

AUDIT REPORT
RESTRICTED GIFTS

Number A-03-05

December 18, 2003



Smithsonian Institution

Office of Inspector General

SUMMARY

Donors contribute two basic types of gifts to the Institution: those with donor-imposed restrictions and those without donor-imposed restrictions. The Office of the Inspector General audited the controls over contributions with donor-imposed restrictions. The purpose of the audit was to determine whether policies, procedures, and internal controls were in place and working effectively to ensure that gifts with donor-imposed restrictions were properly recorded and used in accordance with the donors' wishes. We reviewed the key controls over the receipt, recording, and spending of these restricted gifts in place at the central Office of Development, the Office of the Comptroller, and at the museums and offices. We limited our audit to restricted gifts received and spent from October 1, 2001, through April 30, 2003.

Overall, controls over restricted gifts were adequate to ensure that restricted gifts were properly recorded and used in accordance with the donor's wishes. However, we noted improvements were needed in five areas: (1) recording wire transfers, (2) recording restricted gift expenses in the enterprise resource planning (ERP) system, (3) recording pledges, (4) reconciling the Office of Development's database to the ERP, and (5) classifying restricted gifts properly. During our audit, we observed that both the units and the central offices faced numerous challenges with the implementation of the ERP. Therefore, we made recommendations to improve controls over the receipt, recording, and spending of restricted gifts.

We recommended that the Institution:

- Improve controls over recording revenues for restricted gifts and other funds that the Institution receives through wire transfers by implementing written procedures for the Office of the Comptroller and units, and by training Office of the Comptroller staff.
- Strengthen controls to ensure expenses for restricted gifts and other funds are more promptly entered into the ERP.
- Improve the accuracy of ERP information by recording pledges receivable in the ERP periodically during the year, either monthly or quarterly.
- Ensure information in the Development and Membership Information System (DMIS) is accurate by reconciling it to the ERP at least quarterly, and by developing uniform data entry procedures for the ERP.
- More accurately classify restricted gifts in the ERP by developing simpler and more understandable written procedures for the units.

The Comptroller and the Director of External Affairs concurred with our recommendations and provided implementation plans. We believe that these implementation plans are responsive to our recommendations. The Comptroller has completed action on one recommendation.

Office of the Inspector General
Office of the Inspector General

TABLE OF CONTENTS

	<u>Page</u>
1. Introduction.....	1
A. Purpose	1
B. Scope and Methodology.....	1
C. Background	2
2. Results of Audit.....	4
A. Recording Wire Transfers.....	4
B. ERP Phase I Implementation and Controls Over Restricted Gifts	7
C. Recording Pledges	10
D. Reconciliation of Development and Membership Information System to the ERP	12
E. Classification of Contributions as Unrestricted, Temporarily Restricted, or Permanently Restricted.....	14
Appendix 1. Comments of the Comptroller	17
Appendix 2. Comments of the Director of External Affairs.....	19

ABBREVIATIONS AND ACRONYMS

CMO	Cash Management Office
DMIS	Development and Membership Information System
ERP	Enterprise Resource Planning
FASB	Financial Accounting Standards Board
OC	Office of the Comptroller
OCIO	Office of the Chief Information Officer
OD	Office of Development
OSP	Office of Sponsored Projects
OT	Office of the Treasurer
SD	Smithsonian Directive
SFS	Smithsonian Financial System

INTRODUCTION

A. Purpose

The audit was included in our fiscal year 2003 plan because of the Institution's increasing reliance on the receipt of gifts to support Institution exhibits and programs. The objectives of the audit were to determine whether (1) the Institution's policies and procedures on restricted gifts were adequate and provide sufficient guidance to the Institution staff; (2) the Institution was following policies and procedures for the receipt, recording, and spending of restricted gifts; and (3) restricted gifts were being used in accordance with the wishes of the donors.

B. Scope and Methodology

The audit fieldwork was conducted from March 20, 2003, to September 15, 2003, in accordance with generally accepted government auditing standards. We determined whether controls were in place to ensure that restricted gifts were properly recorded and were used in accordance with the donors' wishes. The scope of the audit covered restricted gifts received by the Institution in fiscal years 2002 and 2003.

In order to determine whether controls over the receipt and recording of gift revenue were working effectively, we interviewed staff at 16 museums, offices, and research facilities (units). We reviewed the Office of the Comptroller (OC) and Office of Development (OD) policies and procedures for receiving and recording restricted gifts, including cash gifts and pledges. We reviewed OC and OD financial and management reports relating to restricted gifts. We reviewed supporting schedules, reconciliation worksheets, and journal entries prepared by OC during the fiscal year (FY) 2002 year-end closing process to record and classify gift revenue. We reviewed supporting documentation for gifts and pledges, including gift letters, transmittal forms, and other related documents to determine whether gifts were properly classified. We reviewed unit internal records used to track restricted gifts received.

