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Adequate Accountability Needed For
Grants Awarded By The National
Endowment For The Arts B-158877

National Foundation on the Arts and the Humanities

UNITED STATES
GENERAL ACCOUNTING OFFICE

OCT. 14, 1971

095501



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-158811

Dear Madam Chairman:

This is our report entitled adequate accountability needed for grants awarded by the National Endowment for the Arts. The report also comments on the need for the National Foundation on the Arts and the Humanities to develop an effective internal audit organization to assist management in its decisions relating to grantees and to furnish information concerning how the program activities are being carried out.

The report contains recommendations for your consideration. We shall appreciate being advised of your views on them and on the matters discussed in this report so that we may consider them in future reviews of the Endowment's activities.

Your attention is invited to section 236 of the Legislative Reorganization Act of 1970 which requires that you submit written statements of the action taken with respect to the recommendations. The statements are to be sent to the House and Senate Committees on Government Operations not later than 60 days after the date of this report and to the House and Senate Committees on Appropriations in connection with the first request for appropriations submitted by your agency more than 60 days after the date of this report.

We are sending a copy of this report to the Chairman, National Endowment for the Humanities, because of the shared interest in the internal audit staff.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "A. T. Samuelson", is written over the typed name.

Director, Civil Division

Miss Nancy Hanks
Chairman, National Endowment
for the Arts
National Foundation on the Arts
and the Humanities

GENERAL ACCOUNTING OFFICE
REPORT TO THE CHAIRMAN,
NATIONAL ENDOWMENT FOR THE
ARTS

ADEQUATE ACCOUNTABILITY NEEDED
FOR GRANTS AWARDED BY THE
NATIONAL ENDOWMENT FOR THE ARTS

National Foundation on the
Arts and the Humanities
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D I G E S T

WHY THE REVIEW WAS MADE

The General Accounting Office (GAO) made a limited review of grants awarded by the National Endowment for the Arts. The purpose was to test the procedures designed to ensure that grantees account properly for grant funds.

GAO examined the records of two grantees: the Coordinating Council of Literary Magazines for the financial assistance provided to small literary magazines and Mr. George Plimpton for the American Literary Anthology series.

GAO also reviewed efforts being made by the Foundation's internal audit staff to ascertain whether the grantees were properly accounting for their grant funds and whether the Endowment's programs were being administered efficiently and economically.

FINDINGS AND CONCLUSIONS

Adequate accountability of Federal funds for the two grantees did not exist. For example:

- Disbursements of grant funds were not reported in proper accounting periods. (See p. 7.)
- Documentation was lacking to support amounts paid for services rendered by outside parties. (See p. 7.)
- Petty cash disbursements of grant funds were not supported by signed receipts. (See p. 7.)
- Separate accountability was not maintained over grant funds; grant funds were commingled with personal funds. (See p. 8.)

The Endowment has made limited use of internal auditing as an element of management control. None of the grants reviewed by GAO have been reviewed by the internal audit staff.

Between 1968 and 1970 the internal audit staff consisted of one person. As of June 1971, the staff consisted of four auditors but the Foundation's Financial Manager indicated that it was expected that the staff would be increased to five in the near future.

Much of the auditors' work has consisted of revising the Foundation's guidelines concerning how the grantees are expected to account for the grant funds and planning, coordinating, and reviewing audit work performed by other Federal audit organizations for the Foundation.

The activities, programs, and accounting system of the Endowment for the Arts have never been subject to a review by the internal audit staff. No manual or other written guidelines have been developed that state the objectives of internal audit or the scope of work and standards of performance to be followed. Reviews by the audit staff to date have been limited to grant activities.

The internal audit function is under the supervision of the Financial Manager who also is responsible for the management of the financial resources of the Foundation. This location of internal audit in this organization tends to detract from the independence of the auditors.

RECOMMENDATIONS OR SUGGESTIONS

The Chairman, National Endowment for the Arts, should

- require that responsible officials determine through discussions and visits with grantees that proper accountability is being maintained over grant funds.

The Chairman, National Endowment for the Arts, in cooperation with the Chairman, National Endowment for the Humanities, should

- continue efforts to develop an internal audit staff of a size and capability sufficient to provide balanced audit coverage of substantive program and grant activities and
- raise the internal audit location within the Foundation organization to ensure adequate independence. If this is not considered feasible, the Chairmen should take steps to provide assurance as to the adequacy of (1) the scope and effectiveness of the internal audit function, (2) the level of staffing, and (3) the attention paid to audit findings and objectives.

