



NATIONAL ENDOWMENT FOR THE  
**Humanities**

OFFICE OF INSPECTOR GENERAL

February 11, 2019

**RETURN RECEIPT REQUESTED**

Board of Trustees  
Humanities Washington  
130 Nickerson Street, Suite 304  
Seattle, WA 98109  
Attn: [REDACTED] Chair

OIG Report Number: OIG-19-02 (DR)

Dear Board Members:

The National Endowment for the Humanities (NEH) Office of Inspector General (OIG) has completed a desk review of the single audit report prepared by Bader Martin, PS (the "IPA"), which includes Federal assistance programs administered by Humanities Washington (the "Council") during the organization's fiscal year (FY) ended December 31, 2017. The independent auditors previously furnished a copy of their audit report dated May 17, 2018, to the Council. The Federal Audit Clearinghouse (FAC) accepted the single audit reporting package on June 12, 2018. The IPA issued unmodified opinions<sup>1</sup> regarding the financial statements and compliance with Federal requirements. Furthermore, the IPA issued no written findings in conjunction with the single audit.

Our review was limited to an examination of the single audit reporting package, email exchanges with the Executive Director and the Associate Director of the Council, a limited review of select IPA workpapers, and review of applicable NEH grant files and accounting records. We did not perform a comprehensive examination of the underlying audit documentation to evaluate the adequacy of the audit work performed; rather, we used the *Guide For Desk Reviews of Single Audit Reports (2016 Edition)*, as issued by the Council of Inspectors General on Integrity and Efficiency (CIGIE), to determine whether the audit report meets the core reporting requirements stipulated by Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (2 CFR Part 200)*. Based on our review, we can assign a rating to the IPA's reporting package of either **Pass**, **Pass with Deficiencies**, or **Fail**. Audit reports receiving a **Fail** rating require corrective action.

We assigned a rating of **Fail** to the FY 2017 reporting package due to key deficiencies that affect the reliability of the report. Accordingly, the audit report and the related data collection form

---

<sup>1</sup> **Unmodified opinion.** The opinion expressed by the IPA upon concluding that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. An unmodified opinion represents the highest level of assurance the IPA can provide that the Council's financial statements as a whole are free from material misstatement, whether due to fraud or error.

(Form SF-SAC) must be revised and resubmitted to the FAC.<sup>2</sup> We noted the following deficiencies during our desk review:

**I. Material Departure from GAAP: Presentation of Federal Grant Revenue in the Audited Financial Statements**

In accordance with Subpart F of 2 CFR Part 200, the IPA shall determine whether the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles (GAAP).<sup>3</sup>

On May 17, 2018, the IPA issued an unmodified audit opinion, assuring that the Council's financial statements for the fiscal year ended December 31, 2017 are presented, in all material respects, in accordance with GAAP. However, we have determined that the grant revenue associated with the Council's NEH awards is presented in the audited *Statement of Activities* on a cash basis rather than an accrual basis, as required by GAAP.<sup>4</sup> This departure from GAAP results in a material overstatement of revenue associated with the NEH program.

Throughout the state humanities council community, two predominant "accrual-based" methodologies are utilized to recognize NEH grant revenue.

1. The more common methodology is to recognize revenue as the NEH Office of Grant Management issues the individual "Notice of Action" funding amendments throughout the life of the general operating support grant, (i.e., "contribution" approach). When using this methodology, NEH grant revenue would be recorded as a temporarily restricted net asset, based upon the notifications of grant award funding. As allowable expenditures are incurred, the assets are released from program restrictions and the corresponding funds would be reclassified from temporarily restricted net assets to unrestricted net assets.
2. The second methodology is to recognize revenue as valid grant expenses are incurred, (i.e., "exchange transaction" approach). When using this methodology, as allowable expenditures are incurred, NEH grant revenue would be recorded as unrestricted and a related receivable would be created.

The Council discloses in the notes to the audited FY 2017 financial statements that grant revenue is recognized when amounts allowed for reimbursement have been expended. This policy is consistent with the "exchange transaction" approach for revenue recognition. However, revenue associated with Federal grant activity is presented in the audited *Statement of Activity* based on cash draw-downs.<sup>5</sup>

---

<sup>2</sup> The Form SF-SAC (i.e., Data Collection Form) is submitted to the Federal Audit Clearinghouse with the single audit reporting package. This form provides information about the Council and its Federal programs, and summarizes the results of the audit. The information in this form must agree with information presented in the single audit reporting package.

