



NATIONAL ENDOWMENT FOR THE

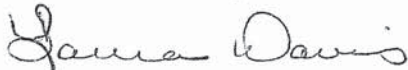
Humanities

OFFICE OF INSPECTOR GENERAL

MEMORANDUM

Date: September 25, 2013

To: Carole Watson, Acting Chairman
Jeff Thomas, Assistant Chairman for Planning and Operations
Adam Wolfson, Assistant Chairman for Programs
Brett Bobley, Director ~ Office of Digital Humanities
Robert Straughter, Director ~ Office of Grant Management

From: Laura Davis, Inspector General 

Subject: Pre-Award Survey Memorandum Report: OIG-13-02 (TS)
Digital Public Library of America
Boston, MA

We have completed our pre-award survey of the Digital Public Library of America (the "Library"). The purpose of our survey was to determine the adequacy of the organization's accounting system, management controls, and the related policies and procedures designed to administer the NEH grant funds.

Last year, NEH awarded Digital Humanities grant HC-50017-12 (\$1,000,000) to the Open Knowledge Commons¹. As anticipated by the original grant proposal, this organization has requested that all unspent award funds be transferred to the newly created Digital Public Library of America. Prior to formally approving the grant transfer, the Office of Grant Management requested that our office perform a pre-award survey of this brand new non-profit organization.

The grant award supports 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 Library will partner with subrecipients located in select states to build interconnected service and content hubs as part of this Digital Hubs Pilot Program.

Scope

Library management initially completed the pre-award survey checklist². The NEH-OIG then obtained supporting documentation and performed other procedures to verify management's responses. As part of this process, we reviewed the organization's accounting and procurement manual, sample chart of accounts, professional service agreements executed with the outsourced bookkeeping and payroll firms, and other documentation needed to validate key controls asserted in the Library's policy manual. Our efforts also included multiple email exchanges with the Library's Executive Director and a conference call with Library staff, the part-time Fiscal

¹ The NEH-OIG previously performed a pre-award survey of the Open Knowledge Commons. This report [OIG-12-03 (TS)] included multiple recommendations to improve the non-profit's internal controls and Federal compliance oversight.

² This document incorporates 47 questions that are used to assess an organization's accounting system and related financial management controls.

Manager, and the third party bookkeeping firm (██████████ - Fiscal Agent). The survey was conducted during the month of July 2013.

Conclusion

As previously noted, the Digital Public Library of America represents a small non-profit organization that launched earlier this year. The Library continues to finalize policies and procedures³ and will shortly commit to managing a material Federal grant. 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 implemented⁴, we believe that the Library's accounting system, management controls, and formalized administrative policies/procedures should allow the organization to sufficiently manage and account for Federal grant funds. The identified areas, in which existing financial management controls require improvement, are as follows:

I. Federal Compliance Requirements

- Although the *Procurement, Travel, Fiscal and Accounting Policies and Procedures Manual* references key OMB 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 subrecipient monitoring, cash management, procurement, payroll, travel, and Federal reporting. See following comments for additional detail.
- In a similar vein, the *Procurement, Travel, Fiscal and Accounting Policies and Procedures Manual* fails to address the organizational prior approval system requirements. In particular, both the *Specific Terms and Conditions* applicable to grant HC-50017-12 and the *NEH General Terms and Conditions for Awards* (GTAC) hold the Library responsible for the administration and supervision of projects and require the entity to maintain an “organizational prior approval system” for grant administration (see Item #5 below).
- Per review of the aforementioned NEH grant budget and proposal, the Library intends to rely upon subrecipients to complete the bulk of the project. The Financial Management Standards articulated in OMB Circular A-110 apply to both the Library and any subrecipients. Accordingly, the Library is ultimately responsible for ensuring subrecipients successfully implement the core components of these standards to include an acceptable financial reporting 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 requirement, written policies and procedures that encompass the items discussed below (Item #4) must be developed.

³ The Library recently engaged an accounting services firm that will maintain the organization's books using QuickBooks accounting software. After reviewing the firm's website (██████████), we noted that there are multiple CPAs 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. Additionally, this firm was previously used by the Open Knowledge Commons therefore the staff are familiar with the NEH award.

⁴ We are pleased to report that DPLA management has already started to address the OIG recommendations. Actions taken include revising certain policies/procedures and making the decision to move to the accrual basis of accounting.

- Presently, the organization lacks a comprehensive Federal cash management 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 grant; therefore procedures must be upgraded to ensure compliance with the cash management rules.
- The Library's purchasing policy does not fully meet Federal standards as defined by OMB Circular A-110. Although the current policy requires competitive bidding for purchases in excess of \$5,000, the existing procedures must be expanded to fully comply. Specifically, the organization must incorporate 1) EPLS searches; 2) required contract clauses for purchases in excess of the simplified acquisition threshold; 3) retention of sufficient documentation to support procurement decisions to include sole source arrangements; and 4) a conflict of interest policy (see Item #3 below).
- The Library needs to develop a document retention policy that conforms to baseline Federal requirements as defined by OMB Circular A-110 (see Item #8 below).

II. Internal Controls

- For such a small organization, management designed a control structure that does a nice job segregating accounting duties. The *Procurement, Travel, Fiscal and Accounting Policies and Procedures Manual* includes a "Division of Duties" section that defines individual job responsibilities. However, this section inadvertently omits the Fiscal Agent's [REDACTED] role. Management should update the manual accordingly.
- The Library's *Procurement, Travel, Fiscal and Accounting Policies and Procedures Manual* properly states that reconciliations are essential for an effective internal control environment and further mandates that reconciliations be performed at least every two months. We recommend that the organization implement best practices and enhance the current policy to require monthly reconciliations.

III. Other Comments

- The Library plans to use the *Class Code* function in QuickBooks to identify NEH-related grant activity. Then, depending upon the level of detail required, [REDACTED] staff stated that *Customer ID* and *Job ID* codes could be established to track the revenues and expenses associated with each individual NEH grant. We concur that this approach should allow the organization to meet current Federal reporting requirements.

Regardless of the structure ultimately used, the accounting system needs to be designed to accommodate future organizational growth. We advised management to consider what the Library will look like in five years --- will the organization manage multiple Federal and private grants, track cost-share, pursue a formal indirect cost rate, open offices in multiple locations, etc. Bottom line, the existing chart of accounts structure must be flexible enough to accommodate future expansion.

We further advised that natural accounts should be created to capture/track expenses that are specifically unallowable per the NEH grant agreement and the OMB circulars.

Digital Public Library of America 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 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 Library 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 \$150,000) 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 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 Library, 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 Library, 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 #7 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. Article 2 of the GTAC discusses the “organizational prior approval system” and stipulates that recipients are required to have written procedures in place for reviewing and approving in advance, proposed administrative changes. The GTAC further states that, recipients are free to design a prior approval system that suits their particular needs and circumstances, however, an “acceptable” system must at a minimum include the following:
- a. the procedure for review of proposed changes must be in writing;
 - b. proposed changes must be reviewed by an official at the recipient organization who is at a higher level of authority than the project director; and
 - c. whenever changes are approved, the recipient has to retain documentation of the approval for three years following the submission of the final financial report.
6. 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.
7. As a new recipient of a Federal grants, the Library 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.
8. Financial records, supporting documentation, statistical records, and all other records pertinent to the NEH award must be retained by the Library 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), [REDACTED] (Board Treasurer), and [REDACTED] (Board President) that the Library 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.