NATIONAL ENDOWMENT FOR THE
Humanities

OFFICE OF INSPECTOR GENERAL

June 19, 2015

RETURN RECEIPT REQUESTED

Board of Directors
Kansas Humanities Council
112 SW 6th Avenue, Suite 210
Topeka, KS 66603-3895
Attn: [redacted], Board Chair

OIG Report Number: OIG-15-08 (DR)

Dear Board Members:

We have completed our desk review of the single audit report prepared by Berberich Trahan & Company, CPAs, which includes the Federal assistance programs administered by the Kansas Humanities Council (the "Council"), for the year ended October 31, 2014. The independent auditor (IPA) previously furnished a copy of their audit report (dated February 3, 2015) to the Council and submitted the related reporting package to the Federal Audit Clearinghouse. The IPA issued an unmodified opinion[1] related to Federal award compliance. Furthermore, no reportable findings were identified.

Our review was limited to an examination of the audit report; email correspondence with Council and IPA staff; and review of select NEH grant files and accounting records. We did not examine the underlying audit documentation to evaluate the adequacy of the audit work performed; rather, the *Guide for Desk Reviews of OMB Circular A-133 Audit Reports (2015 Edition)*, issued by the Council of Inspectors General on Integrity and Efficiency (CIGIE), was used to determine whether the audit report meets the core reporting requirements stipulated by Office of Management and Budget (OMB) Circular A-133. Corrective action is required when the overall desk review conclusion rendered is *fail*.

We determined that the audit report generally meets Federal reporting requirements[2], with the following exception:

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[1] An unmodified opinion represents the IPA's highest level of assurance, indicating that the audited entity's financial presentation of Federal grant activity materially complies with Federal requirements stipulated in OMB Circular A-133 (*Audits of States, Local Governments, and Non-Profit Organizations)* and *Government Auditing Standards.*

[2] Of the three possible conclusions applicable to a single audit desk review, the NEH-OIG has concluded that the Council's FY2014 audit report meets the *Pass with Deficiencies* criteria, [i.e. the report contains quality deficiencies that should be brought to the attention of the auditor (and auditee) for correction in future audits]."

Schedule of Expenditures of Federal Awards

OMB Circular A-133, Section .310(b), discusses the reporting requirements affiliated with the Schedule of Expenditures of Federal Awards (SEFA). At a minimum, the SEFA shall include total expenditures associated with each individual Federal program or program cluster; identify the associated Catalog of Federal Domestic Assistance (CFDA) number(s)[3]; include additional disclosures related to pass-through funding; and sort program expenditures by Federal agency.

According to the FY2014 SEFA, the Council received Federal funding from two independent agencies --- the National Endowment for the Humanities (NEH) and the National Endowment for the Arts (NEA). The Federal expenditures associated with the NEA grant (CFDA #45.024) were erroneously incorporated into the NEH total, thereby leading to potential confusion. To comply with the above guidance, the SEFA should have separately identified expenditures associated with each individual Federal agency.

Moving forward, we fully expect the Council and the IPA to catch these types of errors prior to report finalization. Please note that future audit reports with similar deficiencies may be deemed unacceptable submissions by the NEH Office of Inspector General.

Other Comments:

Although they fall outside the scope of reportable Desk Review findings, we believe two additional interrelated matters warrant further discussion as follows:

1. The Council's FY2014 audited financial statements reflect two distinct accounting methodologies to report NEH grant expenses. Specifically, the *Statement of Activities* utilizes the accrual basis of accounting[4] while the *Schedule of Expenditures of Federal Awards (SEFA)* employs the cash basis. According to professional guidance (i.e. AICPA's A-133 Practice Aid), this presentation approach is acceptable "as long as the SEFA can be reconciled back to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves, the conditions set forth in paragraph .05(a) of AU section 551 are considered met, the auditor may provide an in-relation-to opinion on the SEFA." The IPA substantiated that this reconciliation was performed as part of the audit.

Although the current approach meets existing standards, we recommend the Council expand the SEFA's *Basis of Accounting* disclosure to include a reconciliation between the two accounting methodologies, or, better yet, consider preparing the SEFA on an accrual basis moving forward. This second option would reap additional benefits as discussed in the following comment.