<sup>3</sup> 2 CFR section 200.514(b)

<sup>4</sup> 'Cash basis' refers to an accounting method that recognizes revenue when cash is received and expenses are recorded when cash is paid out. Cash basis accounting does not conform with the provisions of GAAP. GAAP prescribes accrual-based accounting, which requires revenue to be recognized when earned and expenses are recorded when liabilities are incurred, regardless of when cash is received or paid out.

<sup>5</sup> According to the Associate Director of the Council, NEH (and all Federal and state) funds are recognized when earned (i.e., when allowed costs are expended) versus upon award. However, all Federal amounts that appear in the *Statement of Activities* represent the total of all SF 270 draw-downs during the fiscal year.



We compared the revenue amount associated with the NEH program, as reflected in the audited *Statement of Activities* (based on cash draw-downs), to the earned revenue amount (calculated based on the Council's Federal financial reporting of "allowable" expenditures associated with the NEH program for the fiscal year ending December 31, 2017<sup>6</sup>), and determined that the variance exceeds the calculated "materiality" threshold.<sup>7</sup>

Since the variance between the cash basis approach and the accrual-based approach represents a material amount,<sup>8</sup> the:

- audit opinion needs to be modified to reflect an adverse opinion; or
- audit opinion needs to stipulate that the financial statements were prepared using a comprehensive basis of accounting (OCBOA) that does not materially conform to GAAP;<sup>9</sup> or
- grant revenue must be restated and presented on an accrual basis.

The IPA will also need to issue a written finding documenting the Council's weakness in internal control over financial reporting.

## II. The IPA's Conclusion Concerning Compliance with Federal Financial Reporting Requirements is Misleading

In addition to determining whether the Council's financial statements are presented fairly in all material respects in accordance with GAAP, Subpart F of 2 CFR Part 200<sup>10</sup> requires the IPA to determine whether the Council has complied with Federal statutes, regulations, and the terms and conditions of Federal awards that may have a direct and material effect on each of its major

---

<sup>6</sup> On January 24, 2018, the Council submitted an SF-425 - Federal Financial Report (FFR) to the NEH concerning grant award SO-226610-15. We determined that expenditure data certified in the FFR corresponds to data reflected in the audited financial statements and Schedule of Expenditures of Federal Awards (SEFA) for the Council's fiscal year ending December 31, 2017.

<sup>7</sup> We completed the *Financial Statement Materiality Worksheet* template (issued by PPC – a major third-party firm that supplies audit resources to the IPA community) and determined that a financial statement error in excess of \$21,000 represents a "material" amount.

<sup>8</sup>

NEH grant revenue (as reflected in the audited <i>Statement of Activities</i> )	\$795,000
Total NEH grant expenditures (based on the Council's Federal financial reporting)	<u>762,990</u>
Variance	<u>\$ 32,010</u>

<sup>9</sup> 2 CFR section 200.514(b) requires the IPA to determine whether the financial statements are presented fairly, in all material respects, in conformity with GAAP. Some non-profits may find that financial statements prepared on the cash basis or the modified cash basis of accounting are adequate for their governing boards and other users. AU section 623, *Special Reports*, describes the IPA's reporting requirements when the financials are prepared on a comprehensive basis of accounting other than GAAP (OCBOA). Since the accrual basis of accounting is required by GAAP, financial statements presented on an OCBOA basis can only be considered to be in conformity with GAAP if they do not differ materially from financial statements prepared on an accrual basis.

<sup>10</sup> 2 CFR section 200.514(d)

programs. Compliance testing must include tests of transactions and other auditing procedures necessary to support the IPA's opinion on compliance.

