



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

OFFICE OF INSPECTOR GENERAL

December 22, 2008

Ms. A. Sprightley Ryan
Inspector General
Smithsonian Institution
MRC 1204
PO Box 37012
Washington, DC 20013-0712

Subject: Report on the External Quality Control Review of the Smithsonian Institution's Office of Inspector General

Dear Ms. Ryan:

This report presents the results of our External Quality Control Review of the Smithsonian Institution Inspector General Audit Organization. Your response to the draft report is included as Appendix B, with your comments and our response incorporated into the relevant sections of the report.

We agree with your response to make timely updates and revisions to your Manual to reflect changes in audit standards and to continue to seek ways to improve oversight of the Independent Public Accountant. We maintain that there are additional opportunities for the OIG to improve audit documentation and report contents. We thank you and your staff for their assistance and cooperation during the conduct of the review.

Sincerely,

A handwritten signature in black ink, appearing to read "Elizabeth A. Coleman".

Elizabeth A. Coleman
Inspector General

Enclosure



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Ms. A. Sprightley Ryan
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Dear Ms. Ryan:

We have reviewed the system of quality control for the audit function of the Smithsonian Institution's Office of Inspector General (SI OIG) in effect for the fourteen-month period that ended May 31, 2008. A system of quality control encompasses the OIG's organizational structure, the policies adopted, and the procedures established to provide the OIG with reasonable assurance of conforming with generally accepted government auditing standards (GAGAS). The elements of quality control are described in GAGAS, promulgated by the Comptroller General of the United States. The design of the system, and compliance with it in all material respects, are the responsibility of the SI OIG. Our objective was to determine whether the internal quality control system was adequate, as designed and complied with, to provide reasonable assurance that applicable auditing standards, policies, and procedures were met. Our responsibility is to express an opinion, based on our review, on the design of the system and the SI OIG's compliance with the system.

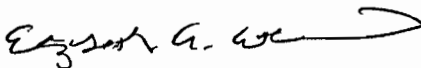
Our review was conducted in accordance with the guidelines established by the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency. In performing our review, we obtained an understanding of the system of quality control for the SI OIG. In addition, we tested compliance with the SI OIG's quality control policies and procedures, including compliance with the SI OIG's policies and procedures on selected audits. Because our review was based on selective tests, it would not necessarily disclose all weaknesses in the system of quality control, or all instances of lack of compliance with it. Nevertheless, we believe that the procedures we performed provide a reasonable basis for our opinion. Our scope and methodology appear as Appendix A. The SI OIG's written response to our draft report is included as Appendix B.

Because there are inherent limitations in the effectiveness of any system of quality control, departures from the system may occur and not be detected. Also, a projection of any evaluation results of the effectiveness of a quality control system to future periods is subject to the risk that the system may become inadequate because of changes in conditions, or because the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the quality control system for the audit function of the SI OIG in effect for the fourteen-month period that ended May 31, 2008, has been designed to meet the requirements of the quality control standards established by the Comptroller General of the United States for a Federal Government audit organization, and was complied with during the period to provide the OIG with reasonable assurance of conforming with applicable auditing standards, policies, and procedures. We noted certain conditions that warrant your attention although they did not affect our opinion. These matters are described in the Findings and Recommendations section of the report.

I would like to thank you and your staff for their cooperation during our review. If you have any questions, please contact me at 202-973-5005 or Andrew Patchan Jr., Assistant Inspector General for Audits and Attestations, at (202) 973-5003.

Sincerely,



Elizabeth A. Coleman
Inspector General

FINDINGS AND RECOMMENDATIONS

During our review, we identified opportunities to further enhance the SI OIG's quality control system in three areas: (1) maintaining and updating written policies and procedures; (2) overseeing the Independent Public Accountant (IPA) firm in performing the annual financial statement audit; and (3) strengthening compliance with policies, procedures, and standards for audit documentation and report contents.

Finding 1 - Maintenance and Update of Policies and Procedures

In May 2008, the SI OIG completed a major revision and update of its 1999 audit manual, bringing it up-to-date with 2007 *Government Auditing Standards*. The SI OIG audit manual provides overall and day-to-day guidance for staff, facilitates consistency in applying audit standards and procedures, and enhances the quality of audits and audit products. However, revisions were made to the GAGAS requirements in 2003; thus, the updating of the manual should have been completed earlier. Specifically, we found the following:

- Among other changes, the 2003 *Government Auditing Standards* added a new chapter and section on attestation engagements and nonaudit services, respectively. The SI OIG management did not develop corresponding written policies and procedures for nonaudit services and attestations prior to the 2008 update of its audit manual; however, they told us that nonaudit services were not performed during our review period, and we found no evidence to the contrary. With regard to attestation engagements, we found that SI OIG management contracted with an IPA to perform an attestation in accordance with American Institute of Certified Public Accountants standards, rather than GAGAS. Based on our review of oversight workpapers, nothing came to our attention to indicate that the work performed by the IPA was inconsistent with GAGAS. The Inspector General Act of 1978 states that inspectors general shall take appropriate steps to assure that any work performed by nonfederal auditors complies with GAGAS. We believe that attestation work performed after the GAGAS revisions in 2003 falls within this requirement.