AGENCY ACTIONS AND UNRESOLVED ISSUES

Foundation officials advised GAO that the Coordinating Council had revised and expanded its fiscal and administrative policy and that the Endowment for the Arts had agreed to make another grant to the Coordinating Council contingent upon the satisfaction of the Chairman of the Endowment that the deficiencies noted by GAO would be resolved adequately.

Foundation officials informed GAO that the Foundation's audit staff would audit the Coordinating Council's records after a second payment had been made under the new grant. According to Foundation officials, this audit is scheduled for this fall.

The Chairman of the Endowment for the Arts notified Mr. Plimpton that the Endowment had decided not to provide additional grant assistance to the American Literary Anthology series. The Chairman stated that the Endowment believed the American Literary Anthology would be better operated as a separate corporation, obtaining funds from sources other than the Federal Government and using the services of the publishing industry.

The Chairman explained that the Endowment was changing its policy regarding grants to individuals. Under the new policy, individual grants will be made to advance creative activity in the future rather than to give recognition of past accomplishments. Concerning GAO's comments on the need to develop an effective internal audit capability, Foundation officials indicated that, after the expansion of the audit staff, more audits would be made of grantees' records. They stated that guidelines for the use of the auditors in reviews of grantee accounting records and expenditures were being developed.

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GENERAL ACCOUNTING OFFICE
REPORT TO THE CHAIRMAN,
NATIONAL ENDOWMENT FOR THE
ARTS

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CHAPTER 1

INTRODUCTION

The General Accounting Office has reviewed grants made by the National Endowment for the Arts to two recipients: the Coordinating Council of Literary Magazines and Mr. George Plimpton for the American Literary Anthology series. The purpose of the review was to determine the effectiveness of the procedures designed to ensure that grantees were properly accounting for funds provided by the National Endowment for the Arts. Our review was made at Endowment headquarters in Washington, D.C., and included visits to the Coordinating Council's office and the Office of the accountant for Mr. George Plimpton in New York City.

The National Endowment for the Arts and the National Endowment for the Humanities were created by the National Foundation on the Arts and the Humanities Act of 1965 (20 U.S.C. 951). The Endowment for the Arts was charged with developing and carrying out a program of grants-in-aid to groups or individuals of exceptional talent engaged in or concerned with the arts to enable them to provide for or support productions, projects, or workshops of professional excellence.

Although the two Endowments are officially designated as the National Foundation on the Arts and the Humanities, a central authority was not established to administer the so-called Foundation. Each Endowment is headed by a chairman who is appointed by and is responsible to the President and who is responsible for establishing and carrying out the Endowment's program. Each Endowment has a separate staff, except that an administrative staff--responsible for such matters as accounting and auditing--serves both Endowments. The accounting and auditing activities are under the immediate supervision of an official designated as the Foundation's Financial Manager. As part of this review, we inquired into the use by the Endowment of the internal audit capabilities to assist management in effectively carrying out its programs.

The legislation that created the Endowments transferred the existing National Council on the Arts to the National Endowment for the Arts. This Council is composed of 26 citizens who are widely recognized for their training, experience, and interest in the arts and whose responsibilities are to (1) advise the Chairman of the Endowment regarding policies, programs, and procedures for carrying out the Endowment's functions and (2) review applications for financial assistance received by the Endowment and make recommendations to the Chairman.

In making our review of grantee accounting records, we considered the Endowment's guidelines, general instructions, and fiscal administration policy provided to each grantee. These issuances provided that the grantees were responsible for

- establishing separate accounts for each grant project;
- maintaining supporting records of grant expenditures in sufficient detail to show the exact nature of each expenditure;
- maintaining payroll authorizations to effect proper control over salaries and wages charged against grant funds; and
- maintaining board of directors' meeting minutes, resolutions, or other authorizations which affect an Endowment grant.

Following is a discussion of our findings concerning how the two grantees were accounting for the grants awarded by the Endowment and on the need for the development of an effective internal audit capability.

CHAPTER 2

ACCOUNTABILITY FOR ENDOWMENT

GRANT FUNDS BY TWO GRANTEES

The Coordinating Council of Literary Magazines and Mr. George Plimpton, editor of the American Literary Anthology series, had not maintained adequate accountability over the grants awarded by the Endowment.

GRANT TO COORDINATING COUNCIL OF LITERARY MAGAZINES

The Coordinating Council did not maintain adequate accounting over Endowment grant funds and documentation to support many expenditures.

The Coordinating Council was established in 1967 to (1) aid small literary magazines and individual artists and writers through awards, scholarships, fellowships, and grants, (2) encourage the formation and development of new magazines and new types of magazines, (3) foster communication and disseminate information among magazine artists and writers and stimulate and coordinate their activities, (4) operate a center which could receive traveling and visiting artists, writers, and intellectuals, and (5) sponsor literary conferences and events.

