NATIONAL ENDOWMENT FOR THE

Humanities

OFFICE OF INSPECTOR GENERAL

May 22, 2015

RETURN RECEIPT REQUESTED

Board of Directors
Delaware Humanities Forum
100 West Tenth Street, Suite 1009
Wilmington, DE 19801
Attn: [redacted], Board Chair

[redacted]
Partner
Barbacane, Thornton & Company LLP
3411 Silverside Road
Wilmington DE 19810

Subject: Quality Control Review of Barbacane, Thornton & Company LLP - Single Audits of the Delaware Humanities Forum (FY2010 - FY2012)
[Audit Report: OIG-15-01 (QCR)]

As the Federal oversight agency for the Delaware Humanities Forum (the "Council"), the National Endowment for the Humanities Office of Inspector General (NEH-OIG) performed a **quality control review**[1] of the single audit reports issued by Barbacane, Thornton & Company (herein referred to as "the IPA") for the three fiscal years ended October 31, 2010 through October 31, 2012. The purpose of our review was to determine whether the audits were conducted in accordance with auditing standards[2] and requirements promulgated by Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Appendix A contains additional background, scope and methodology associated with the quality control review, and Appendix B lists the applicable single audit compliance requirements deemed to be direct and material by the IPA.

NEH-OIG opted to review three fiscal years (FY2010 - FY2012) since the related audit reports were all issued within a few weeks of each other; the IPA utilized a consistent audit approach each year; the same Federal program (CFDA[3] #45.129) was selected for single audit testing during this timeframe; and several "issues" were identified during a less intensive desk review previously performed by the NEH-OIG, related to fiscal year ended October 31, 2009.

---

[1] The Council of the Inspectors General on Integrity and Efficiency (CIGIE) issued the *Guide for Quality Control Reviews of OMB Circular A-133 Audits (2010 Edition)*. This document was used as the basis for performing the quality control review (QCR). See Appendix A for more details.

[2] Applicable auditing standards include both Generally Accepted Government Auditing Standards (GAGAS or Yellow Book) and Generally Accepted Audit Standards (GAAS).

[3] CFDA = Catalog of Federal Domestic Assistance

Background:

The Council, which was incorporated in 1972, represents a nonprofit organization that supports humanities-based endeavors. The entity receives the bulk of its annual funding from the National Endowment for the Humanities (NEH). In fact, the Federal/State Partnership program (CFDA #45.129) supported expenditures totaling $503,676, $582,802, and $573,543 for fiscal years 2010, 2011, and 2012, respectively. This represented 82% ($503,676/$613,983), 92% ($582,802/ $635,062), and 93% ($573,543/$617,560) of the Council's total annual expenses during this timeframe. Due to the material impact of this Federal program, the IPA treated CFDA #45.129 as the major program for single audit purposes each year.[4]

Results:

The quality control review process can result in one of the following four overall conclusions:

[A] Acceptable - Audit documentation contains no quality issues or only minor quality issues that do not require corrective action for the audit under review.

[B] Acceptable with Deficiencies - Audit documentation contains quality deficiencies that should be brought to the attention of the auditor (and auditee, where appropriate) for correction in future audits.

[C] Technically Deficient - Audit documentation contains quality deficiencies that affect the reliability of the audit results and require correction for the audit under review. Except for the deficiencies identified, the documentation appears to support the opinions contained in the audit under review.

[D] Unacceptable - Audit documentation does not support the opinions contained in the audit under review. The quality deficiencies will necessitate that the auditor conduct substantial additional audit work to support the opinions contained in the audit under review.

Note: When the overall conclusion is "technically deficient" or "unacceptable" and additional audit work is necessary to support the opinions contained in the audit, auditors should be advised to follow AU 390 and AU 801.43 with respect to reissuance of the audit report.