In order to determine whether restricted gifts were being used in accordance with the donors' wishes, we reviewed policies and procedures related to spending and tracking restricted gift expenditures. We reviewed unit internal records and financial reports used to track expenditures from restricted gifts, as well as unit controls to reconcile their records to the ERP. We selected and tested a statistical sample of 80 expenditures, totaling \$338,621, from a population of 4,954 expenditures, totaling \$38,951,393, in gift fund codes 800 and 801, during the period October 1, 2002, through April 30, 2003. For each expenditure, we reviewed payroll cost reports and purchase orders, and discussed the expenditure with the unit. We reviewed transmittal forms for gifts and pledges, gift letters, and other related documents to determine the purpose of the gift.

We also interviewed representatives from OD; OC; the Office of the Chief Information Officer (OCIO); the Office of Sponsored Projects (OSP); and the Office of the Treasurer (OT).

C. Background

The Institution receives significant contributions (gifts) from individuals, foundations, corporations, and other organizations. Contributions are received in different forms, including cash, marketable securities, and in-kind gifts. (In-kind gifts are goods and services that would otherwise need to be purchased.) The Institution also receives pledges, or “promises to give,” which are agreements to contribute cash or other assets to the Institution. Cash contributions are primarily received by check or wire transfer. Checks are received directly at the units or through a lockbox.

Financial Accounting Standards Board (FASB) Statement No. 117, ***Financial Statements of Not-for-Profit Organizations***, dated June 1993, requires classification of contributions in three groups -- unrestricted, temporarily restricted, and permanently restricted -- based on the existence or absence of donor-imposed restrictions. Donors' restrictions impose special responsibilities on management to ensure that it uses donated assets as stipulated. The three groups are defined as follows:

- Unrestricted – contributions that are not restricted by donors.
- Temporarily restricted – a donor-imposed restriction that permits the donee organization to use up or expend the donated assets as specified and is satisfied either by the passage of time or by actions of the organization. For example, a temporary restriction may limit the organization's use to a specific purpose, such as a project or program.
- Permanently restricted – a donor-imposed restriction that resources be maintained permanently but permits the organization to use up or expend part or all of the income derived from the donated assets. For example, endowment gifts are permanently restricted gifts.

Our audit covered both temporarily and permanently restricted gifts, but we focused our testing on temporarily restricted gifts. In fiscal year 2002, the Institution received \$108.1 million in contribution revenue. This \$108.1 million included (a) unrestricted contributions, totaling \$51.1 million, (b) temporarily restricted contributions, totaling \$45.7 million, and (c) permanently restricted contributions, totaling \$11.3 million. We were unable to determine the classification breakdown of gifts received in fiscal year 2003, because OC had not calculated this data at the time of our audit. According to OD's records, for FY 2003, during the period October 1, 2002, through April 30, 2003, the Institution had received \$35,550,373 in unrestricted, temporarily restricted, and permanently restricted contributions.

Gift information is maintained in two separate systems: (1) the Development and Membership Information System (DMIS), which is maintained by OD and (2) the ERP accounting system, which OC maintains. DMIS is a database that is used for the collection of information on cash gifts, pledges, in-kind gifts, donors and other fund-raising information. Both ERP and DMIS contain gift information.

The units complete a Form SI-3011, ***Transmittal Form for Gifts & Promises to Give***, for all cash gifts, pledges, and in-kind gifts. Units fill in the amount of the cash or promise to

give, account code, donor information, purpose of the gift, and payment schedule of the pledge. For cash gifts, the Form SI-3011 and back-up documentation is submitted to OC and OD. For pledges and in-kind gifts, the units submit the Form SI-3011 and back-up documentation to OD.

Responsibilities for managing restricted gifts are divided among OC, OD, OT, and units.

OC is responsible for the following:

- Maintaining accounting records and ensuring that they are current and accurate on the basis of proper documentation received;
- Establishing fund numbers for temporarily restricted gifts;
- Preparing reports on the status of Trust funds for management purposes and for compliance with external reporting requirements;
- Assisting the units with administrative and financial matters involving temporarily restricted gifts; and
- Ensuring that obligations and expenditures against all funds do not exceed amounts provided and are made only for authorized purposes.

OD is responsible for the following:

- Maintaining a central database of gifts and pledges received;
- Preparing and distributing reports from the database to the units and senior management; and
- Working with OC to ensure that the ERP reflects accurate and appropriate information.

OT is responsible for the following:

- Administering endowment funds (permanently restricted) and
- Processing sales of securities donated to the Institution.