The SI OIG's May 2008 updated written policies and procedures now address nonaudit services, attestation engagements, and using the work of others. The 2008 Audit Manual states that, due to the SI OIG's small staff size, it contracts with IPAs to conduct financial and attestation engagements and that, for either type of engagement, the applicable GAGAS standard will be followed.

- The SI OIG's 1999 policies and procedures did not explicitly address GAGAS standards in the following areas: (1) taking corrective action on the results of external peer reviews; and (2) consulting with legal counsel about the application or interpretation of laws and regulations. However, our review of audit workpapers and discussions with SI OIG staff and management show that the SI OIG, in practice, complied with both of these standards. The May 2008 SI OIG policies and procedures now address taking remedial corrective action on the results of external peer reviews and consulting with legal counsel regarding the interpretation of pertinent laws and regulations.

Recommendation

We recommend that SI OIG management ensure that its policies and procedures are updated in a timely manner, as changes are made to GAGAS.

SI OIG's Response

SI OIG agrees.

Finding 2 – Oversight of the IPA Performing the Annual Financial Statement Audit

The SI OIG assumed contracting responsibility for the SI annual financial statement audit in 2006, from the Institute's Chief Financial Officer (CFO). The SI OIG contracts with an IPA to conduct and issue three sets of financial statement audit reports, in accordance with different auditing standards and with different reporting timeframes. During our review, we found that the SI OIG's oversight of the IPA was generally comprehensive and workpapers were well documented. For example, the SI OIG performed a timely review of the IPA's 2007 Federal Special-Purpose financial statement audit report issued in accordance with GAGAS and the 2007 SI-wide financial statement audit report issued in accordance with generally accepted auditing standards. However, we found opportunities for the SI OIG management to improve its coordination and oversight of the IPA. The Smithsonian's OMB A-133 Financial Audit of Grants and Contracts issued in accordance with GAGAS (this includes an Independent Auditor's Report on Financial Statements and Report on Internal Controls Over Financial Reporting and on Compliance and Other Matters) was not reviewed until July 2008, which was after its issuance to the CFO in February 2008. According to SI OIG officials, this report was not required to be delivered to the SI OIG until May 2008. However, we found that the IPA issued it directly to the CFO early, because of the IPA's prior working relationship with the CFO. The SI OIG updated written policies and procedures state that, "the COTR must monitor and review the contractor's work and any draft and final deliverable products for technical completeness and compliance with contract terms and conditions."

To perform its oversight of the IPA and to help ensure that the IPA complied with GAGAS, the COTR used the PCIE's Financial Statement Audit Network (FSAN) Monitoring Tool, and our review found that the IPA's reports were in compliance with GAGAS. However, we did determine that the COTR reviewed the IPA's draft Federal Special Purpose audit report against the AICPA Statement of Auditing Standards only, and not against GAGAS. In addition, the COTR reviewed selected portions of the IPA's workpapers, but did not compare the findings included in the IPA's report to the applicable supporting workpaper documentation to ensure that findings were substantiated and documented.

Recommendation

We recommend that SI OIG management ensure that the COTR coordinates with the IPA on the issuance and review of contractors' products to ensure compliance with GAGAS, as well as with contract terms and conditions.

SI OIG's Response

SI OIG agrees in concept with the recommendation. SI OIG effectively monitored and fully documented its oversight of the annual financial statement audit. SI OIG disagrees that the SI-wide financial statement audit report issued in accordance with GAGAS is a contract deliverable.

Analysis of SI OIG's Response

We agree that SI OIG's oversight of the financial statement audit was generally comprehensive and the workpapers were well documented. However, we found opportunities for SI OIG management to improve its coordination and oversight of the audit. The SI financial statement audit report issued in accordance with GAGAS, to comply with OMB A-133 requirements, was required under the IPA's Statement of Work dated July 26, 2007. We have revised wording in our report to clarify that this audit was SI's OMB A-133 Financial Audit of Grants and Contracts.

