

Board of Governors of the Federal Reserve System

REVIEW OF THE FINE ARTS PROGRAM



OFFICE OF INSPECTOR GENERAL



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

OFFICE OF INSPECTOR GENERAL

April 16, 2004

Governor Mark W. Olson
Chairman, Committee on Board Affairs
Board of Governors of the Federal Reserve System
Washington, DC 20551

Dear Governor Olson:

Several months ago, the Office of Inspector General of the Board of Governors of the Federal Reserve System (Board) was asked to evaluate the suitability of the Fine Arts Program's (Program) current organizational placement within the Management Division (MGT). We had already scheduled a review of the fine arts inventory management process, and we expanded the scope of our original project plan to include organizational placement.

To perform this evaluation, we conducted benchmarking studies at a variety of organizations with art programs, including the World Bank, General Services Administration (GSA), the State Department, five Federal Reserve Banks, and a foreign central bank. In addition, we reviewed the Program's inventory management practices, along with procedures for receiving and processing monetary and works of art donations. To determine the accuracy and completeness of the fine arts inventory, we conducted a physical inventory of selected works of art. Inventory records maintained by the Program's director were compared to those supporting the Board's financial statements. In addition, we discussed the Program with its director, the MGT director, the director of the Public Affairs Office, and Board staff in the Finance and Accounting Section (F&A). We conducted our review from November 2003 to March 2004 in accordance with the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency.

EVALUATION RESULTS

ISSUE 1 – ORGANIZATIONAL PLACEMENT

According to the Board's *2002 – 2003 Programs & Objectives*, the Program's goals and objectives are, among other things, to enrich the working environment for Board employees, provide an appropriate atmosphere for official visitors and other guests, increase the Board's art collection, and organize exhibits. In the wake of September 11, 2001, the Program has more of an internal focus, and security concerns have curtailed public tours and exhibits. The Program resides in MGT, operates with a budget of \$421,718 for the two-year period 2004-05, and is staffed by a program director and an administrative assistant. Because Board funds are not used

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to purchase works of art, the program director expands the collection by actively soliciting monetary and artwork donations. These donations qualify for tax deductions under section 170 of the Internal Revenue Code. In addition, the program director appoints a Fine Arts Advisory Panel comprised of fourteen art experts and patrons, each of whom are required to donate \$2,500 annually to the Program. This panel provides advice on the Program's overall direction, but has no policymaking or fiduciary responsibilities.

Our benchmarking analysis revealed that the Program's placement in MGT is generally congruent with what we observed in other organizations. Art programs at GSA, the World Bank, and the State Department are housed within general administrative services types of organizations that are typically responsible for facilities management activities, and fulfill a role similar to MGT's support services functions. For example, the fine arts program at GSA is housed within the Office of the Chief Architect, which is part of the Public Buildings Service. At the World Bank, the function is located within the General Services Department, and at the State Department, it is placed under the Bureau of Administration, Office of General Services Management. Similarly, the fine arts program at the Central Bank of Ireland is placed under the Corporate Services Department, which manages the institution's fixed assets. Of the five Reserve Banks included in our benchmarking study, only the Federal Reserve Bank of Minneapolis (FRB Minneapolis) appears to have an actively managed and growing art collection. The FRB Minneapolis art program is located within its Administrative Services Division, which also houses its facilities support services function.

In our view, the Program's current organizational placement is rational because many of its key activities fit with the MGT's core functions, such as building services activities, fixed asset management, and accounting for and valuing physical inventory. However, in light of the inventory management and internal control problems that are discussed below in Issue 2, it is clear that the Program could benefit from an enhanced level of supervision and oversight. In our opinion, this could be accomplished by placing the Program in MGT's General Services or Engineering and Facilities sections. The program director would prefer to have the Program placed in the Office of Board Members, because she believes an affiliation with the highest levels of the Federal Reserve would lead to greater visibility and enhance the success of donation seeking activities. We believe it is unlikely that placing the Program in the Office of Board Members would affect its visibility or result in additional donations. The general public perceives the Federal Reserve as a prestigious entity, and it is doubtful that a potential donor would make a decision based on where the Program resides within the organization.

Notwithstanding any decisions that are made with respect to organizational placement, we believe it would be useful for the Board to reexamine the appropriateness of soliciting monetary and works of art donations. None of the organizations in our benchmarking studies solicit donations of cash or works of art. Both the State Department and GSA rely entirely upon appropriated funds to purchase works of art. The World Bank, Central Bank of Ireland, and the FRB Minneapolis, all use budgeted funds when making an acquisition.

ISSUE 2 – INVENTORY MANAGEMENT AND INTERNAL CONTROLS

The Board’s collection includes 423 works of art, consisting of 312 Board-owned items, and 111 pieces that are on loan from museums, privately owned galleries, and individuals. The program director is responsible for collection management, which includes applying “museum standards” for recordkeeping. Proper inventory management requires maintaining detailed, accurate, and up-to-date records to ensure physical accountability of assets. In conducting our physical inventory testing, we found that the program director maintains two separate inventory databases that include different information. Neither of these databases reflected a complete or accurate inventory of the Board’s fine arts collection. One database contained basic information, such as title, artist name, and date of accession, while the other was developed to include a scanned image and the work of art’s location. Some of the inconsistencies we found included

- twenty-three Board-owned items that appeared on only one of the inventory databases;
- four Board-owned works of art recorded as “on loan”; and
- three works of art with incorrect or duplicate inventory numbers.