Individual units (museums, offices, and research facilities) are responsible for the following:

- Completing a Form SI-3011, ***Transmittal Form for Gifts and Promises to Give***, with supporting documentation, for all cash gifts, pledges, and in-kind gifts;
- Ensuring that funds committed by the units are within the amount available and for the purposes stated;
- Adhering to all restrictions and limitations on funds provided; and
- Working with OC to ensure that the ERP reflects accurate and appropriate information.

The ERP financial system was intended to help the Chief Financial Officer and Institution management at all levels manage financial information successfully. The Institution put the first phase of this system, including the general ledger, purchasing, and accounts payable modules, into operation on October 1, 2002. Our office is also conducting an audit of the implementation of the ERP.

RESULTS OF AUDIT

A. Recording Wire Transfers

As of May 2, 2003, the Cash Management Office (CMO) had identified a backlog of 84 unrecorded incoming restricted gifts and other types of wire transfers amounting to over \$30 million for the period of March 2003 through April 2003. These delays were caused by reductions in staff and lack of formal training and procedures. This condition prevented some units from being able to spend restricted gifts as needed. This lack of available funds increases the risk of project and exhibition delays and decreases management's ability to manage its resources effectively.

Background

The Institution receives restricted gifts primarily through checks or wire transfers. The CMO processes wire transfers. During the survey phase of the audit of restricted gifts, we observed that there were delays in identifying and notifying the units of wire transfers received from donors. Therefore, we expanded our review to include all wire transfers received in March and April 2003. We conducted interviews of the CMO to further investigate the units' concerns regarding delays in the receipt, notification, and recording of wire transfers.

SD 115, *Management Controls*, dated July 23, 1996, states that transactions should be promptly recorded, properly classified, and accounted for in order to prepare timely accounts and reliable financial and other reports.

The Draft SD 809, *Financial Support From Outside the Smithsonian Institution*, states that electronically transferring funds into an Institutional account is an acceptable method of receiving gift revenue. Units should notify the CMO of anticipated incoming donations and contributions. E-mail should be used to notify the CMO of the units' account chartfields to which the funds should be credited.

Smithsonian Institution Blue Bulletin, dated April 28, 2003, states that OC is committed to processing all revenue entries within five days.

Smithsonian Institution PeopleSoft Document Processing, *Issues and Status of Progress Within the Office of the Comptroller*, states that the OC standard processing turn-around time per document for the posting of gift income is five days.

Results of Review

Wire transfers of incoming gifts were not always recorded to the units' account chartfields on a timely basis. Based on interviews with the units and reviews of supporting documentation, we found the CMO had delayed recording 11 wire transfers of incoming gifts and reimbursements, in FY 2002 and FY 2003, totaling over \$1.8 million, by 2 to 13 weeks after the wires were deposited into the Institution's master bank account.

Through discussion with the CMO, we found that the CMO had identified a backlog of 84 incoming wire transfers. This backlog amounted to \$30 million out of \$126 million in wire transfers received from March 1, 2003, through April 30, 2003. Although the cash received was

deposited and invested, the associated revenue or credit to a receivable was not recorded to the units' accounts in a timely manner. These transfers included restricted gifts, grant payments, payments to Smithsonian units, transfers of endowment income, and other transfers. We determined that transactions on the backlog list were recorded 2 to 16 weeks after receipt. We found that corrective action was initiated during the audit. As of August 6, 2003, the CMO had identified and classified 61 of the transactions, reducing the backlog to \$612,958.

These delays in recording income to the units' accounts were caused by reductions in CMO staff in FY 2002 and lack of formal training and procedures. The departing staff possessed significant Institutional knowledge. In the first quarter of FY 2003, the ERP working group¹ did not conduct formal, functional training² on recording revenue or develop written procedures on recording revenue when the new ERP general ledger, purchasing, and accounts payable modules were implemented on October 1, 2002. The CMO had not developed procedures for recording expected revenue and recording revenue received. The CMO had also not developed procedures for the units to notify the CMO of incoming revenue.

Because the CMO did not promptly record all the wire transfers, including restricted gifts, to the appropriate chartfields, the units were unable to access restricted gifts and other monies. For wire transfers of incoming gifts, the delay prevented two units from obligating funds needed to meet their project and exhibition goals and timelines.

Because the CMO had not developed procedures for the units to notify the CMO of incoming revenue, not all of the units were sending advance notice to the CMO. Without advance notice from the units, the CMO has to conduct additional time-consuming research to determine the beneficiary of the funds and has been unable to record the revenue within five days, as required by OC. In addition, some of the units had not provided the CMO with a chartfield, which prevented the CMO from promptly recording the revenue.