<u>The IPA generally met auditing standards and OMB Circular A-133 requirements, therefore no additional audit work is required in regards to the Council's FY2010 - FY2012 single audit submissions. However, we identified several matters that warrant the attention of both the Council and the IPA (i.e. Acceptable with Deficiencies conclusion).</u>

---

[4] In accordance with OMB Circular A-133 guidelines, the IPA must utilize a risk-based approach to select a sample of the Federal programs administered by the auditee. Since the Council did not qualify as a low-risk entity (as defined by the OMB Circular), these "major programs" must represent at least fifty percent of the total Federal awards expended by the auditee during the fiscal year. For the selected "major programs", the IPA obtains copies of the related grant awards, determines which of the fourteen Federal compliance attributes apply (see Appendix B), and performs detailed testing to ensure the organization 1) implemented sufficient internal controls, 2) adhered to grant terms and conditions, and 3) complied with the relevant Federal compliance provisions. This testing ultimately results in a single audit report (generated by the IPA) that is issued in conjunction with the standard financial statement audit.

Findings/Recommendations:

1) Performance of Nonaudit Services (FY2010 - FY2012)

One of the key provisions of Generally Accepted Government Auditing Standards (GAGAS) is to ensure the IPA remains independent from the auditee. If this provision is violated, in fact or appearance, the related audit report loses credibility. Under the ideal scenario, the auditee prepares all audit schedules, year-end entries, and the draft financial statements. These documents are then shared with the IPA who tests the underlying account balances and issues an audit opinion.

For all three audits reviewed, the IPA performed nonaudit services for the Council to include the preparation of the Schedule of Expenditures of Federal Awards (SEFA), depreciation entries, and the financial statements and related footnotes. Under the previous iteration of GAGAS, which was in effect during the Council's FY2010-FY2012 audits, the IPA could perform nonaudit services without impairing independence when certain conditions were met. Although the IPA documented the related safeguards that prevented the impairment of independence (see Appendix C for detailed explanation), we would like to offer several recommendations to strengthen conformance with the independence standards.

Please note that the standard for nonaudit services is based upon two overarching principles:

1. Auditors should not perform management functions or make management decisions; and

2. Auditors should not audit their own work or provide nonaudit services in situations where the amounts or services involved are significant/material to the subject matter of the audit.

Additionally, management of the audited entity must have the knowledge to evaluate and approve nonaudit services, to include the drafting of financial statements and notes, and take responsibility for them.

Based upon the above, our recommendations are as follows:

A. Preparation of the Schedule of Expenditures of Federal Awards

The SEFA summarizes Federal grant expenditures and represents the summary level document utilized by the IPA to make the single audit "major program" selections. Due to the importance of this schedule, OMB Circular A-133 (Section .500b) requires the IPA to opine on whether the SEFA is fairly stated, in all material respects, in relation to the financial statements taken as a whole. Furthermore, Sections .300d and .310b of the Circular clearly articulate that the responsibility for preparing this schedule falls on the auditee and defines the required data elements.

For the FY2010-FY2012 audits, the IPA prepared the SEFA. Although this appears to represent a potential independence violation, the previous version of GAGAS instituted a safe harbor provision that allowed an audit firm to perform up to 40 hours of nonaudit service work without impairing independence (see Appendix C for details). However, this provision was eliminated with the adoption of the current version of GAGAS.

***RECOMMENDATION*:**

Considering these facts, we strongly recommend Council management begin preparing the SEFA moving forward. This will prevent any appearance of an IPA independence violation, especially in light of the fact that a separate audit opinion is required for this schedule, and further demonstrate management's ability to oversee Federal grant awards.

Please note that tools are readily available to assist the Council with this transition. For example, the American Institute of Certified Public Accountants' (AICPA) Government Audit Quality Center provides several free resources to the general public related to SEFA preparation (see the attached hyperlink below).

> http://www.aicpa.org/InterestAreas/GovernmentalAuditQuality/Resources/AuditPracticeToolsAids/Pages/Single%20Audit%20Practice%20Aids.aspx

B. Documentation of Management's Ability to Evaluate and Approve Nonaudit Services

Under GAGAS, management of the audited entity must possess the requisite knowledge to evaluate and approve nonaudit services and take responsibility for this work. We understand that the Council will continue to task the audit firm with preparing the draft financial statements and related footnotes (i.e. nonaudit service). This represents a common service provided to smaller organizations lacking sufficient accounting personnel.

***RECOMMENDATION*:**

GAGAS independence standards (associated with nonaudit services) are predicated on management's ability to properly evaluate and take responsibility for the related work. The audit firm must use professional judgment when assessing the auditee's technical skills and ability to evaluate the nonaudit services performed. Accordingly, the related thought process and any related supporting documentation should be substantiated in the audit file. Moving forward, we recommend that the IPA bolster existing documentation practices in this area.[5] Specifically, the audit client should be tasked with completing a *Financial Statement Disclosure Checklist*[6] in conjunction with management's review/acceptance of the audit deliverables. This documentation should then be retained by the IPA and incorporated in the audit binder.

