



NATIONAL
ENDOWMENT
FOR THE
HUMANITIES

OFFICE OF INSPECTOR GENERAL

1100 PENNSYLVANIA AVE., NW
ROOM 419
WASHINGTON, D.C. 20506
(202) 606-8350 (PHONE)
(202) 606-8329 (FAX)
WWW.NEH.GOV
HOTLINE 877-786-7598

April 29, 2010

RETURN RECEIPT REQUESTED

[REDACTED]
[REDACTED]

American Research Institute in Turkey
UPA Museum
3260 South Street
Philadelphia, PA 19104-6324

RE: OIG-10-03 (EA)

Dear Dr. [REDACTED]

The National Endowment for the Humanities (NEH) Office of Inspector General has completed a limited audit of documentation supporting a) grant expenditures and b) matching gifts certified on Certification Reports No.1 (dated January 16, 2008) through No. 4 (dated September 21, 2009) for NEH grant [REDACTED] awarded to the American Research Institute in Turkey (the "Institute").

A copy of the report is enclosed, and in general, we believe the report to be self-explanatory. However, we wish to emphasize the need for the Institute to

- 1) revise and resubmit the most recent Certification Report to a) properly allocate the approved matching gifts between the unrestricted and restricted categories and to b) remove the matching gifts deemed unallowable;
- 2) develop and implement revised accounting procedures to ensure purpose and time restrictions related to challenge grant funds (both federal and non-federal) are properly tracked in the accounting records and reported in the financial statements in accordance with generally accepted accounting principles (GAAP);
- 3) ensure endowment investment activity is properly tracked, specifically identifying and allocating the proper portion of investment earnings to the Institute's various programs to include the purpose-restricted NEH challenge grant;
- 4) ensure NEH challenge grant activity is properly incorporated into the A-133 Single Audit and reported on the Schedule of Expenditures of Federal Awards (SEFA); and
- 5) address the two internal control recommendations reported.

Letter to [REDACTED]
April 29, 2010
Page 2

Please consider the recommendations in this report, and within thirty days, provide the OIG with a written response including any comments you have regarding the findings and recommendations and a proposed timeline for implementation of the recommendations. Office of Management and Budget (OMB) Circular A-50, *Audit Follow-up*, requires that all recommendations must be resolved within six months after a report is issued to a grantee.

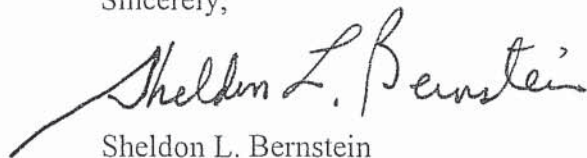
The thirty-day limit has been established for a first response due to the length of time frequently required by grantees and NEH personnel to communicate ideas, reach sound conclusions, and implement recommendations.

If available, documentation supporting the implementation of each recommendation should be included with your response. The response should be addressed to:

National Endowment for the Humanities
Office of Inspector General
1100 Pennsylvania Avenue NW, Room 419
Washington, DC 20506
ATTN: Audit Resolution Section

If you have any questions concerning the findings and recommendations or need accounting assistance, please call Mr. Steve Elsberg at (202) 606-8353. We would like to express our appreciation for the cooperation and assistance extended to our auditor by your staff during the audit.

Sincerely,



Sheldon L. Bernstein
Inspector General

Enclosure



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LIMITED AUDIT REPORT

NATIONAL ENDOWMENT FOR THE HUMANITIES

CHALLENGE GRANT AWARD

TO THE


AMERICAN RESEARCH INSTITUTE IN TURKEY

PHILADELPHIA, PA

OIG-10-03 (EA)



Laura Davis, Deputy Inspector General



Date

LIMITED AUDIT REPORT
NATIONAL ENDOWMENT FOR THE HUMANITIES (NEH)
CHALLENGE GRANT AWARD
TO THE
AMERICAN RESEARCH INSTITUTE IN TURKEY
PHILADELPHIA, PA

I. INTRODUCTION

We have performed a limited audit of the American Research Institute in Turkey (the "Institute") records as they relate to the following NEH challenge grant.