Conclusion

We believe that improved policies and procedures, as well as functional training for the receipt and recording of wire transfers, are needed for both CMO staff and staff at the individual units. Adequate policies and procedures as well as functional training will improve the Institution's ability to effectively and efficiently record incoming wire transfers. Improvements in wire transfer processing would make funds available to units more quickly, which would allow the units to fulfill their mandates more effectively.

Recommendations

We recommended that the Comptroller:

1. With the assistance of OCIO, develop and implement written procedures and provide training for OC staff on recording revenue. These policies should include plans for cross-training CMO staff.

¹ Working groups define functional processes, serve as change agents by coordinating changes to the work environment, and identify training needs.

² Functional training instructs the users how to conduct day-to-day operations using the ERP.

2. Develop and distribute formal written procedures instructing the units to provide advance notice to the CMO of all expected wire transfers, including restricted gifts.

Management Comments

1. Concur. OC, with the assistance of OCIO, will develop and implement written procedures and provide training to OC staff on recording revenue. These policies will include cross-training CMO staff. The target date for development and implementation will be September 30, 2004.
2. Concur. OC is in the process of developing and distributing formal written procedures instructing the units to provide advance notice to the CMO of all expected wire transfers, including restricted gifts. The target date for completion will be December 31, 2003.

Office of the Inspector General Response

The Comptroller's plans of action are responsive to our recommendations.

B. ERP Phase I Implementation and Controls Over Restricted Gifts

Certain expenses paid from restricted gift funds, including payroll, petty cash, and centrally billed travel expenses, were not promptly entered into the ERP from October 1, 2002, to March 31, 2003. In addition, fiscal year 2003 beginning available balances, which included restricted gift funds, were not provided to the units to review until July 2003. These conditions were caused by several factors, including a lack of written procedures and training of OC staff, and delays in defining chartfield elements, such as program codes. Without prompt data entry of expenses, accounting information is not accurate and management cannot depend upon accounting information to manage the Institution's operations, including the use of restricted gift funds.

Background

The Institution is implementing a new ERP system to improve its financial and human resources information. The ERP system replaced the Smithsonian Financial System (SFS) and is being implemented incrementally from FY 2003 through FY 2005. The first phase was implemented on October 1, 2002, and included the general ledger, accounts payable, and purchasing modules.

The Institution has several manuals and directives which govern the implementation of the new financial system. OCIO's Information Technology Life Cycle Management (LCM) Manual and SD 920, *Life Cycle Management*, both indicate end-users should participate early in life cycle activities in order to validate functional requirements. Business process re-engineering should occur before application software development, as should coordinated processing between the current and target environments.

SD 305, *Administrative Control of Funds*, dated March 15, 1999, states that heads of museums, research institutes, and offices are responsible for working with OC to ensure that ERP reflects accurate and appropriate information. SD 115, *Management Controls*, dated July 23, 1996, states that transactions should be promptly recorded, properly classified, and accounted for in order to prepare timely accounts and reliable financial and other reports.

Results of Review

In examining controls over restricted gifts, we discovered two issues surrounding the current implementation of ERP. Certain expenses -- payroll, petty cash, and centrally billed travel -- paid from restricted gift funds were not promptly entered in ERP, and reports on beginning available balances for restricted gift funds were not provided to the units promptly.

Payroll transactions for the period October 2002 to March 2003 were not posted in ERP until April 2003. As of July 2003, petty cash transactions totaling \$181,107 out of \$301,825 (or 60 percent) of all petty cash transactions for the period November 2002 to June 2003 had not been posted. Centrally billed travel expenses, totaling \$915,572, were not allocated to the appropriate Smithsonian units in ERP for the period October 2002 through June 2003 until July 2003. As of July 31, 2003, OCIO allocated all but \$3,194 of these travel expenses to the units.

Fiscal year 2003 beginning available balances were not provided to the units to review until July 2003. As of September 15, 2003, units were still verifying the balances.

This condition had several causes:

- Payroll was not posted from October 2002 through March 2003 because of (1) delays in defining chartfield elements, such as program codes, and (2) the need for coding modifications to Payroll Accounting Distribution System (PAYES), the payroll interface system which links National Finance Center payroll data to the ERP.
- Petty cash expenses were not promptly posted in the ERP because (1) the ERP working group did not conduct formal functional training or develop written petty cash recording procedures for OC staff, and (2) there were reductions in OC staff. As of July 2003, OC had not posted all petty cash transactions.
- Centrally billed travel was not posted in a timely manner because the ERP did not reconcile with Travel Horizons³. OCIO has to perform a time-consuming, manual process of allocating units' centrally billed travel back to the appropriate units.
- Beginning balance reports were not made available to the units until 9 months (July 2003) after the October 1, 2002, ERP Phase I implementation date because, according to OC, the conversion of multi-year funds was more complicated than anticipated. As of September 15, 2003, units were still verifying the balances.

