounts. Our evaluation concentrated on the use of organizational checking accounts, segregation of duties for operating the accounts, and record keeping and transaction documentation. We determined that internal controls were weak and OC oversight for approving and reviewing account usage could be strengthened. Specifically, organizational checking accounts lacked proper segregation of duties. For instance, segregation of duties weaknesses existed at the Smithsonian Tropical Research Institute and the Smithsonian Marine Station at Fort Pierce. At both, a staff member was responsible for more than one of the following functions: approving payments, allocating funds, making deposits, writing and signing checks, and reconciliation of the account. During the audit, Smithsonian Tropical Research Institute management corrected the segregation of duties issue. Also at the Marine Station at Fort Pierce, in order to reimburse their unit's petty cash, the administrative officer often wrote checks payable to the administrative officer.

In addition to segregation of duties weaknesses, transactions records and supporting documentation were not readily available for audit or were incomplete. Cooper-Hewitt Museum for example was unable to provide complete transaction records and supporting documentation for the audit. In addition, numerous checks were unaccountable and individuals were signing checks who were not signatories of the account. A similar situation existed at the Smithsonian Environmental Research Center with records and supporting documentation unavailable for audit.

Based on our review, most transactions could have been made with purchase cards. For example, we determined that units used checking accounts for paying the following:

- travel;
- salary;
- services and vendors;
- postage;
- replenishment of petty cash;
- refreshments; and
- merchant credit card accounts.

We also determined that some units have established merchant credit accounts with Wal-Mart Stores and Home Depot. Units purchase items from these merchants and use the organizational checking account to pay for the items purchased. In some instances, payments were late and the same staff person purchased the items and also wrote the payment checks. We were also able to identify an organizational checking account not listed on Comptroller's records. A checking account was established by the National Zoological Park to support field advances for the Golden Lion Tamarin Project. The account was also used to provide deposits and advances for researchers. According to Department of Conservation Biology staff, there were about four similar checking accounts.

Additionally, for most accounts reviewed, we identified that signatories for the accounts have not been updated and contained former employees including the former Comptroller. We also determined that a Smithsonian Tropical Research Institute checking account used to pay employees maintains an increasing balance resulting from payroll withholding of about \$14,000 as of September 2002.

Current policies were not always followed, were sometimes vague, and were not specific regarding oversight responsibilities. OC did not critically review the need for units to maintain organizational checking accounts. The most recent organizational checking account reviews were performed in 1999. Although, OC does perform some reconciliation of accounts, they have not performed any transaction level reviews.

As a result, unnecessary accounts were maintained, not used for intended purposes, and used without appropriate authority. Without clear policies and procedures, staffs are unaware of their administrative and oversight duties.

Conclusion

Improving oversight and performing transaction level reviews supports the CFO's strategic goal of fiscal discipline through internal controls. Enforcing controls also strengthens the financial integrity of the Institution and minimizes cash management risks. In addition, removing organizational checking accounts and encouraging the use of the purchase card should increase efficiencies and the overhead required to maintain the accounts.

Recommendations

We recommended that the Comptroller:

1. Perform a re-certification of organizational checking accounts.

Management Comments

Concur. The Office of the Comptroller (OC) will perform a re-certification of all 14 Institution checking accounts and will also investigate for initial certification the potential 1 to 5 checking accounts referenced in the audit as ones for which OC had no knowledge. Target date for completion of all re-certifications will be September 30, 2003.

Office of the Inspector General Response

The Comptroller's actions are responsive to the recommendation.

2. Close unnecessary organizational checking accounts.

Management Comments

Concur. OC will close unnecessary organizational checking accounts based upon results of the re-certifications. Target date for completion will be December 31, 2003.

Office of the Inspector General Response

The Comptroller's actions are responsive to the recommendation.

3. Maintain proper documentation and justification in an orderly, easily accessible manner for audit.

Management Comments

Concur. OC will develop procedures for the maintenance of organizational checking account information to include managerial oversight of information retention practices. Target date for development of procedures will be September 30, 2003.

Office of the Inspector General Response

The Comptroller's actions are responsive to the recommendation.

4. Update and revise the current accounting and financial policies to include current offices and the establishment of credit accounts.

Management Comments

Concur. OC will revise Smithsonian Directive 302, ***Financial Management: Payments, Policies, Systems, and Procedures***, to include current offices and the establishment of credit accounts. Target date for revision will be September 30, 2003.