2. In lieu of issuing a standard audit opinion, the IPA highlights the Council's use of an alternative basis of accounting "prescribed by the National Endowment for the Humanities". This approach satisfies the professional standards. However certain third parties that typically require the submission of audited financial statements, such as banks or other creditors, may take exception. Fortunately, with the adoption of a few simple procedural changes (see below), the Council will position itself to qualify

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[3] The Catalog of Federal Domestic Assistance is a government-wide compendium of Federal programs, projects, services, and activities that provide assistance or benefits to the American public. It contains financial and nonfinancial assistance programs administered by departments and establishments of the Federal government. As the basic reference source of Federal programs, the primary purpose of the Catalog is to assist users in identifying programs that meet specific objectives of the potential applicant, and to obtain general information on Federal assistance programs.

[4] As described in financial statement Footnote 1 ~ Basis of Presentation, expenses are recorded in the *Statement of Activities* "at time of [the Council] incurring an obligation."

for the more commonly prescribed GAAP-based[5] audit opinion effective FY2015. As part of the Desk Review closeout process, NEH-OIG vetted this matter with the IPA and Council management.

Accounting guidance for nonprofit organizations stipulates that Federal grant awards be treated as either an exchange transaction or a contribution.

A) **Contribution Approach (Grant primarily provides a public benefit):** Accounting literature states that the revenue associated with contributions should be recorded upon notification unless they are "conditional"[6] in nature. NEH General Support grants span multiple years with funding for future years conditioned upon NEH receiving anticipated appropriations from Congress. As this represents an uncertain event, out of NEH's control, the recipient would recognize grant revenue as NEH notifies the organization of available funding through the issuance of periodic award amendments.

   Accounting standards further require contributions containing donor-imposed purpose or time restrictions be classified as temporarily restricted inflows. The NEH awards incorporate purpose restrictions, therefore the grant funds should be treated in this manner. As the grantee incurs related expenses, the purpose restriction is released. The accounting entry to record the release can be performed as infrequently as annually (i.e. at fiscal year-end).

   <u>Implementation:</u> The Council's existing revenue recognition methodology, used with NEH grant funds, already conforms to the timing noted above. However, these funds are currently treated as unrestricted revenues. To fully comply with accounting guidance, management will need to tweak internal policies and procedures slightly. Specifically, the NEH funds should be classified as temporarily restricted revenues when initially recorded. At the end of the fiscal year, the amount of related grant expenditures represents the release amount, and a related accounting entry should be recorded to effect the release. Any residual balance (i.e. total grant revenue less related expenses) existing at the end of the fiscal year would be retained in the temporarily restricted net asset category and reported as such in the financial statements. This methodology alerts financial statement users to any unspent contributions that include donor-imposed restrictions.

B) **Exchange Approach (Grant primarily resembles a sale transaction with the awarding agency):** Under this approach, the associated revenue (unrestricted) is recorded when the grantee fulfills the terms and conditions associated with the grant award. This common practice used with Federal grants mirrors that of a construction contract, whereby the assumption is made that incurred expenses represent the best indicator of the grantee's progress.

   <u>Implementation</u>: Similar to the net asset release entry associated with the contribution approach noted above, Federal grant expenditures are already tracked and reported in the SEFA. Accordingly, this amount would be used as the basis to recognize the NEH grant revenue (unrestricted). Under this approach, the grant expenditures and the associated grant revenue will always equal.

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[5] Generally accepted accounting principles (GAAP) represent the common set of accounting principles, standards, and procedures that domestic organizations are expected to follow when compiling their financial statements. GAAP represents the authoritative standards issued by the Financial Accounting Standard Board. FASB represents the accounting standard setting body for non-governmental entities within the United States.

[6] Under GAAP, *conditional* contribution revenue should not be recorded in the *Statement of Activities* until the condition has been satisfied. Rather, presentation should be limited to a footnote disclosure only.

Specifically, revenue recognition with conditional transfers are delayed since they rely upon one or more uncertain events.

Assuming the Council adopts one of the above approaches and presents the SEFA on the accrual basis (either in the body of the SEFA or as a footnote disclosure), the IPA should be in the position to issue a fully GAAP compliant unmodified audit opinion. The NEH-OIG office would be happy to assist the Council with this process, if so desired.

Please note that we are a sending a copy of this letter to the managing director at Berberich Trahan & Company to inform her of the results of our review.

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

Laura Davis
Inspector General

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