As a result, unit management and staff could not always depend on ERP to provide accurate and complete financial information to ensure that restricted gifts were being spent in accordance with the donors' wishes. Because payroll, petty cash, and centrally billed travel expenditures were missing, and beginning balance information was not verified in a timely manner, unit staff could not always reconcile their internal records on restricted gift funds with ERP reports.

The inability to adequately monitor all expenditures from gift funds increased the risk that restricted gifts could be spent contrary to the donor's original intent, and decreased management ability to make informed spending decisions on a daily basis. For example, in our testing of FY 2003 expenditures from gift funds, we found one instance in which a unit spent approximately \$18,000 in restricted gift funds contrary to a donor's intent because ERP did not contain payroll transactions and Payroll Cost Reports were not available until May 2003. Spending from this fund occurred between October 2002 and January 2003, but unit staff did not detect the errors until June 2003. Although unit staff could track payroll costs using internal records, they could not reconcile their records to the Payroll Cost Reports during this time because payroll information had not been posted in ERP. Our office is conducting an audit of the ERP implementation that will more comprehensively address the issues surrounding the implementation.

³ Travel Horizons is the Institution's contract travel agency. The Institution sought to reconcile with Travel Horizon's electronic records.

Conclusion

Expenses should be entered into the accounting records promptly to ensure that accurate, timely information is available to provide the basis for management decisions. Institution management needs accurate expense information to ensure that exhibits, research, outreach and other activities are properly managed within available resources, particularly when these activities are funded by contributions with donor-imposed restrictions. Critical to this process are adequate written procedures and training of staff responsible for ensuring data is accurately entered into the accounting system.

Corrective Actions Taken

During the course of our audit, OC utilized a contractor to prepare written procedures on processing petty cash reimbursement. These procedures were completed on March 13, 2003.

Recommendations

We recommended that the Comptroller:

1. Complete the review of the units' beginning available balances.
2. In coordination with the Office of Contracting, review the procedures for centrally billed travel.

Management Comments

1. Concur. OC completed the review of the units' beginning balances in September 2003. OCIO is resolving a small number of balances related to system reconciliation issues. OC believes this finding is complete concerning OC's corrective action.
2. Concur. In coordination with the Office of Contracting, OC will review the procedures for centrally billed travel. Target date for completion will be June 30, 2004.

Office of the Inspector General Response

1. The Comptroller's action is responsive to our recommendation and we have closed this recommendation.
2. The Comptroller's plan of action is responsive to our recommendation.

C. Recording Pledges

OC did not record pledges (promises to give) in the official accounting system⁴ until year-end. In fiscal year 2002, at year-end, OC made a manual journal entry for total pledges received based on a listing of pledges from the Development and Membership Information System (DMIS), which is maintained by OD. Recording pledges in the official accounting system only at year-end increases the risk that information on contributions receivable and revenue may not be complete and accurate. Also, there are no interim reports of pledges during the year from the official accounting system. Management needs timely financial reporting of accounting information to make informed decisions about the allocation of resources. In addition, recording pledges only at year-end creates additional work during the year-end closing process.

Background

A pledge, or promise to give, is an agreement from a donor to contribute cash or other assets to the Institution. In fiscal year 2002, the Institution received 108 new pledges, totaling \$45,588,802. In fiscal year 2003, during the period October 1, 2002, through April 30, 2003, the Institution received 105 new pledges, totaling \$10,602,279. The units complete a form SI-3011, *Transmittal Form for Gifts and Promises to Give*, for each pledge and send it directly to OD. OD records pledge information in DMIS. OC records pledges in the ERP only at year-end based on listings of pledges from DMIS.

Smithsonian Directive (SD) 115, *Management Controls*, dated July 23, 1996, states that transactions should be promptly recorded, properly classified, and accounted for in order to prepare timely accounts and reliable financial and other reports.

FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, dated June 1993, states that unconditional promises to give (pledges) should be recognized as contribution revenue and receivables in the period in which the promise is received.

Results of Review

OC did not record pledges, which are also known as promises to give, in the official accounting system until year-end. In fiscal year 2002, at year-end, OC made a manual journal entry for total pledges received based on a listing of pledges from DMIS. OD maintains DMIS. OC has access to DMIS and can run DMIS reports. During the year, OC maintains spreadsheets of pledges received and updates these spreadsheets monthly using the information in the DMIS reports.

OC advised that the ERP does not currently have an accounts receivable module which would facilitate the recording of receivables. According to OC, the process will change when the Institution implements this module. Pledges will be recorded when received, and the ERP will perform the calculations for discounting, as well as tracking pledge

⁴ Because this condition occurred when the Institution was using both the old accounting system SFS and the new system ERP, we used the term official accounting system to prevent confusion. We used the term official accounting system to distinguish SFS and ERP from the “cuff” or subsidiary systems maintained by the units.

payments. The estimated implementation date for the accounts receivable module is September 2004.