We worked with the program director to reconcile the two inventory databases. Once this was completed, we conducted a physical inspection of a judgmentally selected sample that included high-value works of art housed in each of the Board’s three buildings. Each of the items in our sample was found in the appropriate location. Notwithstanding these results, we believe that maintaining two separate inventory databases is inefficient and provides too many opportunities for error. The technology for a robust single fine arts inventory system is available and should be considered. During our benchmarking studies, we observed off-the-shelf software capable of accommodating all of the information that is currently maintained in the two databases. In addition, there is a fixed asset module that can be purchased as part of the Oracle financial software currently used by the Board. Once a single inventory system is established, routine periodic physical inventory counts should be conducted.

The difficulty associated with determining the exact count of the Program’s current inventory prompted us to conduct additional testing to determine the accuracy of the Board’s accounting records. In January 1995, the Board adopted the Financial Accounting Standards Board 116 (FASB) provision that allows for recording purchased artwork at cost and donated works of art at fair market value as of the date it is received. We found that F&A has not consistently applied FASB 116. Our analysis revealed that only fifty-five of 113 purchased works of art, and ten of 199 donated works of art were recorded in the fine arts subsidiary ledger. Currently, the program director is providing F&A with valuation data; however, at the time we began our review, many donated works of art had not been valued. Based on the latest valuation data provided by the program director, we estimate that purchased and donated works of art could add approximately \$1.7 million to the Board’s fixed asset account.

In light of the previous inconsistent application of FASB 116, F&A revisited its prior decision, decided not to record the fine arts collection in the Board’s financial statements, and made the appropriate accounting adjustments. Notwithstanding this or future accounting decisions related to the accounting treatment of the fine arts collection under FASB 116, we

believe it is important that independent appraisals are performed to provide the Board with an approximate value of these assets.

The absence of an accurate inventory management system also prompted us to expand the scope of our review to include a broader based examination of the Program's internal controls. In a well-designed internal control environment, no one person controls all aspects of a transaction or event. Dividing or segregating key duties and responsibilities, such as authorizing, processing, and inventorying transactions, among different employees, reduces the risk of error and fraud. We found that the Program's key functions, such as obtaining monetary contributions, as well as receiving and recording purchased or donated works of art, are all handled and controlled by the program director. In most cases, monetary contributions, as well as purchased and donated works of art, were received directly by the program director and bypassed the controls that are built into the Board's receiving policies and procedures. Moreover, to avoid the delays caused by the enhanced screening procedures, post-September 11, 2001, the program director had works of art and monetary donations sent directly to her residence.

In our view, the absence of adequate separation of duties exposes the Board to a greater risk that errors and potential fraud will not be detected. We believe that written policies and procedures featuring clear separation of duties are needed to establish a sound internal control environment within the Program. The program director should not be receiving monetary contributions or works of art. These transactions should be processed through the Board's accounts receivable function or existing procedures for receiving property that is delivered to the Board.

RECOMMENDATIONS

Based on our evaluation results, we offer the following recommendations:

- 1. We recommend that the Committee on Board Affairs (CBA) reexamine the appropriateness of the Program's current practice of soliciting cash and works of art donations.**
- 2. We recommend that the Director of the Management Division**
 - remove the responsibility for receiving works of art and monetary contributions from the program director, and establish written policies and procedures to ensure these duties are handled through the Board's existing processes;**
 - implement a single fine arts inventory management system;**
 - institute annual physical inventory counts of the fine arts collection; and**
 - ensure that all donated works of art are valued by an independent appraiser.**

We shared the ongoing results of this evaluation with the Board's external financial auditors. They have relied on our work to make similar recommendations in their reporting to the Board. We also presented our results to the MGT director who agreed with each of our recommendations.

Major contributors to this report were Ms. Kimberly Whitten, Senior Auditor and Project Leader, Ms. Silvia Vizcarra, Auditor, Ms. Keisha Turner, Auditor, and Mr. Anthony Castaldo, Senior Program Manager for Inspections and Evaluations. We have provided copies of this report to Board officials and it will be added to our publicly available web site at www.federalreserve.gov/oig. We will also summarize the report in our next semiannual report to Congress. Please contact me if you would like to discuss this report or any related issues, or if you would like us to brief the CBA.

Sincerely,

/signed/

Barry R. Snyder
Inspector General

cc: Governor Edward Gramlich
Governor Donald Kohn
Mr. Stephen Malphrus
Ms. H. Fay Peters
Mr. Steven Clark
Mr. Craig Hiserman
Ms. Mary Anne Goley
Mr. Anthony Castaldo
Ms. Kimberly Whitten