NEH *General Terms and Conditions for General Support Grants to State Humanities Councils* requires councils to submit a Federal Financial Report (FFR) within 90 days after the completion date of the annual reporting period for each general support grant. Councils use the FFR as a standardized format to report expenditures under Federal awards, as well as cash status, as of the end of the respective reporting period. The annual reporting period for NEH general support grants is November 1<sup>st</sup> through October 31<sup>st</sup>. 2 CFR Part 200 stipulates that the Council's financial management system, including records documenting compliance with Federal statutes, regulations, and the terms and conditions of the Federal award, must be sufficient to permit the preparation of required financial reports; and the tracing of funds to a level of expenditures adequate to establish that such funds have been used according to the terms and conditions of the Federal award.<sup>11</sup> By signing and submitting the FFR to the NEH, Council management certifies to the best of their knowledge and belief that the report is true, complete, and accurate, and the expenditures, disbursements and cash receipts are for the purposes and intent set forth in the award documents. Council management further attests to being aware that any false, fictitious, or fraudulent information may subject the Council to criminal, civil, or administrative penalties.<sup>12</sup>

As part of our desk review, we inquired about the IPA's testing related to the Council's Federal financial reporting. In response to our inquiry, the IPA provided a copy of workpapers that document their testing of the Council's compliance with Federal financial reporting requirements, which included the testing of an FFR related to NEH award SO-226610-15<sup>13</sup>. According to the IPA's workpapers, the following attributes were tested concerning the FFR and no deviations were noted:

- Preparation of the financial report in accordance with the required accounting basis;
- Subsequent resolution of any discrepancies noted in SF-425 reports concerning cash status, (when advance payment method is used);
- Reported data elements trace to supporting worksheets or other documentation that link the financial report to the accounting records, (when intervening computations are required between the accounting records and the financial report);
- Mathematical accuracy of the report and supporting worksheets; and
- Submission of the report to the government.

We reviewed the FFR that the IPA selected for testing, and we noted an error concerning the preparation of the report. Specifically, the FFR was prepared based on the Council's fiscal year versus the reporting period prescribed for the grant award. This anomaly was not acknowledged by the IPA. The "Cash Receipts" amount agrees with cumulative cash disbursements to the Council as of December 31, 2017 versus the October 31, 2017 "Reporting Period End Date" noted on the FFR. The Council reported cumulative "Cash Receipts" (Line "a" of the FFR) in the amount of \$2,412,780. However, according to NEH accounting records, total cumulative disbursements to the Council related to the grant award was \$2,267,780, as of October 31, 2017 – a discrepancy of \$145,000. This discrepancy was not identified by the IPA.

---

<sup>11</sup> 2 CFR section 200.302(a)

<sup>12</sup> Title 18 U.S. Code, Section 1001

<sup>13</sup> Annual SF-425 dated January 24, 2018



Moving forward, we expect Council management to immediately implement new controls and provide staff with the necessary training to ensure all future FFR submissions are prepared correctly. We also recommend that the IPA strengthen its audit procedures to determine whether the Federal financial reports submitted to the NEH are prepared in accordance with governing requirements.

As the Council's oversight agency, the NEH-OIG will not accept the FY 2017 single audit reporting package until the discrepancies discussed above are addressed and corrective action taken, to include resubmission of the reporting package to the FAC, (as revised to correct the deficiencies identified by this desk review). The Council should contact FAC support staff for assistance with the resubmission process since there are special procedures that must be followed.<sup>14</sup> Please notify the NEH-OIG when the revised FY 2017 reporting package has been submitted to the FAC.

The deficiencies noted during our desk review are troubling. Accordingly, we expect the IPA to strengthen their audit testing procedures to ensure that all elements of the Council's single audit reporting package comply with Federal audit requirements.

Please be advised that we are sending a copy of this letter to the Principal at Bader Martin PS and to the official at the other Federal agency with direct expenditures listed on the Schedule of Expenditures of Federal Awards to inform them of the results of our review.

If you have any questions concerning this letter or need accounting assistance, please contact Mr. Daniel M. Gelfand at (202) 606-8353 or via email at [dgelfand@neh.gov](mailto:dgelfand@neh.gov).

Sincerely,



Laura Davis  
Inspector General

**Distribution List:**

Auditor:

██████████, Principal  
Bader Martin PS  
1000 Second Avenue, 34<sup>th</sup> Floor  
Seattle, WA 98104

National Single Audit Coordinator:

National Endowment for the Arts – [watersm@arts.gov](mailto:watersm@arts.gov)

---

<sup>14</sup> FAC support staff can be contacted at 800-253-0696 or [govs.fac@census.gov](mailto:govs.fac@census.gov).