The Coordinating Council consists of a board of directors, an executive committee, and an executive director responsible for the day-to-day operations of the Coordinating Council. The board of directors is assisted by a board of consultants and a grants committee which consists of about five individuals who represent the board of directors, the board of consultants, and individuals of the literary community who are not members of either board.

The Endowment awarded the Coordinating Council five grants totaling \$350,000 between 1966 and 1970. At the time of our review, the Foundation's internal audit staff had made no audit of the Coordinating Council's grant records. We examined the Coordinating Council's records pertaining to (1) expenditures under the grant awarded for calendar year 1969 activities and (2) selected expenditures under grants for other periods.

Our review of the Coordinating Council's accountability for the grant funds showed that:

- Because separate accountability records for each of the five grants had not been maintained, many expenditures could not be related to a specific grant. For example, four of the five grants were awarded to cover activities during the period from March 1967 to December 1969, however, the grant periods overlapped. The accounting records were maintained on a calendar year basis and did not correctly relate expenditures during this period to specific grants. In its final report of expenditures incurred under one grant ended December 15, 1969, for example, the Coordinating Council included costs incurred up to July 1970.
- Decisions of the executive committee affecting the expenditure of Endowment grant funds were not documented and thereby provided no record to substantiate that the amounts paid had been agreed to and were properly authorized. Minutes of executive committee meetings in 1969 were not maintained. The minutes of an October 1969 board of directors' and board of consultants' meeting showed that payment of a bonus to all the Council's staff members in recognition of past efforts was authorized. The chairman and the treasurer (the two members of the executive committee) were authorized to set the amount of the bonuses. The decision of the chairman and the treasurer to pay a bonus of \$1,500 to the executive director of the Coordinating Council was not documented and apparently was not approved by the board of directors. Also the largest grant made by the Coordinating Council--for \$5,000--was not approved by its board of directors.
- Per diem payments exceeded the rate authorized under provisions of the Endowment grant. Because of the inadequacy of the records, we were unable to determine whether the Coordinating Council paid the amount in excess of the established rate from its private funds.
- The Coordinating Council was unable to furnish us with documentation supporting the amounts paid to consultants, what the consultants did, how much time they expended to justify the payments, or how the rates of payment were determined.
- Petty cash disbursements were not supported by signed vouchers showing when, by whom, and for what purpose the expenses were incurred. For example, miscellaneous petty cash disbursements amounting to \$841 during 1969 were not supported or documented by vouchers.

In October 1970 we discussed our findings with Coordinating Council and Endowment officials. Generally they agreed with our findings. Endowment officials agreed also that there was a lack of good accounting control by the Coordinating Council over the expenditures reported.

After considering our findings, the Foundation's Financial Manager informed the Chairman of the Endowment for the Arts that our audit had included enough information to prejudice the Endowment's consideration of future awards to the Coordinating Council. The Financial Manager indicated, however, that the Coordinating Council had revised and expanded its fiscal administration policy and had given assurance that all future executive committee actions would be documented. The Financial Manager stated that more efficient administration should result from these actions and that there should be no need to withhold consideration of any future Coordinating Council applications or awards.

Acting on this recommendation, the National Council on the Arts, at its October-November 1970 meeting, recommended that a \$100,000 grant for continued support of the Coordinating Council's activities be contingent upon the Chairman's satisfaction that the deficiencies noted by us had been adequately resolved. The grant was subsequently approved by the Endowment subject to the reservation that the deficiencies be corrected and to the requirement that the Endowment's internal audit staff make an audit concerning how the Council was accounting for Endowment funds prior to making a second payment under the new grant. According to Foundation officials, this audit is scheduled for this fall.

GRANT TO MR. GEORGE PLIMPTON FOR THE
AMERICAN LITERARY ANTHOLOGY SERIES

Our examination of Mr. Plimpton's records relating to the Endowment's four grants for the American Literary Anthology series showed that Mr. Plimpton had not placed the grant funds in a separate bank account and had not maintained separate records on the financial transactions for each of the Anthology projects. Rather, all grant funds were commingled with Mr. Plimpton's funds in his personal checking account.

The American Literary Anthology series began in 1966 with a grant to Mr. George Plimpton. The purpose of the American Literary Anthology series was to (1) establish an annual literary anthology--a collection of selected literary works--of the best American poetry, fiction, essays, and criticism from American literary magazines, (2) award the authors whose work was chosen for publication in an anthology up to \$1,000, and (3) award the editors who published the

work up to \$500. The Endowment authorized four anthology projects and expended about \$190,900 to carry out the projects. Of this total, about \$49,000 was paid to Mr. George Plimpton who conceived the idea for the Anthology series for administrative costs of the projects; the remainder consisted of awards to writers and publishers and was disbursed directly by the Endowment.

