


OFFICE OF INSPECTOR GENERAL

MEMORANDUM

Date: September 12, 2012

To: James A. Leach, Chairman
Carole Watson, Deputy Chairman
Jeff Thomas, Assistant Chairman for Planning and Operations
Adam Wolfson, Assistant Chairman for Programs
Brett Bobley, Director ~ Office of Digital Humanities
Susan Daisey, Director ~ Office of Grant Management

From: Laura Davis, Acting Inspector General 

Subject: Pre-Award Survey Memorandum Report: OIG-12-03 (TS)
Open Knowledge Commons
Cambridge, MA

We have completed our pre-award survey of Open Knowledge Commons (the “Commons”). The purpose of our survey was to obtain information to determine the adequacy of the organization’s accounting system, management controls, and policies and procedures designed to administer NEH grant funds.

The NEH Chairman recently approved a material Digital Humanities grant (HC-50017; \$1,000,000) to the Commons. This grant will support the incorporation and launch of the Digital Public Library of America (DPLA), a groundbreaking project that seeks to digitize and bring together the contents of our nation’s libraries and archives, and make them freely available to all online. The Commons will partner with subrecipients located in select states to build interconnected service and content hubs as part of this Digital Hubs Pilot Program. During the organizational survey process, the Office of Grant Management determined that the Commons represents a very small 501(c)3 organization, with limited staffing and financial resources. Furthermore, this organization has only administered one immaterial Federal grant prior to receiving the two recent awards from NEH¹. Accordingly, the matter was referred to the Office of Inspector General and a pre-award survey conducted.

Scope

Our efforts consisted of a conference call with the Commons’ Executive Director and an email exchange with the Board Treasurer, which was used as a basis to complete the pre-award survey document. This document provides a road map to assess an organization’s accounting system and related financial management controls. As part of this process, we also reviewed the organization’s accounting and procurement manuals, audited financial statements and IRS Form

¹ In addition to the \$1,000,000 award noted above, the Commons also received a \$280,000 (PW-51014-12) medical journal digitization award with an effective date of 7/1/2012.

990 returns for the past two fiscal years, professional service agreement executed with the outsourced bookkeeping firm, chart of accounts, conflict of interest policy, forms used in conjunction with the payroll and disbursement processes, and other documentation used to validate key controls asserted in policy manuals. The survey was conducted during the month of August 2012.

Conclusion

As previously noted, the Open Knowledge Commons represents a small non-profit organization (one full time employee) that was only recently established. Now that the Commons has chosen to expand into the Federal grants arena, the organization is currently in the process of upgrading existing accounting policies and engaging the services of a bookkeeping firm². For this reason, our report takes a prospective approach and primarily evaluates the anticipated policies and procedures that will be fully implemented in the near term.

Once the NEH-OIG recommendations are implemented, we believe that the Common's upgraded accounting system, management controls, and formalized administrative policies/procedures should allow the organization to sufficiently manage and account for Federal grant funds moving forward. The identified areas, in which existing financial management controls require improvement, are as follows:

I. Federal Compliance Requirements

- Although the *Accounting Policies and Procedures* manual references key OMB Cost Circulars (A-110, A-122 and A-133), the document is generally silent concerning the 14 Federal compliance elements. Specifically, the manual needs to incorporate language addressing Federal compliance requirements related to payroll, procurement, subrecipient monitoring, cash management, travel, and Federal reporting. See following comments for additional detail.
- The Commons' salaries and wages reporting infrastructure does not meet Federal compliance standards as stipulated by OMB Circular A-122, Section 8m. Moving forward, the organization must adopt the use of level-of-effort timesheet reporting for all staff working on Federal grants (see item #2 below). This matter needs to be addressed immediately since the organization just hired a full-time Director of Content, effective September 1, 2012, who will work almost exclusively on the NEH award.
- The Commons' purchasing policy does not fully meet Federal compliance standards as defined by OMB Circular A-110. Although the current policy requires competitive bidding for purchases in excess of \$5,000 and references a conflict of interest policy, the existing procedures must be expanded to be fully compliant. Specifically, the organization must incorporate 1) EPLS searches; 2) required contract clauses for purchases in excess of the small purchase threshold; and 3) sufficient documentation to properly support procurement decisions to include sole source arrangements.

² The Commons recently engaged an accounting services firm that will maintain the organization's books using QuickBooks accounting software. After reviewing the firm's website [REDACTED] we noted that there are multiple CPA's on staff and several employees have experience with non-profits and Federal awards. Accordingly, this professional service firm should be in a position to provide ongoing technical assistance when accounting/finance issues arise.

- Per review of the two aforementioned NEH grant budgets and proposals, the Commons intends to rely upon subrecipients to complete the bulk of these projects. The Financial Management Standards articulated in OMB Circular A-110 apply to both the Commons and any subrecipients. Accordingly, the Commons is ultimately responsible for ensuring subrecipients successfully implement the core components of these standards to include an accounting system, source documentation retention procedures, internal controls/segregation of duties, budget controls, and Federal cash management procedures. To ensure compliance with this key subrecipient monitoring function, written policies and procedures that encompass the items discussed below (item #4) must be developed.

