



FEDERAL ELECTION COMMISSION

WASHINGTON, D.C. 20463

Office of Inspector General

System Review Report

September 30, 2013

Laura Davis, Inspector General
National Endowment for the Humanities
1100 Pennsylvania Avenue, N.W., Room 419
Washington, DC 20506

Dear Ms. Davis:

We have reviewed the system of quality control for the audit organization of the National Endowment for the Humanities (NEH) Office of Inspector General (OIG) in effect for the year ended March 31, 2013. A system of quality control encompasses the NEH OIG's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of conforming with *Government Auditing Standards*. The elements of quality control are described in *Government Auditing Standards*. The NEH OIG is responsible for designing a system of quality control and complying with it to provide NEH OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the NEH OIG's compliance therewith based on our review.

Our review was conducted in accordance with *Government Auditing Standards* and guidelines established by the Council of the Inspectors General on Integrity and Efficiency (CIGIE). During our review, we interviewed NEH OIG personnel and obtained an understanding of the nature of the NEH OIG audit organization, and the design of the NEH OIG's system of quality control sufficient to assess the risks implicit in its audit function. Based on our assessments, we selected one engagement and administrative files to test for conformity with professional standards and compliance with the NEH OIG's system of quality control. The engagements selected represented a reasonable cross-section of the NEH OIG's audit organization, with emphasis on higher-risk engagements. Prior to concluding the review, we reassessed the adequacy of the scope of the peer review procedures and met with NEH OIG management to discuss the results of our review. We believe that the procedures we performed provide a reasonable basis for our opinion.

In performing our review, we obtained an understanding of the system of quality control for the NEH OIG's audit organization. In addition, we tested compliance with the NEH OIG's quality control policies and procedures to the extent we considered appropriate.

These tests covered the application of the NEH OIG's policies and procedures on the selected engagement. Our review was based on selected tests; therefore, it would not

necessarily detect all weaknesses in the system of quality control or all instances of noncompliance with it.

There are inherent limitations in the effectiveness of any system of quality control, and therefore noncompliance with the system of quality control may occur and not be detected. Projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or because the degree of compliance with the policies or procedures may deteriorate. Enclosure I to this report identifies the office of the NEH OIG that we visited and the engagement that we reviewed.

We noted the following deficiency during our review.

1. Deficiency – We identified that the NEH Inspector General (IG) reports administratively to the Chairman of the National Endowment for the Humanities. However, federal law enacted in 2010 requires the IG to report to the National Council of the Humanities (“The National Council”). Specifically, the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Public Law 111-203, H.R. 4173; commonly referred to as Dodd-Frank) was signed into federal law by President Barack Obama on July 21, 2010. Dodd-Frank amended the Inspector General Act (the IG Act) to enhance the independence of IGs in Designated Federal Entities (DFEs) with boards or commissions, to include NEH.

NEH's chairman is advised by the National Council, a board of twenty-six (26) distinguished private citizens appointed by the president and confirmed by the Senate. Dodd-Frank changed the head of the NEH for purposes of IG appointment, general supervision, and reporting under the IG Act to no longer be subject to the judgment of a single individual, the chairman, and instead vested the National Council with these authorities. In addition, Dodd-Frank requires the written concurrence of a two-thirds majority of the National Council to remove the IG.

After Dodd-Frank was enacted, the NEH Office of the General Counsel (OGC) drew up a resolution (“The IG Resolution”) with the purpose of addressing NEH implementation of the new IG reporting provisions of Dodd-Frank. Because the 26 members of the National Council are not involved in managing and/or overseeing NEH’s daily operations and only meet several times a year, NEH did not believe it was practical for the IG to report directly to the full National Council. As a result, the National Council passed the IG Resolution which designated the NEH Chairman to receive regular briefings from the NEH OIG on behalf of the National Council, (since the NEH Chairman is also the Chairperson of the full National Council). According to the IG Resolution, the National Council approved the following:

1. “...that the National Council hereby designates the NEH Chairperson as the representative and point-of-contact between the National Council and the NEH Office of Inspector General;”
2. “... the NEH Inspector General will keep the NEH Chairperson regularly informed of the NEH Office of Inspector General's plans and activities, except

when it would create a conflict of interest or otherwise impact the independence of the NEH Inspector General; and”

3. “... the NEH Inspector General will have, in his or her sole discretion, the opportunity to directly address the full National Council on the activities of the NEH Office of Inspector General at least once a year, or more often, as determined by the NEH Inspector General.”

