

OFFICE OF THE CITY CONTROLLER



**HOUSTON PUBLIC LIBRARY FOUNDATION
PERFORMANCE AUDIT**

Ronald C. Green, City Controller

David A. Schroeder, City Auditor



**OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS**

RONALD C. GREEN

April 19, 2012

The Honorable Annise D. Parker, Mayor

**SUBJECT: REPORT #2012-11
HOUSTON PUBLIC LIBRARY FOUNDATION – PERFORMANCE AUDIT**

Dear Mayor Parker:

The Office of the City Controller's Audit Division has completed a Performance Audit of the Houston Public Library Foundation (HPLF) based upon a request that came from your office through the City Attorney. The four primary audit objectives were to determine whether:

1. Controls over compliance with policies, procedures, plans, laws and regulations (*including donor intent*) provide evidence with reasonable assurance that compliance activities were properly planned, organized, and directed;
2. Controls over the gathering and reporting of financial and operating data can be reasonably assured to result in data that is accurate and reliable;
3. Controls over operations provide reasonable assurance that resources are used efficiently and economically; and
4. Appropriate documentation exists to support management activities.

We concluded that the control structure in place was *not adequate* to assure:

- Compliance (*Policies, procedures, laws, donor intent, etc.*);
- Reporting of financial and operational data;
- Efficient and effective use of resources; and
- Existence of relevant and reliable supporting documentation.

In looking at the findings as a whole, we noted the following systemic issues:

- Lack of accounting and finance expertise to adequately monitor compliance and assess performance (Findings #1-3);
- Lack of timely remediation of internal control issues identified since 2007 (Findings #1,5);
- Lack of integrated communications to most efficiently and effectively utilize donated funds (Finding #1,4);
- Program spending per dollar has declined (Finding #3); and
- Fund-raising efforts have not increased Net Assets, while Administrative and Fundraising costs have increased significantly (See Graph #4 and Finding #3).



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We appreciate the cooperation and professionalism extended to the Audit Division during the course of the project by HPLF, HPL, GHCF, and City Legal staff. While the audit process proved to be challenging at times, members of the HPLF Board showed significant interest and concern for remediation of issues identified, especially during the reporting phase of the project.

Respectfully submitted,

Ronald C. Green
City Controller

cc: City Council Members
Houston Public Library Foundation Board Members
Chris Brown, Chief Deputy City Controller, Office of the City Controller
Waynette Chan, Chief of Staff, Mayor's Office
Susan Bischoff, President, Houston Public Library Foundation
David Schroeder, City Auditor, Office of the City Controller

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Audit Division

EXECUTIVE SUMMARY

INTRODUCTION

The Office of the City Controller's Audit Division has completed a Performance Audit that considered compliance and efficiency of the Houston Public Library Foundation (HPLF), formerly known as Houston Library Board (HLB). The audit originated as a request from the Mayor's Office via the City Attorney based on HPLF seeking City and Council approval to operate as an independent entity. While included in the fiscal year (FY) 2012 Audit Plan, the audit was not a direct result of our Enterprise Risk Assessment process.

It is important to emphasize that the work performed was not an audit or review of the Houston Public Library Department (HPL) within the City of Houston, nor was it a review of the quality of library services provided directly to the constituency by HPL.

The audit focused on the management and administration of donated funds held in trust by HPLF and the control structure put in place to safeguard and account for those funds by the Executive Staff as delegated by the Board.¹

BACKGROUND

On March 29, 1977, the Houston City Council adopted Ordinance No. 77-631 creating the HLB as a non-profit corporation under the Texas Non-Profit Corporation Act. The HLB, in its original form, consisted of 19 members nominated by the Mayor and confirmed by the City Council, with one membership position being occupied by a nonresident of the City. Terms for members is set for a two-year period. In addition to the 19 members, the board consists of two nonvoting members serving as ex-officio. These ex-officio members include the Mayor and the Superintendent of the Houston Independent School District. "*Members of the HLB serve without compensation from the City or any firm, trust, donation or legacy to or on behalf of the City...*" (Section 24-28 of the Ordinance) HLB is considered a *component unit* of the City of Houston (City) and thus their audited statements are incorporated into the City's Consolidated Annual Financial Report (CAFR).²