The Executive Director advised the NEH-OIG that the Commons will be hosting a roundtable conference for the subrecipients shortly. In anticipation of this meeting and based upon the pre-award survey results, this individual plans to develop standardized sub-award agreements, financial reporting templates with standardized submission deadlines, and monitoring procedures prior to distributing any funds to these organizations.

- Presently, the organization lacks a comprehensive Federal cash management compliance policy. When Federal funds are advanced, recipients must follow procedures to minimize the time elapsing between the receipt of Federal funds and the related disbursements. These rules also apply to subrecipients. Due to the organization's small size and limited scope of operations, it is likely that cash advances will be requested to administer the NEH grants, therefore procedures must be upgraded to ensure compliance with the cash management rules.
- The acceptance of Federal grant funds imposes additional travel rules on a recipient organization. The existing accounting manual devotes a brief section to business travel; however, this policy does not discuss many of the unique Federal travel requirements. Specifically, there is no discussion of the Fly America Act, GSA approved per-diem rates, use of coach class plane tickets, prior written approval for foreign travel required from NEH (if not already pre-approved in grant award), etc. Accordingly, the existing travel policy needs to be updated.
- The Commons needs to develop a document retention policy that conforms with baseline Federal requirements as defined by OMB Circular A-110 (see item #7 below).
- Finally, the Commons should develop procedures to ensure that prior written approval is obtained from NEH regarding equipment purchases made with grant funds. Although the award budget lacks a specific line item for equipment purchases, there's a reasonable chance that they may be necessary based upon the nature of the work to be performed.

II. Internal Controls

- For such a small organization, the documented procedures segregate accounting duties nicely. However, to obtain this level of segregation, the grantee relies on the Board Treasurer heavily to perform many day-to-day management functions. For example, the Treasurer wears the Chief Financial Officer hat in multiple cases to include the review of unopened bank statements and bank reconciliations, reviews the Executive Director's monthly credit card activity, acts as a the primary check signor, etc.

There is nothing inherently improper with this approach; yet there is risk. Specifically, if the Treasurer lacks the necessary technical skills and/or neglects to perform these duties in a timely fashion, the overall internal control structure begins to break down. Please be advised that this individual is not compensated and acts in a voluntary capacity. It is imperative that NEH management monitor this key internal control function and ensure it continues to function as intended, especially in light of the grantee's disclosure to the NEH-OIG that the current Treasurer may resign his post due to a pending job change.

- Currently, the Commons utilizes a fairly simplistic chart of accounts. However, with the acceptance of Federal grant funds, anticipated organizational growth, and the recent engagement of an outside accounting services firm, we believe this represents an ideal opportunity for management to review the present account structure. The adoption of a multi-segment chart of accounts will allow the Commons to easily absorb new departments and/or grants (with multiple funders) as the organization grows since it provides for one common set of natural accounts that can then be linked to unique departments, projects, and even funding sources within a project (ie. "class" codes). As an added benefit, organizing the accounting records in this fashion will permit management to utilize the full capability of the accounting software and generate internal financial statements with just a few keystrokes³. Furthermore, the organization must establish unique general ledger accounts to capture and segregate unallowable costs that cannot be charged to the Federal grants.

The NEH-OIG understands that the Commons is actively working with the outsourced bookkeeping firm on this matter and expects to upgrade the chart of accounts structure shortly.

III. Other Comments

- As discussed in the grant proposal, the Commons intends to transfer the NEH award to another organization (DPLA) mid-stream. This organization is just now obtaining IRS non-profit status and hiring an Executive Director. Since there's a good chance that this organization may not even be located in the same geographic region as the Commons and an entirely different administrative/accounting staff will be involved, the results of this survey will not be transferable. We suggest NEH management address this issue in the final grant award and consider the need for another pre-award survey prior to approving the transfer of funds between these two organizations.

Open Knowledge Commons management has also been advised of several core compliance requirements that directly impact the NEH awards and, therefore need to be monitored on an ongoing basis to ensure proper implementation.

1. The organization's accounting system must provide accurate, current, and complete disclosure of all financial transactions related to each federally-sponsored project. Unallowable expenditures should be separately tracked in the general ledger and excluded from charges to Federal awards. The organization must also ensure a system is in place to capture and track cost sharing data, if applicable. Cash contributions to the project from third parties must be accounted for in the general ledger with other award funds. Third party in-kind contributions (non-cash) are not required to be recorded in

³ By incorporating QuickBooks "class" codes in the chart of accounts, the Commons will be able to produce both organization-wide and detailed financial statements drilling all the way down to the individual department, project, and/or funding source level.

the general ledger, but must be under accounting control, possibly through the use of a memorandum ledger.

2. Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, must 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, except when a substitute system has been approved in writing by the cognizant agency.

Reports reflecting the distribution of activity of each employee must be maintained for all staff members 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.

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.

