



NATIONAL ENDOWMENT FOR THE

Humanities

OFFICE OF INSPECTOR GENERAL

July 10, 2013

RETURN RECEIPT REQUESTED

Board of Directors
Connecticut Humanities
37 Broad Street
Middletown, CT 06457
Attn: [REDACTED] Board Chair

OIG Report Number: OIG-13-08 (DR)

Dear Board Members:

We have completed our desk review of the single audit report prepared by Legge, Monroe & Company, CPAs, which includes the Federal assistance programs administered by Connecticut Humanities (the "Council"), for the year ended June 30, 2012. The independent auditors (IPA) previously furnished a copy of their audit report to the Council and submitted the related reporting package to the Federal Audit Clearinghouse (FAC). The IPA issued an unqualified opinion (both financial statements and single audit) with no reportable current year findings.

Our review was limited to an examination of the IPA's audit report. We did not examine the underlying audit documentation to evaluate the adequacy of the audit work performed; rather, the single audit desk review guide (2010 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. Audit reports determined to be *technically deficient* or *unacceptable* require corrective action.

Due to identified deviations from generally accepted accounting principles (GAAP), involving Federal grant revenue and the presentation of financial data on the *Statement of Activities*, we deem the June 30, 2012 reporting package to be technically deficient.¹ Accordingly, the audit report and the Data Collection Form (Form SF-SAC) must be revised and resubmitted to the Federal Audit Clearinghouse.

Please note that the IPA should conduct this work and provide the revised/reissued single audit report at no additional cost to the Council.

¹ As defined by the CIGIE desk review guide, a "technically deficient" finding is warranted when the single audit reporting package contains "quality deficiencies that may affect the reliability of the audit report and, which must be corrected in the audit report under review."

Material Departure from GAAP: Federal Grant Revenues

In accordance with OMB Circular A-133 (*Audits of States, Local Governments and Non-Profit Organizations*), the auditor shall include an opinion on whether the financial statements are presented fairly in all material respects in conformity with GAAP.

In FY2012, the IPA issued an unqualified audit opinion stating that the financial statements materially complied with GAAP. The notes to the financial statements (*Note 1: Summary of Significant Financial Accounting Policies*) further emphasize that “the financial statements have been prepared using the accrual basis of accounting.” However, the revenues associated with the Council’s largest Federal grant were presented using the cash basis rather than the GAAP-approved accrual method.² Since the variance between these two approaches represents a material amount³, 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 GAAP⁴; or
- Federal grant revenues 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 controls over financial reporting.

Material Departure from GAAP: Statement of Activities Presentation

The audited *Statement of Activities* was prepared to mirror the fund accounting approach utilized by the Council. Unfortunately, this presentation does not comply with GAAP. Specifically, the promulgation body in charge of accounting standards for non-profit entities (Financial Accounting Standards Board -- FASB) states that 1) all expenses shall be reported as decreases in unrestricted net assets; and 2) net asset reclassifications shall be reported as separate items to reflect donor imposed restrictions that have been fulfilled by the Council or that expire with the passage of time (i.e. “Net Assets Released From Restriction” subheading within the Revenues section of the *Statement of Activities*)⁵.

Due to these identified deficiencies, this core financial statement must be revised to ensure compliance with FASB requirements.

² Accrual based accounting requires revenue to be booked when earned. Under the cash basis approach, an organization does not record revenue until the cash is received.

³ See Appendix A for a detailed analysis.

⁴ OMB Circular A-133 requires the IPA to issue an opinion on 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 financials prepared on an accrual basis. [Source: OMB Circular A-133 and *AICPA Not for Profit Entities Audit Guide*, Chapter 14, Section .13 & .14 (Basis of Accounting Other Than GAAP)].

⁵ As defined by FASB Accounting Standards Codification 958-225-45.

Other Matters:

The Desk Review identified several other matters that do not adversely impact the FY2012 single audit results. Nevertheless, we feel that these issues should be brought to the attention of Council management and the Board.

Major Program Selection Criteria

OMB Circular A-133, Sections .320 and .520, and the related Compliance Supplement provide guidance concerning the selection of “major programs”. Major programs represent the Federal awards subject to detailed single audit compliance testing by the IPA.