Recording pledges only at year-end increases the risk that pledge information may not be complete and accurate. Also, there are no interim reports of pledges during the year from the ERP. Management needs timely financial reporting of accounting information to make informed decisions about the allocation of resources. Recording pledges only at year-end also creates additional work during the year-end closing process. The Smithsonian's year-end process for closing the books and preparing financial statements is very time-consuming and labor-intensive. Recording pledges during the year will help expedite this process.

Conclusion

We believe that recording pledges in ERP on a periodic basis during the year would increase the Institution's ability to maintain accurate financial records necessary to make informed management decisions, as well as expedite the year-end closing process. Future implementation of the accounts receivable module will also improve the efficiency of recording and tracking pledge payments.

Recommendation

We recommended that the Comptroller record pledges in the ERP periodically during the year, either monthly or quarterly, until the accounts receivable module is implemented.

Management Comments

Concur. OC will record pledges in the ERP quarterly beginning with the first quarter of FY 2004 until the accounts receivable module is implemented.

Office of the Inspector General

1. The Comptroller's plan of action is responsive to our recommendation.

D. Reconciliation of the Development and Membership Information System to the ERP

OD did not reconcile DMIS to the official accounting system.⁵ OD had difficulty comparing the data between these systems because of differences in the definitions of data elements, delays in posting revenue into the accounting records, and inconsistent data being entered into the accounting records. The lack of a reconciliation of data between these systems increases the risk of inaccurate data in DMIS, which in turn decreases the effectiveness of information available for management decisions.

Background

OD maintains a database, DMIS, which is used for the collection of information on cash gifts, pledges, donors and other fund-raising information. OD receives the Form SI-3011, *Transmittal Form for Gifts and Promises to Give*, and back-up documentation from the units or OC, and enters the information into DMIS. All cash gifts, promises-to-give, and in-kind gifts are recorded in DMIS. During the year, OC also records all cash gifts received (including payments on pledges) in the accounting system. Periodically, and at the end of the year, OC sends OD a gift listing from the accounting system of all cash gifts received. This listing is used to reconcile DMIS to the accounting system.

SD 305, *Administrative Control of Funds*, dated March 15, 1999, states that heads of museums, research institutes, and offices are responsible for working with OC to ensure that the ERP reflects accurate and appropriate information.

Internal procedures, entitled *Gift Administration and SI-3011 Distribution*, dated October 19, 1998, issued jointly by OC and OD, state that reports to be sent, on a regular basis, to each unit to be checked for completeness and accuracy. If any contributions are missing or credited to the wrong project, the units should contact the Registrar in the OD. These internal procedures further state that, at the end of each year, OD uses these reports to reconcile the information on the OD and OC databases.

Results of Review

OD did not perform a reconciliation of DMIS to the official accounting system in fiscal years 2002 or 2003. OD and OC developed a report to assist the reconciliation of SFS and DMIS; however, the reconciliation was not completed. OD advised that, although several attempts were made, reconciliation was never completed because of difficulties in reconciling the two systems.

OD had difficulty reconciling the data in these two systems because of differences in the definitions of data elements, delays in posting revenue into the accounting records, and inconsistent data being entered into the accounting records. Specifically, we found that:

- In FY 2002, OD reports used the check date rather than the deposit date. In FY 2003, OD started using the deposit date.

⁵ See note 4.

- In FY 2003, during the period October 1, 2002, through December 31, 2002, we found that there were excessive delays (3 to 12 weeks) between the deposit date and the date the revenue was entered in ERP.
- In FY 2003, we found inconsistent data entry in the reference field in ERP. In some cases the SI-3011 number was entered and, in other cases, the check number was entered.

Monthly, OD sends reports from DMIS to the Secretary, the Under Secretaries, the Director of the International Art Museums Division, and the unit directors. At the end of the year, OD also issues an annual report using the information in DMIS. The lack of reconciliations increases the risk that these reports from DMIS may be inaccurate or incomplete, which could lead to faulty management decisions.

Conclusion

We believe that the reconciliation between DMIS and ERP is needed to ensure that the information in DMIS is accurate, complete, and consistent with the information in the ERP. Complete and accurate information about gifts received is needed by management in making decisions about resource allocation.

Recommendations

We recommended that:

1. The Director of External Affairs reconcile DMIS to the ERP at least quarterly.
2. The Comptroller develop uniform data entry procedures for the reference and date fields in ERP. The Comptroller should also meet with OD to discuss these fields and the reconciliation process.

