



U.S. CONSUMER PRODUCT SAFETY COMMISSION  
WASHINGTON, DC 20207

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System Review Report

December 9, 2010

To: Sheldon Bernstein, Inspector General  
National Endowment for the Humanities

We have reviewed the system of quality control for the audit organization of the National Endowment for the Humanities (NEH), Office of Inspector General (OIG) in effect for the year ended March 31, 2010. A system of quality control encompasses the OIG's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of conforming to *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 OIG is responsible for designing a system of quality control and complying with it to provide reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the OIG's compliance therewith based on our review.

Our review was conducted in accordance with *GAGAS* and guidelines established by the Council of the Inspectors General on Integrity and Efficiency (CIGIE). During our review, we interviewed OIG personnel and obtained an understanding of the nature of the audit organization, and the design of the system of quality control sufficient to assess the risks implicit in its audit function. Based on our assessments, we selected engagements and administrative files to test for conformity with professional standards and compliance with the OIG's system of quality control. The engagements selected represented a reasonable cross-section of the OIG's audit organization, with emphasis on higher-risk engagements. Prior to concluding the review, we reassessed the adequacy of the scope of the peer review procedures and met with OIG management to discuss the results of our review. We believe that the procedures we performed provide a reasonable basis for our opinion.

In performing our review, we obtained an understanding of the system of quality control for the OIG's audit organization. In addition, we tested compliance with the OIG's quality control policies and procedures to the extent we considered appropriate. These tests covered the application of the OIG's policies and procedures on selected engagements. Our review was based on selected tests; therefore, it would not necessarily detect all weaknesses in the system of quality control or all instances of noncompliance with it.

There are inherent limitations in the effectiveness of any system of quality control, and therefore noncompliance with the system of quality control may occur and not be detected. Projection of

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any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or because the degree of compliance with the policies or procedures may deteriorate.


Enclosure 1 to this report identifies the offices of the OIG that we visited and the engagements that we reviewed.

In our opinion, the system of quality control for the audit organization of the NEH OIG in effect for the year ended March 31, 2010, has been suitably designed and complied with to provide reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Federal audit organizations can receive a rating of *pass*, *pass with deficiencies*, or *fail*. The OIG has received a peer review rating of *pass*.

As is customary, we have issued a letter dated December 9, 2010 that sets forth findings that were not considered to be of sufficient significance to affect our opinion expressed in this report.

In addition to reviewing its system of quality control to ensure adherence with *GAGAS*, we applied certain limited procedures in accordance with guidance established by the CIGIE related to the OIG's monitoring of engagements performed by Independent Public Accountants (IPA) under contract where the IPA served as the principal auditor. It should be noted that monitoring of engagements performed by IPAs is not an audit and therefore is not subject to the requirements of *GAGAS*. The purpose of our limited procedures was to determine whether the OIG had controls to ensure IPAs performed contracted work in accordance with professional standards. However, our objective was not to express an opinion and accordingly, we do not express an opinion, on OIG's monitoring of work performed by IPAs.

We made certain comments related to the OIG's monitoring of engagements performed by IPAs that are included in the above referenced letter dated December 9, 2010.



Christopher W. Dentel

Christopher W. Dentel, Inspector General

Enclosures (2)

## SCOPE AND METHODOLOGY (Enclosure 1)

### Scope and Methodology

We tested compliance with the National Endowment for the Humanities (NEH), Office of Inspector General's (OIG) audit organization's system of quality control to the extent we considered appropriate. These tests included a review of 1 of 3 audit and attestation reports issued during the period April 1, 2009, through March 31, 2010, and semiannual reporting periods April 1, 2009 through September 30, 2009 and October 1, 2009 through March 31, 2010.

In addition, we reviewed the OIG's monitoring of engagements performed by IPAs where the IPA served as the principal auditor during the period April 1, 2009, through March 31, 2010. During the period, the OIG contracted for the audit of its agency's Fiscal Year 2009 financial statements to Leon Snead & Company, P.C..

We visited the headquarters of NEH in Washington, D.C., which is also the location of the OIG.