Works to be published in the Anthologies were selected on the basis of comments made by preliminary readers and judges who reviewed numerous poems, short stories, essays, and criticisms submitted by a variety of small magazines.

At Mr. Plimpton's suggestion, we contacted his accountant and requested him to give us all pertinent documentation supporting the expenses incurred in connection with the Anthology projects. He gave us a number of monthly bank statements, canceled checks, and receipt and disbursement ledgers maintained for Mr. Plimpton's financial transactions and copies of miscellaneous correspondence which related to expenses incurred in connection with the Anthology projects. We used this material in an attempt to verify the grant expenditures reported by Mr. Plimpton to the Endowment.

The canceled checks provided to us in support of Mr. Plimpton's reported expenditures accounted for (1) only \$1,840 of the \$2,350 reported as payments to preliminary readers of works submitted by small magazines and (2) \$12,750 of the \$13,080 reported as salary payments to directors and employees involved in the four Anthology series. Since no separate records were kept for grant funds received from the Endowment, and since payments were made from Mr. Plimpton's personal checking account, we were unable to positively determine whether these payments were made for purposes related to the activities for which the grants were made. Also canceled checks, paid bills, or other documentation were not available in support of most reported indirect costs totaling about \$7,800 that were allocated to the Anthology projects.

The above findings were discussed with Endowment officials who, in January 1971, sent a letter to Mr. Plimpton's accountant that summarized the findings for his comment. In response, Mr. Plimpton's accountant admitted that no separate bank account was maintained for the grant funds and indicated that he understood that this was not necessary. He stated that work sheets which listed each expenditure by grant and category had been prepared. Although this statement was true, it did not reflect the fact that the work sheets were prepared after he had been notified of our intention to audit the grants and were not maintained currently during the period of the grant.

Mr. Plimpton's accountant also indicated that documentation in the form of canceled checks was customarily available to support many of the expenditures for the Anthology series and that canceled checks constituted one of the better forms of documentation. Although we did examine a number of canceled checks which appeared to support most of the expenditures reported, we were unable to determine whether the checks represented payments pertaining to the Anthology series since no separate records were maintained for the series and since, in most cases, invoices, bills, or vouchers had not been prepared.

In June 1970 the Chairman of the Endowment for the Arts notified Mr. Plimpton that the Endowment had decided to provide no additional grant assistance. The Chairman stated that the Endowment believed the Anthology would be better operated as a separate corporation, obtaining funds from sources other than the Federal Government and using the services of the publishing industry.

The Chairman also explained that the Endowment was changing its policy regarding grants to individuals. Under the new policy, individual grants will be made to advance creative activity in the future rather than give recognition of past accomplishments.

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The lack of adequate accountability over Endowment grant funds by other grantees has also been the subject of several audit reports by the Endowment's internal auditor prior to the time of our review. In five reports on completed or attempted reviews, two of which involved the same grantee, the auditor indicated that the grantees' records were incomplete and that some were not auditable, that the grantees' practices were inadequate to control grant expenditures, and that some grantees' accounting practices did not conform to the requirements of the grant conditions.

We were informed that, subsequent to these audits, one grantee totally reorganized and improved its accounting functions, another grantee was bankrupt and records supporting the grant expenditures had not been assembled, and an additional grantee's records were also considered inadequate for audit purposes. Subsequent to the audit of another grantee, the Endowment revised its grant provisions to delete the requirement that a separate bank account be maintained, as long as the grantee maintained proper accountability over grant funds. The change was made because the auditor found that the grantee had maintained adequate accountability over the Endowment grant funds without the use of a separate bank account.

CONCLUSIONS

The lack of adequate accountability over the Endowment grant funds by the two grantees whose records we examined and by those grantees whose records had been audited or found to be not auditable by the internal auditors, indicates that this problem may be widespread. The Endowment prepared guidelines governing the type of accounting records and supporting documentation to be maintained by grantees. The latest revision was issued in April 1970.

The revised guidelines are more specific than those issued previously as to the records which the Endowment expects grantees to maintain. Although the development of these revised guidelines is an important step, we believe that a need exists for the Endowment to assure itself that its instructions have been implemented by the grantees.

RECOMMENDATION TO THE CHAIRMAN, NATIONAL ENDOWMENT FOR THE ARTS

We recommend that Endowment officials be required to determine through discussions and visits with grantees whether proper accountability is being maintained over grant funds.

