

August 1997

KENNEDY CENTER

Audit Duplication Can Be Prevented



General Government Division

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August 19, 1997

The Honorable John H. Chafee
Chairman
The Honorable Max Baucus
Ranking Minority Member
Committee on Environment and Public Works
United States Senate

The Honorable Bud Shuster
Chairman
The Honorable James L. Oberstar
Ranking Minority Member
Committee on Transportation and Infrastructure
House of Representatives

Since its inception, The John F. Kennedy Center for the Performing Arts (the Center) has annually contracted with a public accounting firm (the auditor) to perform an audit of its financial statements and provide it with a report on whether those statements present fairly the financial position of the Center. According to Center officials, the financial statement audit is undertaken for several reasons, including the following: first, in response to the requirement in 20 U.S.C. 76l (c) that the Board of Trustees submit to Congress an annual report of its operations, which includes a detailed statement of all public and private money received and disbursed; second, to provide grantors from whom the Center receives funding an accounting of the use of such funds; and third, to assist the Board in carrying out its trust responsibilities under the statute. For these reasons, the officials to whom we spoke said that, in their opinion, the general fiduciary standards governing the responsibilities of the Kennedy Center trustees and officers effectively require an annual audit of its financial statements.

The John F. Kennedy Center Act Amendments of 1994¹ (the Amendments) provide that not less than once every 3 years we are to audit and review the accounts of the Center for the purpose of examining expenditures of funds appropriated in fiscal years 1995 through 1999 for maintenance, repair, and security, and capital projects under the Amendments and for compliance with the Amendments' limitation on the use of those funds for performing arts functions. Beginning with the Center's fiscal year 1995 financial statements, the appropriations were included in the Center's

¹Section 5(d) of the John F. Kennedy Center Act Amendments of 1994, Public Law 103-279, 108 Stat. 1409, 1415-1416 (1994), which amended Section 6 of the John F. Kennedy Act, 20 U.S.C. 76l.

financial statements and, therefore, were subject to the financial statement audit. Thus, our initial audit under the Amendments would cover appropriated funds for fiscal years 1995 through 1996, while our subsequent audit would cover fiscal years 1997 through 1999.

As we performed the work necessary to plan our own audit, we recognized that because the appropriated funds were included in the financial statements and those financial statements were audited annually, the Center's use of those funds would, if we performed our audit, be subject to multiple audits. In the past, in other instances of possible multiple audit requirements, Congress and the executive branch have provided guidance that emphasizes the need for the efficient use of audit resources through the coordination of audit work and the elimination of duplication.

We discussed with your offices the potential for duplication of effort arising from multiple audit requirements involving the Center's appropriated funds. We agreed to determine whether we should continue the work necessary to plan and do our own audit, and if continuation of our work did not appear prudent, to seek legislative relief from the audit requirement. In this regard, we looked to see whether the auditor planned and carried out an audit that complied with the standards set forth in the Government Auditing Standards since both our audit and the auditor's are subject to those standards. We developed information and obtained documentation about the auditor's planned and executed audit work, reviewed some working papers prepared by the auditor, and obtained the reports on the financial statements and compliance with laws and regulations that the auditor had prepared and issued to Center management.

Results in Brief

The information and documentation we obtained from the Center and the auditor and the auditor's records we reviewed demonstrated that our audit, if implemented, would duplicate those portions of the auditor's work involving the understanding of internal controls, sampling of expenditures, and testing for compliance with the limitation on the use of the appropriated funds. Further, the auditor planned and executed the audit under the Government Auditing Standards, which governs our audit work as well.

In the future, according to Center officials, the Center plans both to continue to annually contract with a public accounting firm for a financial statement audit that will include the use of appropriated funds and to

require that its auditor's work be subject to the Government Auditing Standards. Further, at our suggestion, Center officials revised the contract with the auditor, beginning with the fiscal year 1997 audit, to require that the auditor's report specifically state the tests undertaken for compliance with the limitation on the use of appropriated funds and the results of those tests.

On the basis of the information we developed, we believe that efficient use of our audit resources would best be achieved by the Center's continued contracting for a single annual audit of its financial statements subject to the Government Auditing Standards. This audit would include both the use of the appropriated funds and compliance with limitations on the use of those funds. Therefore, as agreed with your offices, we are seeking legislative relief from the requirement for us to periodically audit the Center's use of appropriated funds.