According to the *Schedule of Findings and Questioned Costs*, all three NEH grant programs (CFDA⁶ #'s 45.129, 45.164, and 45.169) were treated as a “cluster”⁷ and tested as a single major program. Neither NEH guidance nor the OMB Circular A-133 Compliance Supplement direct that these programs be treated as a cluster. In fact, they represent unique and distinct programs overseen by different divisions within NEH. Moving forward, the IPA should no longer treat these CFDA programs as a cluster for single audit purposes.

Missing Information on the Schedule of Findings and Questioned Costs

In accordance with OMB Circular A-133, Section .505, the *Schedule of Findings and Questioned Costs* (SFQC) must include certain required information. We determined that two of the required disclosures were missing. Specifically, the schedule 1) does not indicate whether the Council qualifies as a low-risk auditee; and 2) fails to document the major program threshold used to distinguish between Type A and Type B programs. This information must be incorporated into the audit report to ensure compliance with OMB Circular A-133 requirements.

Please note that the related Data Collection Form (DCF), which summarizes the results of the single audit and represents one of the OMB Circular A-133 reporting package documents⁸, appropriately captured this information. Accordingly, it appears that the SFQC omissions represent an administrative oversight on the part of the IPA. However, we noted that the past five audit reports failed to disclose this information thereby indicating a breakdown in the related control structure.

Timely Submission of Audit Report to the Federal Audit Clearinghouse

In accordance with OMB Circular A-133, Section .320, a single audit must be completed and successfully submitted to the Federal Audit Clearinghouse (FAC) within the earlier of thirty days after receipt of the signed audit report, or nine months after the auditee’s fiscal year-end. If a

⁶ CFDA – Catalog of Federal Domestic Assistance

⁷ A “cluster” represents a grouping of closely related programs that share common compliance requirements. The types of clusters of programs are research and development (R&D), student financial aid (SFA), and other clusters. “Other clusters” are as defined by the Office of Management and Budget (OMB) in the compliance supplement or as designated by a State for Federal awards the State provides to its subrecipients that meet the definition of a cluster of programs. A cluster of programs shall be considered as one program for determining major programs.

⁸ OMB Circular A-133 requires the submission of both the *Data Collection Form* and the entity’s audited financial statements. This information must be uploaded to the Federal Audit Clearinghouse (FAC) database in a timely fashion.

grantee does not comply with this standard in either of the previous two years, the organization is precluded from qualifying for “low-risk” status⁹.

According to the June 30, 2012 *Data Collection Form*, the Council was treated as a low-risk auditee by the IPA. However, both the FY2010 and FY2011 single audit packages were submitted late¹⁰. Therefore, the low-risk classification was made in error. Fortunately, the FY2012 major program selections allowed the IPA to effectively satisfy the fifty percent audit coverage requirement; therefore additional single audit testing will not be necessary.

In a similar fashion, there were delays with the FY2012 submission to the FAC (submitted more than thirty days after the report issuance date).

Moving forward, the single audit reporting package must be submitted within the required timeframe (both the Council and the IPA must electronically sign-off). Otherwise, the Council will never be in a position to qualify for low-risk status in future audits, which could potentially result in unnecessarily elevated audit fees.

FY2010 Federal Grant Revenue Reporting Error

Although this Desk Review focused on the FY2012 single audit report, we performed certain procedures that involved the review of prior year data. As part of this process, we discovered that the Federal grant revenue associated with NEH awards, as reported in the FY2010 financial statement footnotes (\$727,590), contradicted the related amount reflected in the *Statement of Activities* (\$356,918). After researching the matter, the IPA determined that an administrative oversight led to the discrepancy. Specifically, the FY2009 grants receivable amount (\$370,672) was misclassified as FY2010 revenue within Footnote 2 thereby causing the reporting variance.

Furthermore, we noted that the Council modified the revenue recognition methodology used with the NEH General Support grant during FY2010. Since the associated revenue represents a significant portion of the organization’s total revenues, the FY2010 financials should have included a *Change in Accounting Principle* disclosure documenting the rationale for the revised accounting approach along with the cumulative impact of the change.

Since the errors were limited to footnote disclosures and the total revenue associated with the specific NEH grant (SO-50182-07) was fully recognized prior to FY2012, the NEH-OIG will not require the restatement of the FY2010 financials. However, we fully expect the Council and IPA to implement new quality control procedures to ensure 1) all financial information reported in the footnotes properly reconciles to the core financial statements; and 2) the audited financial statements incorporate all required disclosures.