We note that items 1 and 2 above contained in the resolution are in direct conflict with the IG Act, as amended by Dodd-Frank, which states that the NEH IG shall report to the National Council on the Humanities, and, importantly, shall not report to any other officer or employee of the NEH. We also identified that the two-thirds majority vote requirement to remove the IG was not explicitly included in NEH’s IG Resolution. According to *Government Auditing Standards*, this creates a potential organizational impairment to the NEH IG’s independence. An organizational impairment is a structural threat that an audit organization’s placement within a government entity, in combination with the structure of the audited entity being audited, will impact the audit organization’s ability to perform work and report results objectively.

We conclude that based on our review, we did not find any evidence to suggest the NEH OIG’s independence was in fact impaired nor did we find evidence that audits conducted would have less than reasonable assurance of performing and/or reporting in conformity with applicable professional standards. However, the nature and relative importance of this finding to Government Auditing Standards and related legislation warrants a deficiency.

Recommendation – The NEH should adhere to the requirements specified in the IG Act, as amended by Dodd-Frank, which stipulates that the NEH IG shall report only to the National Council on the Humanities.

Views of Responsible Official

The NEH IG does not perceive the “IG Resolution”, as approved by the National Council on the Humanities, as an attempt to create an organizational impairment to the NEH IG’s independence. The “IG Resolution” was specifically drafted to address periodic briefings by the IG and does not preclude the IG from addressing the full National Council at any time. As noted above, the National Council represents an advisory body to the Chairman of the NEH. According to the legislation that established the National Council on the Humanities, the Chairman of the NEH serves as the Chairperson of the National Council. The legislation further provides that the Council shall (1) advise the Chairperson with respect to policies, programs, and procedures for carrying out the Chairperson’s functions, and (2) shall review applications for financial support and make recommendations thereon to the Chairperson. The “IG Resolution” was primarily designed to conform to the organizational structure, as established by enabling legislation, (concerning both the National Endowment for the Humanities and the National Council on the Humanities).

Moving forward, the NEH IG will develop procedures that will effect meaningful periodic reporting to each member of the National Council, in addition to distribution of the IG's Semiannual Report to Congress.

Enclosure II to this report includes the response by the NEH OIG to the above deficiency. In our opinion, except for the deficiency described above, the system of quality control for the audit organization of the National Endowment for the Humanities OIG in effect for the year ended March 31, 2013, has been suitably designed and complied with to provide NEH OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Federal audit organizations can receive a rating of *pass*, *pass with deficiencies*, or *fail*. NEH OIG has received a peer review rating of *pass with a deficiency*.

As is customary, we have also issued a letter of comment dated September 30, 2013 that sets forth findings that were not considered to be of sufficient significance to affect our opinion expressed in this report.

In addition to reviewing its system of quality control to ensure adherence with *Government Auditing Standards*, we applied certain limited procedures in accordance with guidance established by the CIGIE related to NEH OIG's monitoring of engagements performed by Independent Public Accountants (IPA) under contract where the IPA served as the principal auditor. It should be noted that monitoring of engagements performed by IPAs is not an audit and therefore is not subject to the requirements of *Government Auditing Standards*. The purpose of our limited procedures was to determine whether NEH OIG had controls to ensure IPAs performed contracted work in accordance with professional standards. However, our objective was not to express an opinion and accordingly, we do not express an opinion, on NEH OIG's monitoring of work performed by IPAs.