Background

The Kennedy Center, established in 1964² as both a national cultural arts center and a living memorial to the 35th President, opened in September 1971. Shortly thereafter, in 1972, the Secretary of the Interior, through the National Park Service, assumed responsibility for building maintenance, security, interpretative, janitorial, and all other services necessary for the operations of the Kennedy Center not related to the performing arts.

In 1994, the Amendments transferred responsibility for the work performed by the National Park Service to the Kennedy Center Board of Trustees and also authorized the appropriation of funds, beginning in fiscal year 1995, to the Board for this work. The Center's financial statements for fiscal years 1995 and 1996 reflected the appropriation received as either operating revenue and expense or capital assets.

Under 31 U.S.C. 712, we are authorized to "investigate all matters related to the receipt, disbursement, and use of public money." In addition, the John F. Kennedy Center Act Amendments of 1994 provide that we are to audit and review the accounts funded by appropriations authorized by those amendments at least once every 3 years.

²In 1958, The National Cultural Center Act, authorized a National Cultural Center in the District of Columbia, which on Jan. 23, 1964, was renamed the John F. Kennedy Center for the Performing Arts.

Objectives, Scope, and Methodology

As agreed with your offices, our objective was to determine whether an audit by us would duplicate work done by the Center's auditor. Further, if we determined that duplication was a problem we would seek legislative relief from the requirement to do our own audit of the Center's use of appropriated funds.³ In this regard, we

- examined the auditor's audit scope and plan;
- reviewed the reports issued by the auditor;
- developed independently our own understanding of the Center's internal control process for managing federal appropriations authorized by the Amendments; and
- developed an understanding of the auditor's actual performance of the audit through (1) discussions with staff of the auditor and Center staff involved in the audit, (2) comparison with requirements in the Government Auditing Standards, and (3) review of selected working papers prepared by the auditor and documentation related to the audit provided by the auditor and the Center.

The field work standards in the Government Auditing Standards set forth general guidelines for undertaking the detailed audit work necessary to evaluate an auditee's financial statements. The field work standards include properly planning the audit to (1) consider materiality in determining the audit procedures, (2) follow up on prior findings and recommendations, (3) obtain a sufficient understanding of internal controls to plan the audit, and (4) provide reasonable assurance of detecting irregularities that have a direct and material impact on the financial statements.

The Government Auditing Standards also contain general guidelines for reporting on financial audits. Regarding reporting on compliance with laws and regulations, the reporting standards require that the auditor report both the scope of testing of compliance with laws and regulations and the results of those tests either in the financial statement report or a separate report.

Because both our work and that of the Center's auditor are subject to the Government Auditing Standards, we looked for elements of the standards in the audit scope and plan of the auditor. Our rationale was that the presence of these elements in the auditor's planned work would constitute

³Our approach was discussed in our May 28, 1997, letter to the Chairmen and Ranking Minority Members of the Senate Subcommittee on Transportation and Infrastructure and the House Subcommittee on Public Buildings and Economic Development, in which we described our objectives, scope, and methodology for this assignment.

evidence of the duplication that would have occurred when we prepared and carried out our audit scope and plan in accordance with the standards. To ensure that the auditor performed the audit work detailed in its audit plan, we checked for evidence of this work in the auditor's records involving sampled expenditure transactions.

To address how to proceed when we were confronted with the multiple audit situation at the Center, we looked at selected federal program audit guidance.⁴ We found that this guidance, both in federal law and executive branch policy, provides direction regarding what an auditor is to do when confronted with an auditee subject to multiple audits. This direction is as follows:

- Audits by different auditors should be coordinated,
- Duplication of audit work should be avoided,
- Auditors should reduce the burden on the auditee, and
- Audit resources should be efficiently used.

To document the scope of the auditor's plan for staffing and undertaking the audit work in accordance with Government Auditing Standards, we obtained

- the audit plan for testing appropriated funds;
- the internal control memorandum prepared by the auditor in planning the work;
- reports issued to the Center as a result of the work;
- documentation on the audit staff's qualifications, independence, and prior experience at the Center and with federal appropriated funds audits; and
- the external critique of the auditor's practice as reflected by the external peer review opinion.