Office of the Inspector General Response

The Comptroller's actions are responsive to the recommendation.

5. Issue policy requiring the use of the SI purchase card for purchases as defined in Smithsonian Directive 314.

Management Comments

Concur. OC will revise Smithsonian Directive 302, ***Financial Management: Payments, Policies, Systems, and Procedures***, to include the requirement of use of purchase cards for purchases as defined in SD 314. Target date for revision will be September 30, 2003.

Office of the Inspector General Response

The Comptroller's actions are responsive to the recommendation.

6. Establish a process for performing periodic compliance reviews to ensure internal controls are operating effectively.

Management Comments

Concur. OC will develop a process for the performance of compliance reviews of organizational checking accounts and will add this type of review to the OC annual compliance review cycle. Target date for submission of the proposed process will be September 30, 2003.

Office of the Inspector General Response

The Comptroller's actions are responsive to the recommendation.

7. Determine how to transfer STRI withholding funds to the appropriate account, and ensure the withheld amounts are in accordance with regulatory guidance.

Management Comments

Concur. OC will analyze STRI withholding funds to determine the appropriate account to transfer the funds and will ensure the withheld amounts are processed appropriately in compliance with regulatory guidance.

Office of the Inspector General Response

The Comptroller's actions are responsive to the recommendation.

Appendix A. Management Comments From Catheryn Hummel, Comptroller, Office of the Comptroller



Smithsonian Institution

Office of the Comptroller

Date April 8, 2003

To Thomas D. Blair
Inspector General

cc Alice Maroni
Chief Financial Officer

From Catheryn Hummel
Comptroller

A handwritten signature in cursive script, appearing to read "Catheryn Hummel".

Subject Management Comments to Draft Report on Audit of Smithsonian Institution
Organizational Checking Accounts

I have reviewed your draft report and concur with each of the recommendations presented. From an internal control standpoint, the issues you have discovered are disconcerting. I am committed to address and resolve these internal control weaknesses. Specifically, my office will perform the corrective action identified in the paragraphs below for the seven findings identified.

1. Perform a re-certification of organizational checking accounts.

Management Comment: Concur. The Office of the Comptroller (OC) will perform a re-certification of all 14 Institution checking accounts and will also investigate for initial certification the potential 1 to 5 checking accounts referenced in the audit as ones for which OC had no knowledge. Target date for completion of all re-certifications will be September 30, 2003.

2. Close unnecessary organizational checking accounts.

Management Comment: Concur. OC will close unnecessary organizational checking accounts based upon results of the re-certifications. Target date for completion will be December 31, 2003.

3. Maintain proper documentation and justification in an orderly, easily accessible manner.

Management Comment: Concur. OC will develop procedures for the maintenance of organizational checking account information to include managerial oversight of information retention practices. Target date for development of procedures will be September 30, 2003.

4. Update and revise the current accounting and financial policies and procedures to include current offices and the establishment of credit accounts.

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Appendix A. Management Comments From Catheryn Hummel, Comptroller, Office of the Comptroller Continued

Management Comment: Concur. OC will revise Smithsonian Directive 302, *Financial Management: Payments, Policies, Systems and Procedures*, to include current offices and the establishment of credit accounts. Target date for revision will be September 30, 2003.

5. Issue policies and procedures requiring the use of purchase cards for purchases as defined in Smithsonian Directive 314.

Management Comment: Concur. OC will revise Smithsonian Directive 302, *Financial Management: Payments, Policies, Systems and Procedures*, to include the requirement of use of purchase cards for purchases as defined in SD 314. Target date for revision will be September 30, 2003.

6. Establish a process for performing periodic compliance reviews to ensure that internal controls are operating effectively.

Management Comment: Concur. OC will develop a process for the performance of compliance reviews of organizational checking accounts and will add this type of review to the OC annual compliance review cycle. Target date for submission of the proposed process will be September 30, 2003.

7. Determine how to transfer Smithsonian Tropical Research Institute (STRI) withholding funds to the appropriate account, and ensure the withheld amounts are in accordance with regulatory guidance.

Management Comment: Concur. OC will analyze STRI withholding funds to determine the appropriate account to transfer the funds and will ensure the withheld amounts are processed appropriately in compliance with regulatory guidance.

If you have any questions regarding the management comments, please call me at 275-0300. I look forward to review of the final audit report.