### Reviewed Engagements Performed by (Reviewed OIG)

<u>Report No.</u>	<u>Report Date</u>	<u>Report Title</u>
OIG-10-01 (EA)	3/10/10	Limited Audit Report on Gifts Certified Under Challenge Grant to Humanities Texas

### Reviewed Monitoring Files of (Reviewed OIG) for Contracted Engagements

<u>Report No.</u>	<u>Report Date</u>	<u>Report Title</u>
N/A (Contracted Out)	11/15/2009	Audit Report on NEH Financial Statements for Fiscal Year 2009

## Letter of Comment (Enclosure 2)

December 9, 2010

To: Sheldon Bernstein, Inspector General  
National Endowment for the Humanities

We have reviewed the system of quality control for the audit organization of the National Endowment for the Humanities (NEH), Office of Inspector General (OIG) in effect for the year ended March 31, 2010, and have issued our report thereon dated December 9, 2010, in which the OIG received a rating of *pass*. That report should be read in conjunction with the comments in this letter, which were considered in determining our opinion. The findings described below were not considered to be of sufficient significance to affect the opinion expressed in that report.

### **Finding 1: Documentation of Audit Policies and Procedures**

We noted several instances where the NEH OIG did not have documented policies and procedures in place to provide reasonable assurance of compliance with Generally Accepted Government Auditing Standards (GAGAS). According to GAGAS 3.51, an audit organization's system of quality control encompasses the audit organization's leadership, emphasis on performing high quality work, and the organizational policies and procedures to provide reasonable assurance of complying with professional standards and applicable legal and regulatory requirements. As such, we were unable to obtain explicit documentation of the policies and procedures related to following GAS requirements:

- 3.06: Impairments to independence
- 3.22 – .30: Independence when performing non-audit services
- 3.44: Additional qualifications for financial audit and attestation engagements
- 3.53: Policies and procedures regarding system of quality control, items (c) and (f)
- 7.23 - .27: Understanding of information system controls
- 4.08; 6.08; 7.49; 8.06: Audit termination documentation
- 7.81: Documenting deviations from GAGAS
- 5.18-.20; 6.39-.41; 8.24-26: Reporting findings directly to parties outside the audited entity
- 5.39-.43; 6.51-55; 8.38-.42: Reporting confidential or sensitive information

Further inquiry of the NEH OIG management found that many of GAS references above are implied, as the NEH OIG ensures that all OIG staff demonstrates a sufficient level of competence in performing their duties. Through our review of NEH OIG staff profiles and training records, we noted that all OIG staff have an exceptional level of competence and expertise. However, having explicitly documented audit policies and procedures reinforces compliance with all GAS requirements.

**Recommendation:** The NEH OIG should update all audit policies and procedures, specifically the NEH OIG Audit Manual periodically to encompass all current GAS requirements.

**Views of Responsible Official:** The NEH OIG Audit Manual was designed to provide guidance concerning various components of the OIG audit operations and facilitates compliance with GAGAS. The Audit Manual requires OIG staff to adhere to all applicable professional auditing standards, which includes Government Auditing Standards (GAS). However, we will reproduce the specific GAS citations noted by the peer review team in the NEH OIG Audit Manual as appropriate.

## **Finding 2: Documentation of Audit Planning**

During our review of the Humanities Texas performance audit, we noted that the NEH OIG did not adequately document audit planning as required by GAGAS. Per GAS 7.06, auditors must adequately plan and document planning of the work necessary to address the audit objectives. Appropriate planning of the audit provides reasonable assurance that the evidence obtained is appropriate to support the auditors' findings and conclusions. Specifically, we noted that the audit methodology planning document in the audit workpaper file did not include an analysis of risks (GAS 7.05), identification of potential users of the audit report (GAS 7.13), an understanding of internal controls (GAS 7.16) and an understanding of information system controls (GAS 7.23).

**Recommendation:** Ensure that the NEH OIG staff understand the importance of preparing and retaining audit documentation related to audit planning. Further, the NEH OIG should encompass the GAS requirements referenced above in all audit planning documents.

**Views of Responsible Official:** The NEH OIG staff understands the importance of preparing and retaining audit documentation related to audit planning. The audit plan, as included in the Humanities Texas audit file, represents a standardized plan developed for limited audits of recipients of NEH challenge grants. The audit plan takes into consideration the overall risks associated with the administrative requirements of NEH challenge grant awards. The procedures reflected in the audit plan are designed to evaluate compliance with the specific NEH administrative requirements, which is the primary objective of the limited audit.