We did not, as part of our work, perform a detailed review of all of the documentation contained in the auditor's files supporting its audit of appropriated funds nor reperform tests conducted by the auditor because it was not our intent to use the auditor's work to develop our own report or opinion on the Center's use of appropriated funds and its compliance with the restrictions on the use of the appropriations. However, we completed the work we deemed necessary to confirm the auditor's documented understanding of internal controls. In addition, we did

⁴The Single Audit Act of 1984, 31 U.S.C. 7501-7507; Audits of State and Local Governments, Office of Management and Budget, Circular No. A-128, Apr. 12, 1985; and Audits of Institutions of Higher Education and Other Nonprofit Institutions, Office of Management and Budget, Circular No. A-133, Mar. 8, 1990.

conduct a limited review of the auditor's documentation for some of the sampled transactions and held discussions with the auditor's and Center's staffs to obtain an understanding of the work performed concerning compliance with appropriation law. For example, we reviewed some of the auditor's records to verify that they contained evidence of an examination of a sample of the Center's appropriated funds transactions.

On August 5, 1997, we provided a draft of this report to the Chairman of the Kennedy Center for review and comment. The Center's comments are discussed at the end of this report.

The Work of the Auditor Was Governed by Contractual Agreement and Implemented Using an Audit Plan

We assessed the potential for our duplicating the auditor's work by focusing on the objectives and audit work envisioned by the two documents that guided that work—the engagement letter (the contractual agreement) and the audit plan. These documents established the objectives that the audit had to fulfill and defined how the auditor was to proceed to achieve those objectives. The letter specified (1) the agreed-upon scope of work, (2) the general limitations of the audit, and (3) the reports to be provided to the Center as a result of the general work. To implement the terms and conditions of the engagement letter, the auditor developed a detailed plan, known as the audit plan, that laid out the specific steps for testing appropriated expenditures, including sample selection, tests of sampled transactions, and internal summaries and documents to be produced.

The Engagement Letter Established the Financial Statement Audit Objectives

We obtained the July 21, 1996, engagement letter between the Center and the auditor that set forth the contractual terms for the Center's fiscal year 1996 financial statement audit. The engagement letter included both a statement of the scope of the audit and the terms and conditions for completing the work. The auditor's scope included work at The John F. Kennedy Center for the Performing Arts; the National Symphony Orchestra; the Kennedy Center Productions, Inc.; and the Kennedy Center Electronic Media Technologies, Inc.

Reflecting the field work standard requirements of the Government Auditing Standards, the engagement letter set forth the terms of the audit in a section entitled Audit Responsibilities and Limitations. This section required that (1) the audit be conducted in accordance with generally accepted auditing standards, the standards contained in the Government

Auditing Standards;⁵ and OMB Circular A-133, “Audits of Institutions of Higher Education and Other Non-Profit Institutions;” (2) the auditor conduct the audit by examining, on a test basis, the evidence supporting the amounts and disclosures in the financial statements; and (3) in addition to the opinion on the financial statements, a report, or reports, on the Center’s internal controls and compliance with laws and regulations be issued to Center management.

The Audit Plan Laid Out the Steps for Achieving the Audit Objectives

To manage the work necessary to meet the requirements of the audit as specified in the engagement letter, the auditor developed a step-by-step audit plan for testing of appropriated expenditures. The audit plan included specific objectives for the work, such as determining whether (1) appropriations were properly recorded; (2) accounting procedures and controls conformed to established procedures, and that such procedures were operating effectively and provided proper control over appropriated funds disbursements; and (3) capital project fund balances had been properly classified using the following categories: invested capital, obligated but not invoiced, and unobligated.

The audit plan laid out the specific steps to be undertaken to test expenditures of appropriated funds. These steps included

- obtaining an understanding of the flow of federal transactions through discussions with appropriate personnel;
- completing a random disbursement test for operation and maintenance and capital expenditures by sampling the universe of each type of transaction;
- obtaining documentation for each sample transaction and testing it for approvals, signatures, recording of vendor and amount in the financial records, receipt of purchased item(s); and
- testing compliance with statutory limitations on the use of appropriations.

Our review of some auditor documentation of its tests, discussions with the auditor’s staff about those tests, and discussions with audited Center staff confirmed that the auditor did carry out the audit steps set forth in its audit plan regarding the Center’s use of appropriated funds.

⁵The Government Auditing Standards for financial audits incorporate the American Institute of Certified Public Accountants Statements on Auditing Standards, often referred to as generally accepted auditing standards (GAAS).