2) Payroll Control Testing (FY2010 - FY2012)

Payroll-related costs represent more than half of the Council's total annual expense and are routinely charged to Federal grants. OMB Circular A-133 (Section .500) states that "in addition to the requirements of GAGAS, the auditor shall perform procedures to obtain an understanding of internal control over Federal programs sufficient to plan the audit to support a low assessed level of control risk for major programs." To plan for a low assessed level of control risk, the auditor should select a representative sample of transactions and test the key controls over the related accounting

---

[5] During the Quality Control Review (QCR), we noted that the IPA's audit files included both a memo and a management representation letter documenting the Council's acceptance of the nonaudit services. However, the workpapers did not substantiate that management possessed the requisite skillset to properly review, understand, and take responsibility for the nonaudit work performed.

[6] These formalized checklists, which capture the unique accounting guidance associated with nonprofit organizations, help ensure all relevant disclosures are properly incorporated into the entity's financial statements and related footnotes. Completion of the applicable *Financial Statement Disclosure Checklist* documents management's formal review and acceptance of the final audit report. Current GAGAS rules stipulate that an independence impairment exists when an IPA prepares an auditee's financial statements and the organization cannot validate that it possesses the requisite skills, knowledge or experience to properly evaluate the adequacy of the auditor's work. The Disclosure Checklist represents a great tool for management to demonstrate that the necessary competencies exist within the nonprofit entity.

cycle/compliance area[7]. Furthermore, it should be noted that OMB Circular A-122 specifically defines the key payroll controls, to include level of effort reporting, that must be instituted by nonprofit recipients of Federal grants (See Appendix D for details).

If the detailed testing fails and internal control over compliance is deemed likely to be ineffective, OMB Circular A-133 states that the auditor should assess control risk at maximum and consider testing compensating or redundant controls. If compensating/redundant controls are not operating effectively, the auditor should report a significant deficiency or material weakness as part of the single audit findings.

We noted that the IPA opted against payroll control testing (FY2010-FY2012). Rather than perform formalized control testing, the IPA substantively tested aggregate payroll/fringe costs using predictive analytics. Although this approach substantiated total payroll costs, it neither tested the key internal controls related to the payroll allocation process, nor tested the Council's compliance with OMB Circular A-122 level-of-effort tracking requirements (see Appendix D).

The IPA asserted that the Council uses a consistent process to track and record payroll, therefore a simple walk-through of key payroll controls was deemed sufficient (1 transaction). The auditor further stated that internal control testing over the payroll allocation process was not warranted since all salary costs are essentially charged to the NEH. However, this was not clearly articulated in the working papers. During our review, we noted that (1) the Council receives restricted grant funding from the state of Delaware; (2) NEH funding has historically included multiple awards made under different CFDA programs; and (3) private grantors occasionally provide purpose-restricted funding. Accordingly, an independent reviewer with no knowledge of the Council's operations[8] would reasonably conclude that payroll costs need to be allocated among multiple funders and grants. Furthermore, the related controls over the payroll allocation process warranted testing due to the material nature of this accounting cycle.

Since the IPA did not plan for a low assessed level of control risk and did not deem the related control processes to be deficient (i.e. no written finding concerning breakdown of payroll controls), we believe the audit approach, as documented in the working papers, did not comply with OMB Circular A-133 requirements. Upon further inquiry, the IPA asserted that payroll is not charged to the other purpose-restricted funding streams; therefore, all Council payroll is applied to the NEH General Operating Support grant. Assuming this is truly the case, the substantive testing approach adopted by the audit firm is reasonable. However, based upon this disclosure, it appears that the Council's payroll process does not facilitate the allocation of labor-related costs to individual cost centers/grants using an acceptable level-of-effort tracking methodology. Since we could not verify the Council's actual payroll allocation process using the workpaper documentation included in the audit files, and the Council's