<u>Grant Number</u>	<u>Grant Period</u>	<u>Amount Awarded</u>
██████████	12/1/06 – 7/31/2012	\$550,000

Matching Gifts: Per Certification Report No. 1 (dated January 16, 2008) through Certification Report No. 4, (dated September 21, 2009), the Institute certified that eligible gifts totaling \$██████████ were received and used to meet the matching requirements stipulated by the above NEH challenge grant. The grantee conveyed in the certification reports that all restricted gifts were made in response to the NEH challenge grant; that the gifts meet the criteria for eligibility established by NEH and would be expended for the intended grant purposes; and that the total of any unrestricted gifts certified does not exceed the federal portion of the challenge grant. The grantee further certified that documentation that substantiates the sources, purposes, eligibility, and expenditure of the gifts would be retained for three years following the submission to NEH of the final financial and performance reports. Based upon the cumulative matching gifts reported on the four Certification Reports, NEH has released \$██████████ in federal funds.

Grant Expenditures: As noted below, \$██████████ of the total \$██████████ to be raised has been budgeted to help underwrite fundraising costs, act as bridge funds, and cover moving/renovation costs. Per the Institute's most recent performance report, the organization spent approximately \$██████████ in NEH challenge grant funds. The grantee conveyed that these expenditures conformed to the intended grant purpose(s), as stipulated in the NEH challenge grant award.

II. BACKGROUND

The Institute is a nonprofit organization established in 1964. The Institute's programs and operations are designed to promote research in Turkey in all fields of the humanities and social sciences. In this regard, the Institute sponsors fellowships and operates two libraries and hostels in Turkey. The Institute has been granted tax-exempt status under Section 501(c)(3) of the Internal Revenue Code.

The Institute was awarded this \$ [REDACTED] challenge grant in order to 1) support the expansion and enhancement of the Institute's overseas library facilities in Istanbul and Ankara (Turkey) and 2) create an endowment to cover the additional cost of library facilities, IT equipment, professional staffing, and collections development, including electronic and print media. To meet the terms of the grant award, the Institute must raise three times the federal offer in eligible non-federal matching funds. Of the total \$ [REDACTED] to be raised (\$ [REDACTED]) will be used to help underwrite campaign fundraising costs, act as bridge funds while the endowment is being raised, and fund moving and renovation costs related to the two research libraries. The remaining \$ [REDACTED] will be invested as an endowment that will yield annual support to help cover annual costs associated with running the two research libraries.

III. LIMITED AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

The principal objectives of this limited audit were to determine that 1) the gifts certified by the Institute were eligible to release federal matching funds and 2) grant expenditures were made in accordance with applicable provisions of NEH's *General Terms and Conditions for Awards to Organizations* and the terms of the approved grant budget. Our review was conducted in accordance with *Generally Accepted Government Auditing Standards (GAGAS)* as promulgated by the Comptroller General of the United States.

We examined documentation provided by the Institute supporting a) the eligibility of matching gifts included in Certification Reports No. 1 through 4 (tested \$ [REDACTED] of the total \$ [REDACTED]), and b) the allowability of expenses incurred for the challenge grant (tested \$ [REDACTED] of the total \$ [REDACTED]). We also reviewed the Institute's accounting system as it pertains to the challenge grant donations and expenditures and gained an understanding of procedures implemented by management to oversee the Institute's endowment and related investment portfolio.

IV. LIMITED AUDIT FINDINGS AND RECOMMENDATIONS

A. Certification Report Findings – Treatment of Matching Gifts

Based upon our testing, we determined that a material bequest (which was paid in two installments) received by the Institute was 1) improperly treated as both an unrestricted and a restricted matching gift on the Certification Reports submitted to NEH and 2) a portion of these funds (\$ [REDACTED]) was restricted by the decedent for purposes not consistent with the NEH challenge grant.

Per NEH's challenge grant administration manual (see www.neh.gov/manage/challenge_admin.html), restricted matching gifts must be in response to or in anticipation of the challenge grant and must be used to support the

purposes outlined in the approved challenge grant application/budget. Additionally, unrestricted matching gifts may be certified only up to the amount of the federal portion of the challenge grant award. The cumulative amount of any unrestricted matching gifts must be tracked and properly reported on the Certification Reports submitted to NEH.

Recommendation A

The Institute must amend and resubmit the most recent NEH challenge grant Certification Report to reflect the removal of the \$ [REDACTED] in unallowable matching gifts (\$ [REDACTED] treated as restricted and \$ [REDACTED] treated as unrestricted match). The unallowable funds will need to be replaced with new matching gifts, as stipulated under the challenge grant guidelines, prior to the conclusion of the grant period. Furthermore, the allowable portion of this bequest (\$ [REDACTED]) should be reclassified and treated as a “restricted” matching gift on the amended Certification Report since the purpose of this donor restricted gift parallels that of the challenge grant.

