



FEDERAL ELECTION COMMISSION

WASHINGTON, D.C. 20463

Office of Inspector General

System Review Report

January 27, 2017

Ronald Stith, Inspector General
National Endowment for the Arts
400 7th Street, S.W.
Washington, DC 20506

Dear Mr. Stith:

We have reviewed the system of quality control for the audit organization of the National Endowment for the Arts (NEA) Office of Inspector General (OIG) in effect for the year ended March 31, 2016. A system of quality control encompasses the NEA 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 NEA OIG is responsible for establishing and maintaining a system of quality control that is designed to provide NEA OIG with reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the NEA OIG's compliance therewith based on our review.

Our review was conducted in accordance with *Government Auditing Standards* and the Council of the Inspectors General on Integrity and Efficiency (CIGIE) *Guide for Conducting Peer Reviews of the Audit Organizations of Federal Offices of Inspector General*. During our review, we interviewed NEA OIG personnel and obtained an understanding of the nature of the NEA OIG audit organization, and the design of the NEA 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 NEA OIG's system of quality control. The engagement selected represented a reasonable cross-section of the NEA 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 NEA 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 NEA OIG's audit organization. In addition, we tested compliance with the NEA OIG's quality control policies and procedures to the extent we considered appropriate.

These tests covered the application of the NEA OIG's policies and procedures on the selected audits. 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 1 to this report identifies the office of the NEA OIG that we visited and the engagement that we reviewed.

We noted the following deficiency during our review:

1. Deficiency – We identified that the NEA Inspector General (IG) reports to and is under the general supervision of someone other than that specifically designated by the Inspector General Act of 1978, as amended (IG Act).

Prior to passage of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Public Law 111-203), signed into law by President Barack Obama on July 21, 2010 (*Dodd-Frank*), the NEA IG reported to the Chairperson of the National Council on the Arts (National Council). The Chairperson of the National Council also serves as the Chairperson of the NEA. The National Council is a board of 18 distinguished private citizens appointed by the president and confirmed by the Senate, and six members of Congress who serve in an ex officio, non-voting capacity, whose role is generally to provide advice and recommendations to the Chairperson regarding NEA matters such as applications for grants, funding, and leadership initiatives.

Dodd-Frank changed the head of the NEA 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 Chairperson, and instead vested the National Council with these authorities. In addition, the IG Act now requires the written concurrence of a two-thirds majority of the National Council to remove the IG. As a result of the *Dodd-Frank* amendments, section 8G(a)(4)(G) of the IG Act expressly states that the "head of the designated Federal entity" (the NEA is classified as this type of agency in the IG Act) shall mean, "with respect to the [NEA] . . . the National Council on the Arts." Section 8G(d)(1) of the IG Act further states that the IG shall "report to and be under the general supervision of the head of the designated Federal entity, but shall *not* report to, or be subject to supervision by, any other officer or employee of such designated Federal entity." (Emphasis added).

In response to passage of *Dodd-Frank*, the National Council unanimously passed a "National Council on the Arts Designation" (IG Designation) on October 29, 2010 which contains the following provisions:

1. ... in order to implement Public Law 111-203 in the most efficient manner for the daily work of the Inspector General and the entire agency, the National Council on the Arts designates the Chairman as the point-of-contact for day-to-day supervision and reporting purposes;
2. ...the National Council on the Arts' designation provides that the Inspector General shall have the opportunity to brief the full National Council on the Arts once per year, or more often on an as-needed basis to be determined by the Inspector General, on the activities of the Office of the Inspector General. At all other times, the Inspector General will keep the Chairman generally informed as to the Office of Inspector General's plans, activities, and accomplishments.

These provisions of the IG Designation are in direct conflict with the IG Act, which states that the NEA IG shall report to and be under the general supervision of the National Council, and, importantly, shall not report to or be under the general supervision of any other officer or employee of the NEA. According to *Government Auditing Standards*, this creates a situation that could impair the NEA IG's independence. Specifically, the IG Designation constitutes a structural threat to independence, in which an audit organization's placement within a government entity, in combination with the structure of the audited entity being audited, has the potential to impact the audit organization's ability to perform work and report results objectively.

Based on our review, we did not find any evidence to suggest the NEA OIG's independence was impaired. Also, we did not find evidence that the audits conducted were impacted negatively by the IG Designation and were found to contain 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 National Council should rescind the IG Designation, as it contradicts express provisions of the IG Act.

Views of Responsible Official

We concur with this recommendation.

Enclosure 2 to this report includes the response by the NEA 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 Arts OIG in effect for the year ended March 31, 2016 has been suitably designed and complied with to provide the NEA 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*. NEA OIG has received a peer review rating of *pass with a deficiency*.

As is customary, we have also issued a letter of comment dated January 27, 2017 that sets forth matters 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 the NEA 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 the NEA OIG had controls to ensure the 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 the NEA OIG's monitoring of work performed by IPAs.

We made a comment related to the NEA OIG's monitoring of engagements performed by IPAs that is included in the above referenced letter dated January 27, 2017.

A handwritten signature in black ink, reading "Lynne A. McFarland". The signature is written in a cursive, flowing style.

Lynne A. McFarland
Inspector General
Federal Election Commission

Enclosures

SCOPE AND METHODOLOGY (Enclosure I)

Scope and Methodology

We tested compliance with the National Endowment for the Arts (NEA) Office of Inspector General (OIG) audit organization's system of quality control to the extent we considered appropriate. These tests included a review of 1 of 3 limited scope audit reports issued during the period April 1, 2015 through March 31, 2016 and semiannual reporting periods from September 1, 2015 to March 31, 2016.

In addition, we reviewed the NEA OIG's monitoring of engagements performed by IPAs where the IPA served as the principal auditor during the period April 1, 2015 through March 31, 2016. During the period, the NEA OIG contracted for the audit of its agency's Fiscal Year 2015 financial statements that were performed in accordance with *Government Auditing Standards*.

We visited the headquarters of the NEA OIG in Washington DC.

Reviewed Engagements Performed by NEA OIG

<u>Report No.</u>	<u>Report Date</u>	<u>Report Title</u>
LS-15-02	05/06/2015	Limited Scope Audit Report on Selected NEA Grants to – Mid Atlantic Arts Foundation, Inc.

Reviewed Monitoring Files of NEA OIG for Contracted Engagements

<u>Report No.</u>	<u>Report Date</u>	<u>Report Title</u>
N/A (contract audit)	12/02/2015	Audit Report on National Endowment for the Arts Financial Statements for Fiscal Year 2015



January 23, 2017

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

Ms. McFarland,

I have reviewed the draft report on the system of quality control for the audit organization of the National Endowment for the Arts (NEA) Office of Inspector General (OIG). We are pleased that you determined that our system of quality control was suitably designed and that our adherence to this system provided reasonable assurance that the audit organization performed work and reported results in accordance with professional standards.

Finding

The NEA Inspector General (IG) reports to and is under the general supervision of someone other than that specifically designed by the Inspector General Act of 1978, as amended (IG Act).

Recommendation

The National Council should rescind the IG Designation, as it contradicts express provisions of the IG Act.

Response

We concur with this recommendation.

Thank you for providing the draft report on the external quality control review of NEA OIG. We would like to thank you and your staff for the time and effort in conducting our peer review. If you have questions or need additional information, please feel free to contact me at (202) 682-5774.

Sincerely,

A handwritten signature in blue ink, appearing to read "Ron Slith", is written over a light blue circular stamp.

Ron Slith
Inspector General