---

[7] The AICPA Government Audit Quality Center (GAQC) issued related guidance entitled "*Audit Sampling Considerations of Circular A-133 Compliance Audits*" that highlights the audit requirements associated with single audits. According to the guidance memo [represents an extract of key passages pulled from the applicable AICPA audit guide entitled *Government Auditing Standards and Circular A-133 Audits*], if the auditor determines that internal control over compliance is effectively designed and implemented, OMB Circular A-133 requires that the IPA plan the audit to support a low level of assessed control risk. This requires the auditor to plan to obtain a high level of assurance that controls operate as designed. Samples for control tests are typically designed to achieve a 90–95% confidence level. The guidance then defines suggested minimum sample sizes for tests of controls. Generally, if the population is over 250 transactions a sample size of 25 or 40 would be expected (with expectation of zero errors). If population is less than 250 transactions, suggested sample sizes are also provided (generally at least 10% of population).

[8] Auditing standards require that audit documentation be appropriately detailed to provide a clear understanding of the work performed, the evidence obtained, and the conclusions reached. The documentation should be in sufficient detail to enable an experienced auditor, who did not participate in the engagement, to understand from the documentation the nature, timing, extent, and results of the audit procedures performed and the evidence that supports the auditors' significant judgments and conclusions, [GAS 4.19].

approach does not seem to adhere to the baseline requirements defined in OMB Circular A-122 (Section 8m), an undocumented control deficiency may exist.

***RECOMMENDATION*:**

We request that the Council provide the NEH-OIG with a written explanation of the payroll allocation process currently in place and document whether the organization is in compliance with the Federal requirements.*** Please provide a written response within 30 business days.

***Please note that the Office of Management and Budget (OMB) issued new guidance regarding Federal grant awards entitled *OMB Uniform Guidance: Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*. This guidance, which had an effective date of December 26, 2014, streamlines eight Federal regulations (to include OMB Circular A-110, A-122, and A-133) into a single, comprehensive policy guide. The *Uniform Guidance* makes certain revisions to the level-of-effort requirements discussed above, therefore we strongly recommend Council management familiarize itself with this document. A hyperlink to the key passage impacting payroll requirements has been provided (2 CFR Part 200 - Subpart E, Section 200.430).

http://www.ecfr.gov/cgi-bin/text-idx?SID=fbb70fe83009e152ac327498f6ec18c4&node=se2.1.200_1430&rgn=div8

3) Compliance Testing: Matching/Cost-Share (FY2010 – FY2012)

The Federal/State Partnership program (CFDA #45.129) includes matching/cost share requirements for both the "Outright" and "Matching" funds associated with General Operating Support Grants. As this represented the major program selection and the matching/cost-share compliance element was deemed to be direct and material, the IPA performed testing related to this compliance requirement.

Concerning "Matching" funds, NEH will not release the associated Federal funds until the grantee submits proper supporting documentation; therefore, an inherent control exists. Concerning "Outright" funds[9], the NEH Office of Grant Management relies upon the IPA community to verify 1) compliance with the applicable cost-share requirement; and 2) the accuracy of the cost-share reported to the Agency. As defined by the A-133 Compliance Supplement (CFDA #45.129), Councils must cost-share the "Outright" funds on a dollar-for-dollar basis. Cost sharing for "Outright" funds may take the form of cash contributions to the Councils from any source, program income the councils have earned, unreimbursed allowable costs that a subrecipient (regrantee) incurs in carrying out a Council-funded project, and/or the value of in-kind contributions made by third parties.

In regards to compliance testing performed by the IPA, the firm limited testing to a sample of regrants awarded by the Council each year. The audit procedures ensured i) selected regrantees properly reported cost-share/matching to the Council; and ii) the related amount either equaled or exceeded the regrant award amount (as required by Council program documentation). However, the IPA did not perform a top-level test to verify that the Council (in aggregate) was meeting the cumulative cost share requirement associated with the "Outright" funding stream.

According to the IPA, the audit firm's interpretation of the compliance requirement did not call for this level of testing. NEH-OIG disagrees with the IPA's interpretation and concludes that this additional testing was necessary to fully ascertain whether the Council complied with the major program cost-share requirements.

---

[9] Outright funds represent the material component of NEH award SO-50352-10, comprising over 95% of the total funding.