B. Management of NEH Challenge Grant Endowment Funds

The vast majority of the Institute’s challenge grant (almost 90 percent of the total earmarked funds) will be used to create an endowment which will help defray the costs involved with operating the two research libraries. As of December 2009, over \$ [REDACTED] (challenge grant goal = \$ [REDACTED]) had been raised and temporarily invested in a conservative money market fund since the Institute lacks formalized investment and endowment spending policies. Additionally, per our review of the prior year financial statements (6/30/08), we noted that 100 percent of the Institute’s investment earnings were treated as unrestricted revenue.

All related earnings generated from the NEH challenge grant endowment must be properly identified, tracked appropriately in the accounting records, and used specifically for the approved, restricted purposes defined by the challenge grant. Furthermore, industry best practices dictate the development/implementation of an investment policy (to include asset allocation targets, allowable investments, benchmark return goals, etc.), a formalized endowment spending policy, and the engagement of an investment custodian or utilization of in-house staff/Governance with the requisite skills to professionally manage these funds.

Recommendation B

The Institute must implement policies and procedures to ensure all earnings generated from the NEH challenge grant endowment are properly identified, tracked appropriately in the accounting records (i.e. treated as temporarily restricted funds), and used specifically for the approved, restricted purposes defined by the challenge grant proposal/budget. Also see recommendation C below.

Although current investment policies are deficient and fall short of industry best practices, we noted that the grantee is making definite strides in this area. The Institute recently a) expanded its Board of Directors, electing members who have financial expertise and b) the President appointed a Finance Committee charged with developing an investment and spending policy. We recommend that management continue to develop and implement both an investment and a spending policy, as soon as possible, to ensure proper management of the endowment funds into the foreseeable future.

C. Proper Classification of NEH Matching Gifts - Financial Statements

Per review of the Institute's most recent audited financial statements (June 30, 2008), we noted that there were neither restricted contribution revenues nor restricted net assets reported. Yet, the Institute certified \$ [REDACTED] as NEH challenge grant matching gifts (Certification Reports No. 1 and 2) as of June 30, 2008. These funds represent restricted contributions (as defined by generally accepted accounting principles - GAAP) because the donors limited their use to purposes more narrowly defined than the Institute's general non-exempt mission.

In accordance with the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard (SFAS) 116, *Accounting for Contributions Received and Contributions Made*, contributions should be recorded in the accounting system upon receipt as unrestricted, temporarily restricted, or permanently restricted support dependent upon the absence or existence and nature of donor-imposed restrictions.

Recommendation C

Management must implement necessary procedures/controls to ensure all matching gifts affiliated with the NEH challenge grant are properly reported as "restricted" or "board designated"¹ contributions in the Institute's accounting records and, ultimately, the audited financial statements to ensure a) compliance with GAAP and b) proper tracking of the purpose restricted NEH challenge grant funds.

We understand new outside auditors were recently engaged and they are currently performing the audit of the June 30, 2009 financial statements. As part of this process, they are closely scrutinizing the NEH challenge grant activity and working with management to properly reclassify related net assets (by restriction class) as required.

D. Schedule of Expenditures of Federal Awards Reporting (Financial Statements)

As of June 30, 2008, the Institute received \$ [REDACTED] in challenge grant funding from NEH for the primary purpose of creating an endowment to support humanities programs as approved in the challenge grant budget. However, these funds were not

reported on the Schedule of Expenditures of Federal Awards (SEFA) as required by OMB Circular A-133 for the fiscal year ended June 30, 2008. Accordingly, the NEH challenge grant program was not considered by the independent auditor (IPA) when selecting federal programs to be audited as part of the A-133 audit.

OMB Circular A-133, Section 205(e) states that the cumulative balance of federal awards for endowment funds (i.e. the Institute's challenge grant) which are federally restricted are considered awards expended in each year in which the funds are still restricted. Moreover, the *Administration of NEH Challenge Grants* manual states that funds deposited into an income-earning account are to be treated as federal expenditures (see Finding B). Accordingly, the \$ [REDACTED] should have been reported as federal expenditures on the SEFA since the funds are restricted to build an endowment.