3. The Commons should establish written procurement procedures that provide for, at a minimum, the following procedural requirements:
 - a. The organization must ensure that all parties with whom they contract for goods or services are not debarred or suspended from doing business with the Federal government (see Excluded Parties List System) when (1) the amount of the contract is \$25,000 or more; or (2) the contract requires NEH consent; or (3) the contract is for federally-required audit services. A term or condition must be included in the contract that requires the contractor's compliance with Subpart C of 2 CFR Parts 180 and 3369.
 - b. Some form of price or cost analysis should be made in connection with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, market prices, and similar indicia, together with discounts. Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability, and allowability.
 - c. Procurement records and files for purchases in excess of the simplified acquisition threshold (currently \$100,000) shall include the basis for contractor selection, justification for lack of competition when competitive bids or offers are not obtained, and the basis for award cost or price.
 - d. The type of procurement instrument used, e.g., fixed price contracts, cost reimbursable contracts, incentive contracts, purchase orders, will be determined by the organization, but must be appropriate for the particular procurement and for promoting the best interests of the program involved. The "cost-plus-a-percentage-of-cost" or "percentage of construction cost" methods shall not be used.

- e. Contracts in excess of the simplified acquisition threshold (currently \$100,000) must provide for:
 1. Administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and such remedial actions as may be appropriate.
 2. Termination for cause and for convenience by the Commons, including the manner by which it will be effected and the basis for settlement. In addition, these contracts shall also contain a description of the conditions under which the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.
 3. Access by the Commons, the NEH, the Comptroller General of the United States, or any other duly authorized representatives to any books, documents, papers, and records of the contractor which are directly pertinent to that specific contract for the purpose of making audit, examination, excerpts, and transcriptions.
4. As discussed in the OMB Circular A-133 Compliance Supplement, subrecipient monitoring policies/procedures should address the following:
 - a. The grantee must provide to the subrecipient identifying information on the Federal award, such as the award name and number, NEH's name, and the relevant CFDA number (found at the bottom of the "Official Notice of Action").
 - b. The grantee must advise the subrecipient of the requirements of the NEH award, such as the applicable Federal laws and regulations, as well as the terms and conditions of the NEH grant agreement.
 - c. The grantee must collect the certifications that flow down to subrecipients, as outlined in the application guidelines for the particular NEH grant program.
 - d. The grantee must maintain an organizational prior approval system to manage the subrecipient's activities.
 - e. The grantee shall review financial and performance reports submitted by the subrecipient.
 - f. The grantee shall conduct site visits to review financial and programmatic records and observe operations.
 - g. The grantee shall ensure that the scope of the project, as approved by NEH, is not changed without prior approval from NEH.
 - h. In addition to the grantee's own audit, it must ensure that the subrecipient has a single audit, if one is required by the standards outlined in OMB Circular A-133 (see #6 below). The subrecipient must be required to provide both the grantee, auditors, and the funding Agency access to its records and financial statements as necessary.

- i. The grantee is responsible for issuing management decisions on subrecipient audit findings; and must ensure that the subrecipient takes timely and appropriate corrective action in response to the audit.
 - j. The grantee must monitor the activities of and maintain contact with the subrecipient as necessary to ensure compliance with the requirements mentioned above, and to ensure achievement of performance goals.
5. Arrangements with consultants must be documented in writing. The written consultant agreement should include (at a minimum):
- a. A clear description of all services to be rendered and/or products (written reports, etc.);
 - b. Fees to be paid;
 - c. Method of payment (submission of invoices, payment schedule, etc.);
 - d. Allowable expenses for reimbursement;
 - e. An explanation of who will provide materials, equipment, and office space;
 - f. A statement that the consultant pays applicable state and Federal income taxes;
 - g. An acknowledgement by the consultant that he/she is not entitled to any of the benefits provided to employees of the organization;
 - h. A description of the term of the agreement, (one week, one season, or until the project is completed); and
 - i. A description of the circumstances under which the organization or the consultant can terminate the agreement.
6. As a new recipient of a Federal grants, the Commons was notified that OMB Circular A-133 “Audits of States, Local Governments, and Non-Profit Organizations” requires non-Federal entities that expend \$500,000 or more in a fiscal year in Federal awards to undergo a single or program-specific audit. We further advised management that the two NEH awards (\$1,280,000) exceed the single audit threshold therefore an OMB Circular A-133 audit will likely be required for the current fiscal year that ends June 30, 2013.
7. Financial records, supporting documentation, statistical records, and all other records pertinent to the NEH award must be retained by the Commons for three years from the date of submission of the final *Federal Financial Report*.

Management Representations

We have received written assurance from [REDACTED] (Executive Director and President) and [REDACTED] (Board Treasurer) that the Commons will:

1. Maintain supporting documentation in accordance with NEH and OMB regulations;

2. Comply with all of the specific terms and conditions of the NEH award;
3. Comply with the Uniform Administrative Requirements of OMB Circular A-110;
4. Comply with the Cost Principles for Nonprofit Organizations (OMB Circular A-122);
5. Comply with NEH General Terms and Conditions for Awards to Organizations; and
6. Comply with the audit requirements of OMB Circular A-133.

Please note that the Office of Inspector General may perform an interim review to assess the organization's a) compliance with the terms and conditions of the NEH award and b) progress made addressing the items discussed in the *Conclusion* section of this memorandum.