***RECOMMENDATION*:**

We ask that the Council (within 30 business days) provide NEH-OIG with a detailed schedule that supports the total cost-share amount reported in the most recently submitted *Federal Financial Report (SF-425)* related to NEH award SO-50352-10.[10] As this amount exceeds the total Outright Federal funding associated with the General Operating Support Grant, it appears that the Council successfully complied with the cumulative cost-share requirement.

4) Schedule of Expenditure of Federal Awards (SEFA) Preparation [FY2010-FY2012]

Most organizations design the chart of accounts, in sufficient detail, to allow for the creation of a financial snapshot report for each individual Federal grant administered.[11] This information can then be used as the basis to prepare the SEFA.

In the case of the Council, an unorthodox methodology has been developed since the NEH Federal/State Partnership award represents the vast majority of the organization's public support funding.[12] Rather than create an overly complex accounting system, management simply backs out the expenditures related to the Delaware state grant and the net, fixed asset activity at the end of the fiscal year. The remaining expenses represent CFDA #45.129 grant activity and are reported on the SEFA. Management met with the IPA concerning this approach and both parties agreed that it represented a reasonable basis to calculate Federal expenditures.

Upon initial inspection, NEH-OIG wasn't sure if the above methodology met the base requirements stipulated in OMB Circular A-110, Subpart C (Section 21 – Standards for Financial Management). Per subsequent review, the Circular provides organizations leeway requiring that "records adequately identify the source and application of funds for federally-sponsored activities." The system must be accurate, complete, and ensure complete disclosure of the related financial results.

Due to the (1) unique circumstances associated with the Council, (i.e., one active Federal grant as of October 31, 2012); (2) nature of the NEH general support grant; and (3) fact that the Council was able to provide the IPA with supporting documentation for all transactions selected for testing, NEH-OIG determined that the Council met the baseline requirements. However, the existing system will, most likely, fail to provide the requisite information if the Council begins receiving additional sources of purpose-restricted grant funds (private, state, and/or Federal). Additionally, as noted in Finding 2 above, the Council's payroll allocation methodology may need to be revised to ensure compliance with the Federal requirements.

While in Delaware, the NEH-OIG auditor took the opportunity to discuss these matters with the Council's Executive Director and Fiscal Officer. During this session, the Federal administrative requirements and the components of a successful financial management system were emphasized. In particular, time was devoted to time/effort reporting and the benefits of a multi-segment chart of accounts structure.

---

[10] The Council's most recent *Federal Financial Report* (Final) for award SO-50352-10 (dated January 20, 2015) reported $1,972,258 in cumulative cost-share.

[11] This is typically accomplished through the use of multiple segments in the chart of accounts. Depending on the level of complexity, an organization may have anywhere from 2 to 5 account segments to capture the natural account, department code, division code, individual grant award, etc.

[12] In FY2012, the Council's non-investment income consisted of one NEH Federal/State Partnership award ($560k); a Delaware state grant ($[redacted]); and smaller dollar contributions from private parties ($[redacted]), which were primarily unrestricted (i.e. no purpose restrictions).

***RECOMMENDATION*:**

In conjunction with Finding 2, we request that the Council evaluate the organization's existing chart of accounts and payroll allocation methodology. Please provide the NEH-OIG with a written assessment as to whether the existing infrastructure 1) meets Federal requirements; and 2) can successfully track and account for future growth to include the administration of multiple purpose-restricted awards (private, state and Federal).

5) Prior Period Restatement (FY2010 only)

The FY2010 financial statements included a prior period net asset restatement of almost $[redacted] (documented in Note N of the financial statements) which exceeded the calculated audit materiality threshold. Yet, the single audit report did not include a written finding concerning this internal control weakness.[13]

According to the IPA, the audit firm opted against issuing a written finding since the audits for FY2010-FY2012 were essentially issued at the same time. In particular, "by the time we got to FY2012, we were confident that the books and records were correct, properly recreated, and that the issue was three years old at that point. This was a judgment call at the time of issuance."

Although we understand the IPA's logic that the issuance of the FY2010 audit was severely delinquent (due to staff turnover and other issues at the Council) and the related matter had been addressed by the time the FY2010 - FY2012 audits were concurrently issued in the third quarter of calendar year 2013, we maintain that the standards require a written finding whenever a material, prior period adjustment exists. However, due to the age of the financial statements we do not see value in reopening the audit to report the control deficiency.