Finding 3 – Audit Documentation and Report Contents

For one of the five projects reviewed, we identified opportunities to improve audit documentation and report contents. Specifically, we found the following:

- We observed that all of the summary workpapers contained evidence of supervisory review. However, several workpapers used to support findings and recommendations in the report did not contain evidence of supervisory review. GAGAS Section 7.68d states that, "audit documentation should contain evidence of supervisory review, before the audit report is issued, of the work performed that supports findings, conclusions, and recommendations contained in the audit report." In addition, SI OIG policies and procedures require documented evidence of supervisory review on workpapers.
- The audit report could have provided more details on the sampling methodology used to support findings. The scope and methodology section of the audit report identified the population and sample size, but did not identify the methodology used to select the sample, nor the reason such methodology was chosen. GAGAS Section 8.11 and SI OIG policies and procedures require that, when sampling significantly supports auditors' findings, the audit report shall describe the sample design and state the reason it was chosen.
- The report could have more clearly stated a conclusion for all audit objectives. The report did include a results-in-brief section that summarizes the overall findings and conclusions, but did not contain a stated conclusion for one of the three audit objectives. GAGAS Section 8.27 requires that the conclusions should be clearly stated. SI OIG policies and procedures also require that the report should specify a conclusion (opinion) for each finding, in order to answer the questions (purposes) that prompted the audit.

Recommendation

We recommend that SI OIG management ensure that: (1) the workpapers that support audit findings, conclusions, and recommendations have documented evidence of supervisory review; (2) the sampling methodology and the supporting rationale is clearly described in the report when the sample results are significant to the auditors' findings; and (3) the audit reports include a conclusion for each of the audit objectives.

SI OIG's Response

SI OIG agrees in concept with the recommendation. SI OIG disagrees that it did not provide and document adequate supervisory review of workpapers; that it did not provide sufficient detail on the sampling methodology to support findings; and that it did not clearly state conclusions for each audit objective.

Analysis of SI OIG's Response

SI OIG states that it fully met GAGAS standards for supervisory review of workpapers by reviewing all summary workpapers and performing multiple levels of review, including referencing. We agree that summary workpapers contained evidence of supervisory review, and that these reviews assist in meeting the requirements of GAGAS. However, we found that eight of the detailed workpapers used to support conclusions and recommendations lacked evidence of supervisory review. We believe that supervisory review of a summary document drawn from multiple workpapers does not replace supervisory reviews of the sufficiency and appropriateness of evidence contained in detailed workpapers supporting the summary.

SI OIG states that the methodology section of the audit report described the sampling in sufficient detail to allow knowledgeable users of the report to understand the SI OIG's work. We agree that the report described the universe of 246 employees and that the SI OIG selected a sample of 154. But we maintain that the report does not clearly describe how the 154 were selected for the sample versus the other 92 in the universe.

SI OIG states that the audit report clearly stated the conclusions for each objective. We maintain that the report contained a conclusion for the audit objectives of whether all tax liabilities were addressed, and whether policies and procedures were adequate, but that no conclusion was included for the audit objective of whether payments were made in accordance with policies and procedures.

SCOPE AND METHODOLOGY

To test compliance with the SI OIG's system of quality control, we reviewed a judgmental sample of five of the twelve audit reports issued during the September 30, 2007, and the March 31, 2008, semiannual reporting periods. We also reviewed the monitoring activities covering: (1) the audits of the FY 2007 financial statements and information security program for the Smithsonian Institution that were performed under contract by KPMG LLP and Cotton & Company LLP, respectively; and (2) the attestation of the Smithsonian Business Ventures Chief Executive Officer Compensation and Expenses that was also performed under contract by Cotton & Company LLP. The table below lists the specific reports we reviewed.

Audit Reports Reviewed

Report Number	Report Date	Report Title
A-06-01	August 26, 2007	Friends of the National Zoo Revenue Operations
A-06-04	July 19, 2007	Review of Smithsonian Business Ventures Chief Executive Officer Compensation and Expenses
A-07-01	March 31, 2008	Quality Assurance Letter on the FY 2007 Financial Statement Audits ¹
A-07-04	September 28, 2007	Administration of Relocation and Recruitment Payments
A-07-08	March 31, 2008	FY 2007 FISMA Audit of the Smithsonian Institution's Information Security Program

Office Reviewed

We performed all fieldwork in Washington, D.C. The SI OIG does not have regional or satellite offices. Our work was conducted from July 7, 2008, through August 8, 2008.

¹ The SI OIG contracts with an IPA to perform audits of the Smithsonian's: (1) Federal Special-Purpose Financial Statements; (2) Entity-Wide Financial Statements; and (3) OMB Circular A-133.



Office of the Inspector General

November 28, 2008

Ms. Elizabeth A. Coleman
Inspector General
Board of Governors
The Federal Reserve System
20th & Constitution Avenue, NW
Washington, D.C. 20551

Dear Ms. Coleman:

Thank you for this opportunity to comment on the formal draft report on your peer review of the Smithsonian Institution's Office of Inspector General's (OIG) quality control system over audit operations.

We are very pleased that the report concluded that the OIG's quality control system is designed to meet the standards established by the Comptroller General of the United States for a federal audit organization and that these standards have been complied with during your period of review to provide the OIG with reasonable assurance of conforming with applicable auditing standards, policies, and procedures.