Management Comments

1. Concur. The Director of External Affairs anticipates that a target date for full compliance with the recommendation will be June 30, 2004, assuming satisfactory training and data entry procedures in OC have taken place.
2. Concur. The Comptroller will develop uniform data entry procedures for the reference and date fields in ERP and will meet with OD to discuss these fields and the reconciliation process. The target date for development of procedures will be June 30, 2004.

Office of Inspector General Response

1. The Director's plan of action is responsive to our recommendation.
2. The Comptroller's plan of action is responsive to our recommendation.

E. Classification of Contributions as Unrestricted, Temporarily Restricted, and Permanently Restricted

Units -- museums, offices, and research facilities -- had not always classified gifts into the proper categories -- unrestricted, temporarily restricted, and permanently restricted -- for financial statement reporting. Unit personnel responsible for classifying gifts on the Form SI-3011, *Transmittal Form for Gifts and Promises to Give*, did not clearly understand the distinctions between these classifications. Because the units did not always classify gifts correctly, OC could not rely on the account codes that were entered into the official accounting system⁶, during the year, to prepare the financial statements. Rather, OD and OC did a special review at year-end to classify gifts correctly as temporarily restricted. This process is very time consuming and labor intensive. Also, because OC does not correctly classify temporarily restricted gifts until year-end, management did not have accurate reports from the ERP, during the year, on unrestricted and restricted contributions.

Background

The units complete a Form SI-3011, *Transmittal Form for Gifts and Promises to Give*, for all cash gifts, pledges, and in-kind gifts. The units are responsible for filling in the account code on the Form 3011.

FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, dated June 1993, and SD 318, *Externally Funded Grants and Sponsored-Project Contracts*, dated June 28, 1998, state that contributions (gift) should be classified as unrestricted, temporarily restricted, or permanently restricted. These terms are defined in SD 318 as follows:

- Unrestricted (Account Code 5601) - Unrestricted contributions may be used for any purpose because they are received without donor-imposed restrictions on their use.
- Temporarily Restricted (Account Code 5602) - Temporarily restricted contributions are subject to donor-imposed restrictions that permit the Institution to use the donated assets as specified and are satisfied either by the passage of time or by actions of the Institution.
- Permanently Restricted (Account Code 5603) - Permanently restricted contributions must be maintained in perpetuity but the Institution may expend part or all of the income or other economic benefits derived from the donated assets.

Results of Review

Units did not always accurately classify gifts received as unrestricted, temporarily restricted, or permanently restricted. We found \$10,625,764, or 23 percent, out of a total of \$45,904,980 in temporarily restricted gifts received in FY 2002, that was incorrectly classified by the units during the year. Of the \$10,625,764 in misclassified gifts,

⁶ See note 4.

\$9,572,515 was incorrectly classified as unrestricted, and \$1,053,249 was incorrectly classified as permanently restricted. These classification errors were made by 13 units throughout the Institution. At the end of the year, during the year-end process for preparing financial statements, OC correctly classified these gifts as temporarily restricted.

Units advised that they did not completely understand the definitions of unrestricted, temporarily restricted, and permanently restricted. The definitions in SD 318 and in other internal procedures were written in accounting terms and did not include specific examples. We found that the most recent written internal procedures on processing gifts were issued by OC on October 19, 1998.

Because the units did not always classify gifts correctly, OC did not rely on the account codes that were entered into the official accounting system during the year to prepare the financial statements. Rather, OD and OC did a special review at year-end to correctly classify gifts as temporarily or unrestricted⁷. At year-end, OC sends OD a listing of new gifts. OD reviews the gift information in DMIS and notes on the listing which gifts are temporarily restricted. OC then prepares a manual reconciliation of temporarily restricted gifts. This process is very time-consuming and labor-intensive.

Because OC did not correctly classify temporarily restricted gifts until year-end, management does not have accurate reports from the accounting system during the year on unrestricted and restricted contributions. Instead of using the accounting system, units relied on their internal “cuff” records to ensure that gifts were spent in accordance with the donors’ wishes.⁸

Conclusion

OC and the units should work together to improve the accuracy of account codes (unrestricted, temporarily restricted, and permanently restricted) at the transaction level during the year rather than waiting until year-end. More accurate classification of transactions during the year will increase the usefulness of financial information available in ERP by facilitating the preparation of accurate, periodic (quarterly or monthly) reports and expediting the year-end closing and financial reporting process. To reduce unit dependence on “cuff” records and increase their confidence in the accuracy of ERP information, we believe that the units should work with OC to ensure the accuracy of the account codes in ERP.

Recommendation

We recommended that the Comptroller develop written procedures on classifying contributions that are simpler and more understandable. These procedures should include examples whenever possible.