Auditor Issued Various Reports to Kennedy Center Managers at Audit Conclusion

The auditor's engagement letter, reflecting the reporting standards in the Government Auditing Standards, provided that the auditor was to issue several reports to Center management at the conclusion of its work, which gave the Kennedy Center a clean opinion on its financial statements for fiscal years 1995 and 1996. On November 27, 1996, the auditor issued reports covering the financial statements audit as well as work done as part of the financial statement work on internal controls and compliance with laws and regulations. Specifically, these reports were entitled

(1) Financial Statements As of September 29, 1996, and October 1, 1995, Together With Auditors' Report, to the Board of Trustees;

(2) OMB Circular A-133 Supplementary Financial Report For the Fiscal Year Ended September 29, 1996, Together with Auditors' Reports, to the Board of Trustees; and

(3) Comments and Suggestions for Consideration For the Year Ended September 29, 1996, to the President of the Kennedy Center.

We also noted that the auditor, again reflecting the reporting requirements of the Government Auditing Standards, included an update of prior-year audit comments and suggestions in the Comments and Suggestions letter.

Areas of Potential Duplication Exist in Our Work and the Work of the Auditor

The work we undertook in planning our own audit convinced us that had we performed our own audit of the Center's use of appropriated funds, we would have duplicated the work of the auditor. The areas of duplication included

- developing an understanding of the Center's internal control process for appropriated expenditures;
- testing expenditure transactions for compliance with law and with the limitation on the use of appropriated funds; and
- preparing and issuing a report, or reports, on the use of appropriated funds, internal controls, and compliance with the law and the limitation on the use of these funds.

To assess the likelihood of duplication, we obtained documentation from the auditor, reviewed some documentation in the auditor's records of the testing of sampled transactions, and discussed the audit work with the auditor's staff and Center staff involved in the audit. We focused on the

auditor's understanding of internal controls, tests of transactions, and compliance with the limitation on the use of the appropriated funds.

Auditor Developed Understanding of Internal Controls in Planning Audit Work

The auditor, in applying the field work standards for developing an understanding of internal controls, prepared an August 19, 1996, internal control memorandum entitled "Purchasing Procedures for Federal Acquisitions." The memorandum, according to auditor staff, represented the auditor's understanding, from discussions with Center staff, of the process by which the Center makes purchases using the appropriated funds.

In completing the work necessary in planning our own audit, we discussed appropriated funds procedures with Center staff and obtained Center appropriated funds financial reports and documentation from several purchase/contract files to develop our own understanding of the Center's process for making purchases using appropriated funds. Although we did not prepare an internal control memorandum, we were able to confirm the process that the auditor presented in the August 19, 1996, memorandum. We found the auditor's memorandum accurately reflected our own understanding of the Center's controls over the use of appropriated funds.

Auditor Tested Samples of Appropriation Expenditure Transactions

The auditor, in applying the field work standards for testing of transactions, selected a sample of the operation and maintenance and capital improvement appropriations expenditures for use in testing transactions. The auditor advised us that its sample was selected from the universe of expenditures in the fiscal year for each type of funding. To plan for our own tests of the use of appropriated funds, we identified and obtained expenditure records from the Center that provided the universe of expenditures by fiscal year and type of funding. Although we did not proceed to select and test our own sample, on the basis of the auditor's audit plan and the sampling used by the auditor, we concluded that the auditor's planned procedures were adequate.

By reviewing the auditor's plan and the documentation we obtained from the records prepared by the auditor related to the testing of transactions, and our discussions with both the auditor's staff and staff at the Center, we developed an understanding of the work performed by the auditor in its specific testing of documentation supporting each sampled expenditure. The auditor's plan included verifying that documentation existed, that appropriate signatures and approvals were thereon, and that

the financial aspects of the transaction were recorded. The documentation we obtained from the auditor showed that it sampled 37 maintenance, repair, and security expenditure transactions and 36 capital projects expenditure transactions. We believe that had we proceeded to do our own audit, our approach would have been similar to the one used by the Center's auditor.

Auditor's Report Did Not Specifically Reflect Coverage of Tests for Compliance With Limitation on Use of Funds

In addition to the uses for which funds were authorized—namely, maintenance, repair, and security, and capital projects—the Amendments imposed a specific limitation on the use of funds to support performing functions. This limitation provided that

“No funds appropriated pursuant to this section may be used for any direct expense incurred in the production of a performing arts attraction, for personnel who are involved in performing arts administration (including any supply or equipment used by the personnel), or for production, staging, public relations, marketing, fundraising, ticket sales, or education.”⁶

The auditor's plan, audit records, and our discussions with both the auditor's staff and staff of the Center provided us with an understanding of the work both planned and performed by the auditor in the testing of compliance with the limitation on the use of appropriated funds in support of performing functions. For each sampled transaction, the auditor considered whether the expenditure was consistent with the act's limitation. Had we continued with the work necessary to plan and do our own audit, we would have developed and executed tests to determine whether expenditures were consistent with the Amendments' limitation.