CHAPTER 3

NEED TO DEVELOP EFFECTIVE

INTERNAL AUDIT CAPABILITY

The Endowment has made very limited use of internal auditing as an element of management control. Our review showed that the activities, programs, and accounting system of the Endowment had never been subjected to a review by internal auditors and that no internal audit manual had been developed that stated the objectives of internal audit, the scope of the internal audit work to be performed, or the standards of performance to be followed by the internal auditors.

The administrative staff, which is shared with the National Endowment for the Humanities, performs the accounting, personnel, administration of grants, audit, and other service functions common to both Endowments. From the inception of the Foundation in 1965 to 1968, no audit position was authorized. Between 1968 and February 1970 one audit position was authorized. During this period only three audits of grantees' records were completed. Preliminary audit work concerning three other grantees showed that the grantees' records were so incomplete that the audits could not be made. The only other audit work performed involved a determination of the overhead rate which an additional grantee proposed to use and a follow on to a General Accounting Office report in another case.

In two of the reviews which were completed, the auditor reported that the grantees' accounting practices did not conform with requirements of underlying grant conditions. In one of these reports, the auditor stated that the grantee's management practices were inadequate to properly control grant expenditures and that there were significant weaknesses in the control and accountability of expenditures and matching funds.

Much of the auditor's work at the time of our review consisted of revising the Foundation's guidelines concerning how the grantees were to account for grant funds and coordinating and reviewing audits of grants to colleges and universities that were made by audit organizations of other Federal agencies.

As important as the development of guidelines for grantees may be, it tends to detract from the primary responsibility and the independence of the auditor. Consultation between auditors

and the individuals responsible for developing accounting systems is necessary to ensure that adequate controls are established, particularly by grantees, but we believe that the internal auditor should not be assigned the responsibility for developing and installing methods, systems, or procedures. He should, however, call attention to problem areas and necessary improvements and he should be consulted on proposed corrective actions.

The internal auditor is under the supervision of the Financial Manager who also has responsibility for the management of the financial resources of the agency. The position of the internal auditor in an organization is such that he should be independent of the officials who are directly responsible for the operations he reviews. To provide for an adequate degree of independence, the internal auditor should be responsible to the highest practical organizational level, preferably to the agency head or to a principal official reporting directly to the agency head.

We realize that, in a small organization, complete separation of duties and responsibilities may not be practical. In these cases:

- The agency head should satisfy himself that the official to whom the internal auditor reports not only permits but also encourages the internal auditor to exercise latitude in setting the scope of work and in reporting on results of his audits. The internal auditor should be sufficiently independent to be able to make impartial appraisals of the operation of agency programs and activities, including those under the official to whom the internal auditor reports.
- The head of the agency should be concerned with the scope and effectiveness of the internal audit function and its staffing and with the adequacy of attention paid to audit findings and recommendations.
- The internal auditor, when he deems it necessary to the fulfillment of his responsibilities, should have direct access to the head of the agency.

We were informed in April 1971 that four additional audit positions had been authorized by the Office of Management and Budget. As of June 1971 the Financial Manager informed us that three had been filled. According to the Financial Manager when all these positions are filled, the major audit activity will continue to be directed to grantees. We were

informed also that guidelines were currently being developed for use by the auditors regarding reviews of grantees' accounting records and expenditures.

CONCLUSION

Although the auditing of grantees' use of grant funds is an important function, internal audit should not be limited solely to this function. Internal auditing should extend to all agency activities and related management controls. In addition to reviewing financial transactions, the internal auditor should also review operations and activities so that he may provide management with information on the effectiveness, efficiency, and economy with which they are being carried out.

The internal audit function can provide a highly valuable service to management by reviewing, appraising, and reporting on the extent and nature of internal compliance with management's policies, plans, and procedures as well as with applicable legal and external regulatory requirements.

RECOMMENDATIONS TO THE CHAIRMAN, NATIONAL ENDOWMENT FOR THE ARTS

We recommend that the Chairman, National Endowment for the Arts, in cooperation with the Chairman, National Endowment for the Humanities, continue the efforts to develop an internal audit staff of sufficient size and capability to provide balanced audit coverage of substantive program and grant activities. We recommend also that the internal audit location be raised within the organizational framework of the Foundation to ensure adequate independence. If this is not considered feasible, we recommend that the Chairmen take steps to provide assurance as to the adequacy of (1) the scope and effectiveness of the internal audit function, (2) the level of staffing, and (3) the attention paid to audit findings and recommendations.