6) Required SEFA Disclosure (FY2010 – FY2012)

OMB Circular A-133.310(b)(5) states that pass-through entities, to the extent practical, should identify the total amount of funding provided to subrecipients from each Federal program. The current NEH Federal/State Partnership awards (CFDA #45.129, "SO" prefix) include specific funding for regrants[14] which are awarded by the Council to subrecipients on an annual basis. According to the audited *Statement of Activities*, the Council issued between $[redacted] and $[redacted] in regrants during the fiscal years ended October 31, 2010 through October 31, 2012. However, we noted that the SEFA lacked any disclosure concerning the value of federally-funded regrant awards.

***RECOMMENDATION*:**

Moving forward, please ensure the SEFA incorporates all required disclosures. Future audit reports with similar deficiencies will be deemed unacceptable submissions by the NEH Office of Inspector General.

---

[13] As defined in the "*Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*", a material weakness over financial reporting represents a deficiency when there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis." Accordingly, a written internal control finding should always be incorporated into a single audit report when a material, prior period restatement of the financial statements takes place.

[14] The NEH-approved budget for grant SO-50352-10 included annual regrant allocations of approximately $100,000 for the fiscal years in question.

Other Comment:

1) Suspension and Debarment Compliance Requirements

As noted in Appendix B, the IPA determined that the Procurement, Suspension, and Debarment compliance attribute did not warrant Single Audit testing due to a lack of overall materiality. Although not specifically tested by the auditor, Council management should note that the related Federal requirements still apply and directly impact the nonprofit. The OMB Circular A-133 Compliance Supplement[15] stipulates that non-Federal entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred, or whose principals are suspended or debarred. "Covered transactions" include procurement contracts for goods and services, paid with Federal funds, expected to equal or exceed $25,000; and all non-procurement transactions (i.e. regrants to subrecipients), irrespective of award amount. This verification may be accomplished by 1) checking the Excluded Parties List System (EPLS) maintained by the General Services Administration and available at https://www.sam.gov/portal/public/SAM/; 2) collecting a written certification from the entity; or 3) adding a clause or condition to the agreement executed with the entity. Based upon our review of the audit workpapers, it was unclear as to whether the Council instituted the requisite safeguards to prevent the disbursement of Federal funds to suspended or debarred parties. Accordingly, we are bringing this matter to management's attention.

Please note, according to the President's Council on Integrity and Efficiency (PCIE) Statement No. 6, *Questions and Answers on OMB Circular A-133* (Question 80), an independent auditor's time with Federal agencies during a quality control review is similar to other time for quality control such as training, auditor policies and procedures, and peer review. Accordingly, Federal awards should not be charged for the independent auditor's time spent on quality control reviews.

We appreciate the courtesies extended to the NEH-OIG auditor. If you have any questions concerning this letter or need accounting assistance, please contact Mr. Steve Elsberg at (202) 606-8353 or via email at selsberg@neh.gov.

Sincerely,

Laura Davis
Inspector General

Distribution List:
Delaware Humanities Forum
100 West Tenth Street, Suite 1009
Wilmington, DE 19801
Attn: [redacted], Executive Director

---

[15] Part 3 - Compliance Requirements (Section I: Procurement and Suspension and Debarment)

***Please note that Part C, Section 200.212 and Part D, Section 200.330 of the new *Uniform Guidance* provide additional guidance concerning subrecipient monitoring and suspension/debarment requirements.

Appendix A–Description of the Quality Control Review Process

Background, Scope and Methodology

The Single Audit Act, Public Law 98-502, as amended, was enacted to improve the financial management of State and Local Governments and nonprofit organizations by establishing a uniform set of auditing and reporting requirements for all Federal award recipients required to obtain a single audit. OMB Circular A-133 establishes policies that guide the implementation of the Single Audit Act and provides an administrative foundation for uniform audit requirements of non-Federal entities expending Federal awards. Entities that expend $500,000 or more are subject to the Single Audit Act and the audit requirements documented in OMB Circular A-133.[16] Therefore, they must have an annual single or program-specific audit performed in accordance with Government Auditing Standards and submit a complete reporting package to the Federal Audit Clearinghouse (FAC).