Per the Ordinance, the HLB was created for the following purposes (mission and objectives):

- "*Solicit funds, gifts, and bequest for library acquisitions, additions and improvements.*"
- "*Review and make advisory recommendations to the mayor and city council on the acceptance of gifts of real estate, art objects, and items of similar nature. Review and make advisory recommendations to the mayor and city council on any proposed physical additions and improvements to be paid for with city funds.*"
- "*Review and make recommendations on library department matters submitted to it by the director of the library department or by the mayor and city council.*"
- "*Manage and invest and oversee the management and investment of funds, gifts, and bequest donated for library purposes and held in special trust accounts set up by the board for these purposes or invested by the board.*"
- "*...cooperate with any trust created for purpose similar to its own...*"
- "*...contract for financial management and investment services and pay reasonable fees for funds from gifts, bequests and income...*"
- "*Whenever funds are given to the Houston Public Library (HPL) with a specific purpose... exercise sole discretion on how to accomplish the intended purpose...*"
- "*...seek removal of any trustee of trusts created to benefit the libraries of the City...*"³

¹ While, the executive functions and management of the operations of HPLF have been delegated to a hired staff, the Board is ultimately accountable for those activities. For further definition of the boundaries and objectives of the audit, see "Audit Scope and Objectives" section.

² A Component Unit is generally defined as a related entity that has its leadership appointed by the Primary Government and is financially dependent or serves the primary government and therefore would not otherwise exist.

³ Bullets represent information taken directly from Section 24-31 and 24-32 of the Ordinance. A quorum of membership needs to be present to record the key discussion points and document the voting results that support the actions taken.

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For most of its history, HLB did not have paid administrative or executive staff. HPL, under the direction of the HLB, maintained records of all donations, managed the day-to-day operations related to spending donations/gifts, and kept the financial accounting records of the HLB.

In 2006, HLB started on a process of attempting to become an independent non-profit organization as opposed to continuing as a governmental component unit of the City. On July 1, 2006, the HLB submitted to the IRS Form 1023 (Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code). On Aug. 16, 2006, the IRS informed the HLB that their application had been approved and the HLB became recognized as a Section 501(c)(3) tax exempt organization effective July 3, 2006. Organizations classified under this section are further classified as either public charities or private foundations.⁴ *It's important to identify that while HLB was granted 501(c)(3) for tax purposes, the ownership and legal structure as created by the City ordinance has not changed. Thus, when considering both the legal structure and the fact that HPLF is classified and reported as a Component Unit of the City, HLB/HLPF remains under the direct financial and management control of the City.*

In December 2006, the HLB hired its first Executive Director/President, effective January 8, 2007. The Executive Director then hired a full-time executive assistant and a full-time Director of Development (for fundraising) along with two other staff. On June 8, 2007, the Executive Director of HPLF filed a Certificate of Amendment with the Texas Secretary of State changing its name to the Houston Public Library Foundation (HPLF) and on July 1, 2007, HPLF merged with the Friends of the Houston Library (Friends). 'Friends' has retained their Board of Directors and a separate bank account, while HPLF records 'Friends' membership dues as part of their revenue and contributions. HPLF also assists Friends in administering their two annual book sales, the Children's Book Sale and the Annual Bargain Book Sale, which are also recorded as their revenue and contributions.

On May 27, 2008, the HPLF President outsourced the accounting functions to the Greater Houston Community Foundation (GHCF). These were additional steps taken to become more independent from the City and the HPL.⁵

Since 2006, there has not been substantive liquid donation activity that has increased or impacted the overall fund balance. Specifically, the Total Net Assets held in trust on behalf of HPL and the City as of June 30, 2006, was \$18,833,596.⁶ The Total Net Assets as of June 30, 2011, were \$23,359,944. *The \$4.5 million change in net assets between FY2006 and FY2011 was due to a non-cash pledge (commitment) from Microsoft for software of approximately \$4.3 million, with the remaining amount being attributable to fluctuations in the market value of investments⁷ (See Graph 4).*

⁴ HLPF continues to be classified as a public charity as determined by the IRS on August 16, 2006.