We made a comment related to NEH OIG's monitoring of engagements performed by IPAs that are included in the above referenced letter dated September 30, 2013.



Lynne McFarland,
Inspector General
Federal Election Commission

Enclosures

SCOPE AND METHODOLOGY (Enclosure I)

Scope and Methodology

We tested compliance with the National Endowment for the Humanities (NEH) OIG audit organization's system of quality control to the extent we considered appropriate. These tests included a review of 1 of 2 limited scope audit reports issued during the period April 1, 2012, through March 31, 2013, and semiannual reporting periods from April 1, 2012 to March 31, 2013.

In addition, we reviewed the NEH OIG's monitoring of engagements performed by IPAs where the IPA served as the principal auditor during the period April 1, 2012 through March 31, 2013. During the period, NEH OIG contracted for the audit of its agency's Fiscal Year 2012 financial statements that were performed in accordance with *Government Auditing Standards*.

We visited the headquarters of the National Endowment for the Humanities OIG in Washington DC.

Reviewed Engagements Performed by NEH OIG

<u>Report No.</u>	<u>Report Date</u>	<u>Report Title</u>
OIG-12-02 (EA)	07/16/2012	Limited Audit Report – Southeastern Library Network (SOLINET) and Lyrasis

Reviewed Monitoring Files of NEH OIG for Contracted Engagements

<u>Report No.</u>	<u>Report Date</u>	<u>Report Title</u>
N/A (contract audit)	11/15/2012	Audit Report on National Endowment for the Humanities Financial Statements for Fiscal Year 2012



NATIONAL ENDOWMENT FOR THE
Humanities

OFFICE OF INSPECTOR GENERAL

September 30, 2013

Ms. Lynne McFarland
Inspector General
Federal Election Commission
999 E Street, NW
Washington, DC 20463

Dear Ms. McFarland:

I have reviewed the draft report on the system of quality control for the audit organization of the National Endowment for the Humanities (NEH) Office of Inspector General (OIG) in effect for the year ended March 31, 2013. Your review identified a deficiency resulting in a potential organizational impairment affecting the NEH IG's independence. In your opinion, except for the deficiency described in the draft report, the system of quality control for the audit organization of the NEH OIG in effect for the year ended March 31, 2013, has been suitably designed and complied with to provide NEH OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects, thereby receiving a peer review rating of *pass with a deficiency*. Herein documents my response to the deficiency noted during your review.

It was noted during your review that provisions of the "IG Resolution", as approved by the National Council on the Humanities (National Council), are in direct conflict with the IG Act, as amended by the *Dodd-Frank Wall Street and Consumer Protection Act*. The identified provisions address regular reporting by the NEH Inspector General (IG) to a designee of the National Council.

I do not perceive the "IG Resolution", as approved by the National Council, as an attempt to create an organizational impairment to the NEH IG's independence. The "IG Resolution" was specifically drafted to address periodic briefings by the IG and does not preclude the IG from addressing the full National Council at any time. The National Council represents an advisory body to the Chairman of the NEH. According to the legislation that established the National Council, the Chairman of the NEH serves as the Chairperson of the National Council. The legislation further provides that the Council shall (1) advise the Chairperson with respect to policies, programs, and procedures for carrying out the Chairperson's functions, and (2) shall review applications for financial support and make recommendations thereon to the Chairperson. The "IG Resolution" was primarily designed to conform to the organizational structure, as established by enabling legislation (concerning both the NEH and the National Council).

Moving forward, the NEH IG will develop procedures that will effect meaningful periodic reporting to each member of the National Council, in addition to distribution of the IG's Semiannual Report to Congress.

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Thank you for the opportunity to respond to the noted deficiency. I wish to express my appreciation to you and your staff for the professionalism exhibited during the performance of this peer review.

Respectfully submitted,

A handwritten signature in cursive script that reads "Laura Davis".

Laura Davis
Inspector General