It appears that the IPA treated these funds as deferred revenue in the June 30, 2008 financial statements and, therefore, excluded the amount from the SEFA. Per Note A of the financials statements (Section 1 – Nature of Activities), it states that Federal “grants and contracts are considered exchange transactions, which are a reciprocal transfer in which each party receives and sacrifices approximately equal value”. We disagree with this accounting treatment and are of the opinion that the NEH challenge grant more closely represents a conditional promise to give (i.e. matching requirement present) and, therefore revenue recognition should be treated accordingly. This stance is supported by OMB Circular A-133, Section 205(e) and the definition of funds “expended” as set forth in the NEH administrative guidelines.

Finally, we noted that the other NEH program administered by the Institute (Advanced Fellowship in the Humanities for Research in Turkey) was reported on the SEFA but the Catalog of Federal Domestic Assistance (CFDA) number was omitted. This program falls under CFDA number 45.161.

Recommendation D

We recommend that the Institute, after consulting with their IPA, provide an explanation documenting why:

- 1) The NEH challenge grant (CFDA # [REDACTED]) expenditures were omitted from the June 30, 2008 A-133 audit. Please note that the required 3:1 conditional matching requirement (i.e. non-federal dollars) was satisfied and certified to NEH as of June 30, 2008 (i.e. Certification Report #2).
- 2) The CFDA number associated with the NEH Advanced Fellowship in Humanities grant was not reported on the SEFA.

Additionally, we understand that the June 30, 2009 audit is now taking place. We recommend that the Institute review its policies concerning the NEH challenge grant and revise the methodology used to report the related revenues and federal

expenditures accordingly. Finally, the CFDA numbers for both NEH funded programs must be reported on the SEFA moving forward.

E. Internal Control Comments

During our review, two internal control related issues came to light as follows:

- 1) The Institute created a unique class code (i.e. project/department) to track NEH challenge grant revenues (both federal and non-federal) in the accounting software. However, the organization has not linked related expense accounts to this class code. This results in an incomplete and inefficient tracking of NEH challenge grant activity.
- 2) Due to limited accounting personnel, the Institute relies upon the [REDACTED] to perform certain review work to ensure an adequate segregation of finance related duties. As part of this role, the [REDACTED] reviews the monthly bank and investment account reconciliations prepared by management. This individual does not have on-line access or receive original, unopened bank statements when performing this review; rather, copies are provided by Institute staff along with the reconciliations.

Recommendation E

- 1) Although the Institute's current approach meets the minimum requirements stipulated under generally accepting accounting principles (GAAP) and the challenge grant administrative guidelines, we encourage management to take advantage of Quickbook's functionality and link both expense and revenue accounts to the unique class code created in the accounting software to exclusively track NEH challenge grant activity. Moving towards this approach will a) allow for the creation of separate mini-financial statements that capture the financial results (both revenues and expenses) of the NEH challenge grant, b) reduce the potential for errors since all of the various natural accounts (printing, salaries, contributions, investment income, etc) will be linked directly to the NEH challenge grant class code thereby simplifying reconciliation procedures, and c) will ensure a mechanism is in place to track future NEH challenge grant endowment earnings and related expenditures.²
- 2) To tighten internal controls even further and to act as a fraud deterrent, we recommend that the [REDACTED] be provided with either a) read-only, on-line access to the Institute's bank/investment accounts or b) have hard copies of the monthly statements mailed directly to him/her. Implementing this new safeguard (i.e. direct access to 3rd party statements) will provide the [REDACTED] with a higher level of assurance that the activity reported in the monthly bank/investment reconciliations is accurate and properly stated.

V. EXIT CONFERENCE

The results of our review were discussed with Ms. [REDACTED] [REDACTED], on February 3, 2010.

Institute management agrees with the above recommendations and has asserted that these issues will be addressed in a timely fashion.

¹ NEH challenge grant awards (made subsequent to May 2005) allow grantees to use unrestricted gifts for matching purposes up to the value of the federal portion of the award. To ensure proper tracking of these funds and to adhere to GAAP, we recommend management adopt necessary procedures and classify any unrestricted funds, which have been internally restricted for use with the NEH challenge grant, as board designated net assets within the unrestricted net assets category.

² Prior to the issuance of this final report, the Institute's management implemented new procedures and addressed this finding. Both revenue and expense accounts related to the NEH challenge grant are now linked to the related class code in the accounting software.