⁹ When an organization qualifies for low-risk status under OMB Circular A-133, the IPA is only required to test Federal programs that encompass at least 25 percent of the total Federal expenditures for the fiscal year. If an organization does not qualify for low-risk status, the IPA must test Federal programs that encompass at least 50 percent of the total Federal expenditures.

¹⁰ Although both single audit reporting packages were submitted to the FAC within nine months, more than thirty days passed between the audit issuance date and the FAC submission date. Specifically, the FY2010 audit report was dated December 10, 2010 but not submitted to the FAC until March 30, 2011 and the FY2011 audit report was dated December 20, 2011 but not submitted to the FAC until February 7, 2012.

Letter to the Board of Directors
July 10, 2013
Page 5


As the Council's oversight agency, NEH will not accept the FY2012 single audit report submission until the material GAAP departures and the SFQC disclosure omissions discussed above are addressed and restated financials prepared. Please contact the Federal Audit Clearinghouse support staff for assistance (800-253-0696 or govs.fac@census.gov) with the single audit resubmission process since special procedures must be followed.

Since these errors were missed by both the Council's management and the IPA, we expect the Council to strengthen internal controls associated with grant revenue recognition and financial statement preparation. Similarly, the IPA must enhance internal procedures to guard against the single audit deficiencies identified during this Desk Review. To document this process, we expect Council management to provide the OIG with a written corrective action plan regarding the noted deficiencies within 30 days of receipt of this letter.

Please note that we are sending this letter to the audit partner at Legge, Monroe & Company to inform him 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
Inspector General

Distribution List:

Auditor:

██████████, *Audit Partner*
Legge, Monroe & Company
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Middletown, CT 06457

Appendix A – NEH Grant Revenue Analysis (FY2012)

Federal grant activity at the Connecticut Humanities during FY2012 consisted of three types of NEH awards: State Operating (SO), American History and Cultural Organization Implementation (GI), and We The People (BC) grants. The Council elected to recognize revenue for the largest NEH program (SO awards) based upon cash receipts.

To determine if the grant revenue variance between cash and accrual basis accounting was "material" to the financial statements, the following spreadsheet was prepared. Based upon our completion of the *Financial Statement Materiality Worksheet* template (issued by PPC – a major third party firm that supplies audit resources to the IPA community), we determined that a financial statement error in excess of \$35,000 represents a "material" amount.

Two predominant accrual-based revenue recognition methodologies (used to recognize Federal grants) are utilized by the State Humanities Council community.

1. The most common approach recognizes revenue as NEH's Office of Grant Management issues the individual "Notices of Action" amendments throughout the life of the grant award (i.e. contribution approach).***
2. The other approach recognizes revenue as valid grant expenses are incurred (i.e. exchange transaction approach).

The OIG a) calculated grant revenue under both of these approaches; b) compared these amounts to the cash basis amount reported in the audited financials; and c) determined if the variance exceeded the calculated "materiality" level. Based upon the results below, the cumulative variance between the cash and accrual methodologies associated with the current State Operating grant (as of June 30, 2012) exceeds the materiality threshold.

Fiscal Year:	Calculated Materiality	Award	Accrual Basis- Option 1			Accrual Basis- Option 2		
			Cash Basis Grant Revenue Per Financials	NEH Grant Amendments	Difference	Cash Basis Grant Revenue Per Financials	Total Grant Expenditures	Difference
			<i>[Footnote 2]</i>	<i>*Per GMS</i>		<i>[Footnote 2]</i>	<i>*Per SEFA</i>	
Desk Review Audit Year: FY12	\$ 34,955	SO-50351-10 [Nov 2009 - Oct 2014]	\$ 650,398	\$ 675,490	\$ (25,092)	\$ 650,398	\$ 566,501	\$ 83,897
Other Years Grant Active: FY11	\$ 34,685	↓	\$ 390,018	\$ 704,420	\$ (314,402)	\$ 390,018	\$ 329,434	\$ 60,584
FY10	\$ 33,175	↓	\$ 199,003	\$ 655,740	\$ (456,737)	\$ 199,003	\$ 208,640	\$ (9,637)
Totals			\$ 1,239,419	\$ 2,035,650	\$ (796,231)	\$ 1,239,419	\$ 1,104,575	\$ 134,844

***Since full funding of the multi-year "SO" awards is contingent upon the NEH receiving anticipated appropriations from Congress each year, the grant revenue is recognized throughout the life of these awards as the NEH Office of Grant Management formally authorizes grant funds (rather than entirely upon award notification).