Utilizing the *Guide for Quality Control Review of OMB Circular A-133 Audits (2010 Edition)*, we reviewed the Council's FY2010-FY2012 single audits and the related reporting packages submitted to the FAC. This guide, which is issued by the Council of the Inspectors General on Integrity and Efficiency (CIGIE), represents the standard guidance used to perform a **quality control review** (QCR). A QCR institutes additional requirements above and beyond an A-133 **desk review** to include a detailed review of the auditor's working papers. We conducted our on-site review of the working papers during the month of May 2014 at the IPA's Wilmington, DE office. The QCR was conducted in accordance with the *Quality Standards for Inspection and Evaluation*, as issued by the CIGIE.

As described in the QCR guide, the objectives of a quality control review are to:

1. Determine whether the audit was conducted in accordance with applicable standards, which include Generally Accepted Government Auditing Standards (GAGAS) and Generally Accepted Auditing Standards (GAAS), and meets the requirements of OMB Circular A-133;
2. Identify any follow-up work needed to support the opinions contained in the audit report; and
3. Identify issues that may require Federal program management attention.

The QCR focused on the following qualitative aspects of a single audit:

- Auditor Qualifications
- Independence
- Due Professional Care
- Quality Control
    - Firm Peer Review
    - Planning and Supervision
    - Sufficient Audit Documentation
- Determination of Major Programs
- Schedule of Expenditures of Federal Awards (SEFA)
- Sampling Methodology
- Internal Control and Federal Compliance Testing
- Data Collection Form (DCF) and Reporting of Deficiencies

Note: Our office has not performed any other quality control reviews of this audit firm during the past five years. However, as previously noted, NEH-OIG issued an OMB Circular A-133 Desk Review report related to the Council's FY2009 single audit [OIG-11-04(DR)].

---

[16] The newly enacted *Uniform Guidance*, which had an effective date of December 26, 2014, increases the single audit threshold from $500,000 to $750,000.

Appendix B–Major Program Compliance Requirements [17]

Audit Years: FY2010 - FY2012

Compliance Requirements	Applicable	Not Applicable/ Not Material
Activities Allowed/Unallowed	X	
Allowable Costs/Cost Principles	X	
Cash Management	X	
Davis-Bacon Act		X
Eligibility		X
Equipment and Real Property Management		X
Matching, Level of Effort, Earmarking	X	
Period of Availability of Federal Funds	X	
Procurement, Suspension, and Debarment		X
Program Income		X
Real Property Acquisition and Relocation Assistance		X
Reporting	X	
Subrecipient Monitoring		X
Special Tests and Provisions		X

***Major Program Selected*:**

NEH Promotion of the Humanities-Federal/State Partnership, CFDA#: 45.129 (Award: SO-50352-10***).

***The IPA selected this multi-year grant as the Single Audit major program in FY2010, FY2011 and FY2012.

[17] This chart reflects the IPA's determination concerning the direct and material Federal compliance elements. Since the same NEH program was selected as the major program each year, the above grid applies to all three years (FY2010 - FY2012).

Appendix C - Yellow Book Independence Standards

Since the period covered by this Quality Control Review relates to the Delaware Council's FY2010 thru FY2012 audits, the GAO *Government Auditing Standards (Amendment 3: Independence)*[18] and GAO *Government Auditing Standards (Answers to Independence Standard Questions)*[19] were applicable. The current update to the GAO Yellow Book Standards became effective for audit engagements with fiscal years ending on or after December 15, 2012.

GAS-Amendment 3 (Section 3.21) contained the key provisions related to audit firm independence when performing nonaudit services. Specifically, before an IPA agrees to perform nonaudit services, it must consider two overarching principles:

1. The IPA should not perform management functions or make management decisions; and
2. The IPA should not audit its own work or provide nonaudit services in situations where the nonaudit services are significant/material to the subject matter of the audits.

Section 3.26 provided further clarification concerning the interpretation of the two overarching principles. The guidance states that certain nonaudit services performed by an IPA typically would not create an impairment to the audit organization's independence to include: preparing draft financial statements, preparing draft notes to the financial statements, and maintaining depreciation schedules. This is predicated on the assumption that the IPA does not maintain or prepare the audited entity's basic accounting records or maintain/assume responsibility for basic financial records.