Management Comments

Concur. OC will develop written procedures on classifying contributions that are simpler and more understandable. The target date for completion will be June 30, 2004.

⁷ The third group of gifts, permanently restricted gifts, are classified by the Treasurer’s office.

⁸ Units maintain “cuff” or subsidiary records because the ERP is not yet able to meet the users’ needs for management and financial information.

Office of Inspector General Response

The Comptroller's plan of action is responsive to our recommendation.

WRITTEN COMMENTS BY THE COMPTROLLER

Smithsonian Institution

Office of the Comptroller

Date **October 24, 2003**

To **Thomas D. Blair**
Inspector General

cc **Alice Maroni** *AM*
Chief Financial Officer

From **Catheryn Hummel** *CH*
Comptroller

Subject **Management Comments to Draft Report on Audit of Restricted Gifts, # A-03-05**

I have reviewed your draft report and concur with each of the recommendations presented. Specifically, my office will perform the corrective action identified in the paragraphs below for the seven (7) findings identified.

1. Record pledges in the official accounting system periodically during the year, either monthly or quarterly, until the accounts receivable module is implemented.

Management Comment: Concur. The Office of the Comptroller (OC) will record pledges in the official accounting system quarterly beginning with the first quarter FY 2004 until the accounts receivable module is implemented.

2. Develop written procedures on classifying contributions that are simpler and more understandable. These procedures should include examples whenever possible.

Management Comment: Concur. OC will develop written procedures on classifying contributions that are simpler and more understandable. Target date for completion will be June 30, 2004.

3. Develop uniform data entry procedures for the reference and date fields in PeopleSoft. The Comptroller should also meet with OD to discuss these fields and the reconciliation process.

Management Comment: Concur. OC will develop uniform data entry procedures for the reference and date fields in PeopleSoft and will meet with OD to discuss these fields and the reconciliation process. Target date for development of procedures will be June 30, 2004.

4. With the assistance of OCIO, develop and implement written procedures, and provide training for OC staff on recording revenue. These policies should include cross-training CMO staff.

Victor Building, Suite 5100
750 9th Street, NW, MRC 911
Washington DC 20560-0911
202.275 0300 Telephone

WRITTEN COMMENTS BY THE COMPTROLLER

Management Comment: Concur. OC, with the assistance of OCIO, will develop and implement written procedures and provide training for OC staff on recording revenue. These policies will include cross-training CMO staff. Target date for development and implementation will be September 30, 2004.

5. Develop and distribute formal written procedures instructing the units to provide advance notice to the CMO of all expected wire transfers, including restricted gifts.

Management Comment: Concur. OC is in the process of developing and distributing formal written procedures instructing the units to provide advance notice to the CMO of all expected wire transfers, including restricted gifts. Target date for completion will be December 31, 2003.

6. Complete the review of the units' beginning available balances.

Management Comment: Concur. OC completed the review of the units' beginning available balances in September 2003. OCIO is resolving a small number of balances related to system reconciliation issues. OC believes this finding is complete concerning OC's corrective action.

7. In coordination with the Office of Contracting, review the procedures for centrally billed travel.

Management Comment: Concur. In coordination with the Office of Contracting, OC will review the procedures for centrally billed travel. Target date for completion will be June 30, 2004.

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.

WRITTEN COMMENTS BY THE DIRECTOR OF EXTERNAL AFFAIRS

Smithsonian Institution

Memo

Virginia B. Clark
Director of External Affairs

Date October 10, 2003

To Thomas D. Blair, Inspector General
Lisa Leonard, Office of the Inspector General

cc Catheryn C. Hummel, Comptroller

From Virginia B. Clark

Subject Response to the Audit on Restricted Gifts – A-03-05

We have reviewed the Draft Report of the Audit of Restricted Gifts, and we applaud your work in reporting in cogent terms the nature and scope of our responsibilities.

The Office of External Affairs has one (1) "Recommendation" to which a response has been requested: *C. Reconciliation of DMIS to the Official Accounting System*. My response to this request is as follows:

1. The information presented is accurate according to our records.
2. I/we concur with the recommendation that the Office of External Affairs reconcile DMIS to the official accounting records (PeopleSoft) at least quarterly.
3. Because this recommendation relies upon satisfactory training and direction in the Office of the Comptroller, we will cooperate fully with that Office to assist in the sharing of information as necessary.
4. We anticipate that a target date for full compliance with the recommendation will be on or before June 30, 2004, assuming satisfactory training and data entry procedures in the Office of the Comptroller have taken place.

Please let me know if there is anything further we can do to assist your work.

Sincerely,

Signature: _____ Date: 10/14/03 _____

Smithsonian Institution
SIB 105, MRC 027
PO Box 37012
Washington DC 20013-7012
202.786.2701 Telephone
202.633.0183 Fax