Although the auditor tested transactions for compliance with the statutory limitation on the use of appropriated funds, its report on compliance with provisions of laws neither listed this limitation among those for which compliance was tested nor provided information specifically relating to the Center's compliance with the limitation as evidenced by the auditor's tests. We brought this matter to the attention of Center officials. We suggested that they include a contractual requirement in future financial statement audit engagement letters requiring that the auditor include in its report to the Center information about specific tests of compliance with

⁶Section 12(c) of the John F. Kennedy Center Act Amendments of 1994, Public Law 103-279, 108 Stat. 1409, 1416 (1994), 20 U.S.C. 76r.

the limitation on the use of funds that it had undertaken and a statement of the results of those tests.

In response, Center officials agreed with our suggestion to revise future contracts and included a requirement in the fiscal year 1997 financial statement audit contract that the auditor, in its report, include specific information about tests conducted and the results of those tests.

Conclusion

The funds appropriated to the Center for maintenance, repair, and security, and capital projects are currently subject to duplicative audit work. The Amendments provide that we are to review and audit the accounts that use these appropriated funds. But because these appropriated funds are also included in the financial statements of the Center, they are also subject to the Center's annual financial statement audit.

Our discussions with Center officials and the auditor's staff, as well as our review of the auditor's audit plan, documentation from the auditor's records, and Center documents, convinced us that our audit would have duplicated the work of the auditor, would not have been an efficient use of our audit resources, and would have imposed an unnecessary burden on Center staff.

As long as Center officials continue retaining an auditor whose work is subject to Government Auditing Standards, and Center officials require the auditor to specifically address its tests of compliance with the limitation on the use of appropriated funds and the results of those tests in its audit report, we believe Congress would receive little, if any, benefit from our duplicative audit of funds appropriated to the Center. If Congress is concerned that the Center may not continue to retain an auditor to perform an annual audit in compliance with the Government Auditing Standards, it could impose a statutory requirement that the Kennedy Center continue to have annual audits performed. Furthermore, even if the statutory language that specifically provides for audits by the Comptroller General of the Center's use of appropriated funds is repealed, Congress could still request that we review and examine the Center's use of those funds under our general authority in 31 U.S.C. 712.

Recommendation

We recommend that Congress delete the requirement that the Comptroller General audit the funds appropriated. To statutorily ensure continued audits of those funds, Congress may wish to consider including, in the reauthorization legislation, a requirement that the Center (1) continue contracting for annual financial statement audits, subject to the Government Auditing Standards, to ensure that appropriated funds are properly obligated and expended in compliance with statutory authorities and limitations and (2) communicate the results of such audits to Congress annually.

Agency Comments

We provided copies of a draft of this report to the Chairman, John F. Kennedy Center, for comment. On August 11, 1997, the Center's Vice President, Facilities; Chief Financial Officer; General Counsel; and Controller provided us with oral comments on the draft report. These officials advised us that they generally agreed with the information in the report and the recommendation to Congress. They also stated that in the Kennedy Center's view, it is not necessary to amend the Kennedy Center Act to specify auditing requirements because the trustees and officers already have an obligation to ensure that expenditures of funds are audited in accordance with current auditing standards. However, they said that the Kennedy Center has no objection to amending the act as recommended.

The Kennedy Center officials also provided comments to clarify some of the information presented in the report, which we have incorporated where appropriate.

We are sending copies of this report to the Chairman of the Senate Subcommittee on Transportation and Infrastructure, Committee on Environment and Public Works; the Chairman and Ranking Minority Member of the House Subcommittee on Public Buildings and Economic Development, Committee on Transportation and Infrastructure; the Chairman of the John F. Kennedy Center for the Performing Arts; and other interested committees and subcommittees. Copies will be made available to others upon request.

Major contributors to this report are listed in the appendix. If you have any questions about the report, please call me on (202) 512-8387.

A handwritten signature in black ink, appearing to read "Bernard L. Ungar". The signature is fluid and cursive, with the first name "Bernard" and last name "Ungar" clearly distinguishable.

Bernard L. Ungar
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