The following are our responses to your findings and recommendations.

Finding 1 - Maintenance and Update of Policies and Procedures

We agree with this recommendation. In keeping with the recent update of our Manual to reflect the 2007 revision of generally accepted government auditing standards (GAGAS), we will continue to make timely updates and revisions to our Manual to reflect any relevant changes in audit standards.

Finding 2 – Oversight of the IPA Performing the Annual Financial Statement Audit

While we agree in concept with the recommendation, we are confident that we effectively monitored and fully documented our oversight of the annual financial statement audit.

The Smithsonian issues three major annual financial statements audited under four different audit standards using four sets of accounting and reporting principles. For each audit, the Independent Public Accounting (IPA) firm conducts overlapping or concurrent audit tests to gain efficiencies or to comply with applicable standards.

Your statement in the draft report that "The SI-wide financial statement report issued in accordance with GAGAS . . . was not reviewed until July 2008, which was after its issuance to the CFO in February 2008" is inaccurate. That "report" was not a contract deliverable, there was no requirement for the OIG to review it, and it had no bearing on any of the three major audit deliverables.

For oversight purposes, we adapted the guidance provided in the PCIE's Financial Statement Audit Network (FSAN) Monitoring Tool into a set of roughly 60 procedures, all of which were addressed based on the COTR's professional judgment. Our oversight included reviewing planning documents, internal control documentation, workpapers, and reports, throughout each phase of the audit. We also attended numerous weekly status meetings, communicated regularly via e-mail with the IPA and CFO staff, evaluated key judgments, provided guidance and documentation where necessary, analyzed findings, and evaluated corrective actions from previous audits.

Further, each year, based on our oversight, we prepare a Quality Assurance Letter for the members of the Smithsonian's Audit and Review Committee. This letter presents our observations on the Institution's financial statement audit and financial reporting processes and includes recommendations for improving these processes. This letter, a direct result of our effective oversight, has helped improve the financial statement audit process.

We believe our work effectively and successfully met the goals for overseeing IPAs conducting federal audits. And we will of course continue to seek ways to improve our oversight of the IPA in all respects.

Finding 3 – Audit Documentation and Report Contents

While we agree in concept with the three parts of this recommendation and will continue to meet all GAGAS, we do not agree with the three parts of your finding.

You stated that, in one of the five audits you reviewed, we did not show evidence of supervisory review on every individual workpaper. GAGAS require that documentation contain evidence of supervisory review of the work performed that supports findings, conclusions, and recommendations contained in the audit report. We fully met this standard. We documented our reviews of the workpapers in a number of ways: (1) we noted evidence of review on all the summary workpapers and on the majority of the detailed supporting workpapers; and (2) we performed and documented multiple levels of review, by the Supervisory Auditor, the Assistant Inspector General for Audits, and the independent referencer, all of whom produced comprehensive sets of notes to document their reviews.

We also disagree that we should have provided more detail on the sampling method to support the findings. We explained in our methodology how we reviewed payroll data from the Office of Human Resources to determine the total universe of relocation and recruitment payments made to Smithsonian employees. We identified 246 employees who received relocation and recruitment payments and we selected a sample of 154 employees based upon the various methods the Smithsonian used to pay its employees. The report described how we sampled 100 percent of payments to employees made through Smithsonian Business Ventures, as well as those paid by travel vouchers and purchase orders. The report also explained that we sampled 65 employees who received lump-sum disbursements over \$3,000. Thus, as required by GAGAS, we clearly described in sufficient detail our sampling methodology to allow knowledgeable users of the report to understand our work.

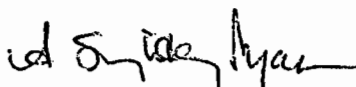
Finally, we disagree that one of our reports did not clearly state conclusions for each objective. We fully complied with the GAGAS section 8.27 requirement that auditors should clearly state conclusions in the audit report by reporting our conclusions clearly in the In Brief, Results in Brief, and Results of Audit sections of the report.

* * * * *

In closing, we note that the OIG has undergone dramatic change over the last few years. In 2006, the OIG began reporting to the Institution's Board of Regents, rather than the Secretary. This change significantly enhanced the independence and stature of our office. In addition, in FY 2006, we assumed responsibility for oversight of the IPA conducting the annual financial statement audits of the Institution. This change led to our gaining greater insight and influence over the Institution's key financial management and audit processes. In addition, in response to the 2007 revision to GAGAS, we created the position of Quality Control Manager. This Manager periodically evaluates OIG audits for compliance with GAGAS and our own policies and procedures.

We are grateful for the work of your staff in providing this independent evaluation and appreciate your efforts to help us improve our quality control system.

Very truly yours,



A. Sprightley Ryan
Inspector General