GAS 7.13 requires auditors to obtain an understanding of the potential use that will be made of the audit results or report as they plan the audit. It is the NEH OIG policy that all OIG audit reports are addressed and distributed to NEH management and management of the audited entity.

GAS 7.23 discusses the auditor's understanding of information systems controls used extensively throughout the program under audit and the fundamental business processes related to the audit objectives that rely on information systems. An understanding of information systems controls was not pertinent to the accomplishment of the objectives of the

*Limited Audit of Gifts Certified under the Challenge Grant to Humanities Texas*, thus not reflected in the audit plan.

### **Finding 3: Documentation of Fraud Risks**

During our review of the Humanities Texas performance audit, we noted that the NEH OIG did not document the consideration of fraud during the planning and fieldwork phases of the audit. Per GAS, 7.30 in the planning of audit, auditors should assess risks of fraud occurring that is significant within the context of the audit objectives. Further GAS 7.31, states that assessing the risk of fraud is an ongoing process throughout the audit and relates not only to planning the audit but also to evaluating evidence obtained during the audit. Discussions with NEH OIG indicated that fraud was considered in the planning and conducting the audit.

**Recommendation:** Ensure that the consideration of fraud during audit planning and fieldwork phases of the audit are documented the audit working papers. Further, the NEH OIG should encompass the GAS requirements referenced above in all audit planning and fieldwork documents.

**Views of Responsible Office:** The audit procedures, as reflected in the planning document, were designed to identify and address fraud that may exist respective of the audit objectives. A primary objective of the Humanities Texas audit was to determine if the gifts certified by the grantee were eligible to release Federal matching funds. The audit plan required the OIG auditor to select a sample of the certified gifts and test the supporting documentation. The transactions (gifts) actually tested by the OIG auditor during execution of the plan represented 98 percent of the total amount certified by the grantee as eligible gifts.

### **Finding 4: Documentation of Impairment to Independence from the Performance of Non audit Services**

During our review of the NEH OIG audit policies and procedures, we noted that the OIG has performed a non audit service, for which the OIG does not have adequate documented policies and procedures to ensure that non audit services do not impair auditor or organizational independence. According to GAS 3.20, audit organizations that provide non audit services must evaluate as to whether providing the service creates an impairment of independence either in fact or appearance with respect to entities they audit. Further GAS 3.22 states that (1) audit organizations must not provide non audit services that involve performing management functions or making management decisions and (2) audit organization must not audit their own work or provide non audit services in situations in which the non audit services are significant or material to the subject matter of the audits. However, audit organization can provide non audit services, if supplemental safeguards are established, as described by GAS 3.30.

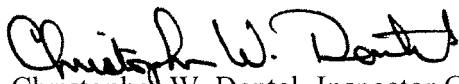
Specifically, we noted that the NEH OIG has performed technical desk reviews of indirect cost proposals submitted by NEH grant recipients. Upon completion of the technical desk

reviews, NEH management will negotiate and finalize indirect costs with the recipients using OIG recommendations. While NEH management utilizes the OIG recommendations as a basis to finalize the indirect cost rate; the service creates an impairment of OIG independence in appearance. As NEH management uses the OIG recommendations as a basis for finalizing indirect costs and through a review of NEH OIG policies and procedures where supplemental safeguards have not been established as specified in GAS 3.30, we determined that NEH OIG's independence of NEH management is impaired in appearance when performing indirect cost proposal reviews. It is important that auditors and audit organizations maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as impartial by objective third parties. As such, the NEH OIG and NEH management have recognized that this is a potential problem and have ceased having the OIG perform reviews of indirect cost proposals as of July 2009. As a result, NEH management has contracted out this service.

**Recommendation:** Establish documented policies and procedures to address impairments of independence, for instances of non audit services that may be performed in the future.

**Views of Responsible Office:** We do not agree that technical review of indirect cost proposals prepared and submitted by NEH grantees creates an impairment of OIG independence. The objective of the desk reviews was to determine the appropriateness of grantee-proposed indirect cost rates based on historical, audited data. Objective, analytical techniques were utilized as part of the OIG evaluations, the results of which were communicated to NEH management, (as are the results of all OIG engagements). However, as a matter of agency policy, NEH management's ultimate use of the results differed from OIG recommendations.

In the future, we will consult GAGAS to properly identify activities that create impairments to OIG independence and will implement supplemental safeguards as appropriate.



Christopher W. Dentel, Inspector General