Due to the overwhelming number of inquiries received from practitioners, GAO subsequently issued the *GAS-Answers to Independence Standard Questions* publication. This document further clarified that, under normal circumstances, several safeguards needed to be implemented when nonaudit services were provided in conjunction with a financial statement audit. Specifically,

(a) Personnel who performed nonaudit services would be precluded from performing any related audit work;
(b) An audit organization's work could not be reduced beyond the level that would be appropriate if the nonaudit work was performed by another unrelated party; and
(c) Certain documentation and quality assurance requirements must be met.

Item #30 stated that requirement (a) above would be waived when the nonaudit service is performed in fewer than 40 hours. Item #46 also clarified that the audit team could prepare financial statements and related notes as long as management takes responsibility for basic financial transactions and the chart of accounts; the management representation letter acknowledges the IPA's role in preparing the draft financial statements and notes but highlights fact that management is ultimately responsible for reviewing and approving the statements; and management of the audited entity has necessary knowledge to evaluate and approve the draft financial statements and take responsibility for them. Finally, item #49 clarified that an IPA could prepare depreciation schedules for an audit client without impairing independence, as long as management takes responsibility for the schedules and determines the depreciation methodology to be used.

For all three fiscal years reviewed (FY2010-FY2012), the audit team completed an auditor independence memo documenting the safeguards that prevented nonaudit services from impairing the firm's independence under Yellow Book. In summary, the following nonaudit services were provided:

- Prepared draft financial statements (to include the SEFA) with notes;
- Prepared the Council's depreciation schedule; and
- Same IPA employees performed both the nonaudit services and the attest engagement

---

[18] GAO-02-388G dtd Jan 2002

[19] GAO-02-870G dtd July 2002

Proper exclusions and/or safeguards were implemented (and documented) by Barbacane, Thornton & Company, thus preventing an impairment to independence. In particular, the *GAS-Answers to Independence Standard Questions* publication (Items 30, 46 & 49) addressed the three nonaudit issues noted above. Furthermore, we determined that Council management posted the depreciation entry and accepted full responsibility for the financial statements and the SEFA, as evidenced by the signed management representation letter.

As noted above, the current version of the GAGAS Yellow Book standards became effective for the Council's FY2013 audit (fiscal year ending on or after December 15, 2012). Significant changes were made to the independence standards to include the elimination of the 40 hour de minimis exemption for nonaudit service work. Accordingly, the Council needs to assess the impact of these changes and determine whether to continue the practice of engaging the IPA to perform these nonaudit services moving forward. Additionally, see the QCR comments regarding this matter (Findings 1 & 4).

Appendix D - Required Components of a Payroll Allocation System (For Nonprofit Organizations)

In accordance with OMB Circular A-122: *Cost Principles for Non-Profit Organizations* (Attachment B, Section 8m-Support of salaries and wages), nonprofit organizations administering Federal grant funds must establish a payroll allocation system that meets this baseline:

(1) Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports, as prescribed in subparagraph (2), except when a substitute system has been approved in writing by the cognizant agency.

(2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. In addition, in order to support the allocation of indirect costs, such reports must also be maintained for other employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s) (e.g., an employee engaged part-time in indirect cost activities and part-time in a direct function). Reports maintained by non-profit organizations to satisfy these requirements must meet the following standards:

(a) The reports must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.

(b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.

(c) The reports must be signed by the individual employee, or by a responsible supervisory official having first-hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.

(d) The reports must be prepared at least monthly and must coincide with one or more pay periods.

(3) Charges for the salaries and wages of nonprofessional employees, in addition to the supporting documentation described in subparagraphs (1) and (2), must also be supported by records indicating the total number of hours worked each day maintained in conformance with Department of Labor regulations implementing the Fair Labor Standards Act (FLSA) (29 CFR Part 516). For this purpose, the term "nonprofessional employee" shall have the same meaning as "nonexempt employee," under FLSA.

(4) Salaries and wages of employees used in meeting cost sharing or matching requirements on awards must be supported in the same manner as salaries and wages claimed for reimbursement from awarding agencies.

NOTE: As documented in the Recommendation to Finding #2, the newly enacted *Uniform Guidance* superseded OMB Circular A-122, effective December 26, 2014. Council management will need to familiarize themselves with this major overhaul of the Federal grant guidelines. The hyperlink to the relevant payroll allocation requirements was provided.