⁵ For key definitions used throughout this report, see the Appendix.

⁶ FY2006/2005 Audited Comparative Financial Statements.

⁷ The pledge originated in FY2009



AUDIT SCOPE AND OBJECTIVES

The original engagement scope consisted of the analysis and review of financial, operational, and administrative records from FY2006 through FY2011. Because the creation of HLB dates back to 1977, consideration was given to establishing a review period ranging from fiscal year 1977 through FY2011; however, reliable supporting documentation for the entire 35-year period was not available.

Our original objectives were broadly defined as: 1) Due diligence based on compliance with relevant GASB, FASB pronouncements and other applicable authoritative guidance; 2) Test the effectiveness of controls identified; and 3) Identify and quantify the City's interest in funds currently held, controlled, managed and/or reported by HPLF.

After conducting our initial research on foundations and charitable entities as well as interviews with key personnel to gain an understanding of the functions performed by HPLF and HPL, we further refined the engagement objectives to determine whether:

1. Controls over compliance with policies, procedures, plans, laws and regulations provide evidence with reasonable assurance that compliance activities were properly planned, organized, and directed (*including donor intent*);
2. Controls over the gathering and reporting of financial and operating data can be reasonably assured to result in data that is accurate and reliable;
3. Controls over operations provide reasonable assurance that resources are used efficiently and economically; and
4. Appropriate documentation exists to support management activities.

PROCEDURES PERFORMED

In order to obtain sufficient evidence to achieve engagement objectives and support our conclusions, we performed the following:

- Reviewed and analyzed investment transactions (between June 26, 2006, through June 30, 2011);
- Reviewed endowment fund balances and restrictions;
- Interviews and inquiries with relevant business process owners;
- Reviewed, analyzed and verified transactions that support HPLF financial statements and HPL program spending (including key schedules prepared by HPLF management, allocations and classifications of HPLF expenses, etc.);
- Reviewed and verified the receipt, recording of contributions and deposits;
- Analyzed annual HPLF financial statements and Form 990s; and
- Reviewed Board minutes for authorization(s) concerning Payroll benefits and bonuses, bank signatory authority, and endowment fund activity.

AUDIT METHODOLOGY

Our work was conducted in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Practice of Internal Auditing as promulgated by the Institute of Internal Auditors. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.



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The scope of our work did not constitute an evaluation of the overall internal control structure of HPLF. Management is responsible for establishing and maintaining a system of internal controls to ensure that City assets are safeguarded; financial activity is accurately reported and reliable; and management and employees are in compliance with laws, regulations, and policies and procedures. The objectives are to provide management with reasonable, but not absolute assurance that the controls are in place and effective.

CONCLUSIONS AND SIGNIFICANT ISSUES

We believe that we have obtained sufficient and appropriate evidence to adequately support the conclusions provided below as required by professional auditing standards. Each Conclusion is aligned with the related Audit Objective for consistency and reference. For detailed findings, recommendations, management responses, comments and assessment of responses, see the “***DETAILED FINDINGS, RECOMMENDATIONS, MANAGEMENT RESPONSES, AND ASSESSMENT OF RESPONSES***” section of this report.

In looking at the findings as a whole, we note the following systemic issues:

- Lack of accounting and finance expertise to adequately monitor compliance and assess performance (Findings #1-3);
- Lack of timely remediation of internal control issues identified since 2007 (Findings #1,5);
- Lack of integrated communications to most efficiently and effectively utilize donated funds (Finding #1,4);
- Program spending per dollar has declined (Finding #3); and
- Fund-raising efforts have not increased Net Assets, while Administrative and Fund-raising costs have increased significantly (See Graph #4 and Finding #3).

CONCLUSION 1 –

Based on the results of the procedures performed, there were *inadequate and/or ineffective internal controls over compliance with laws and regulations (including donor intent)*. Because of the deficiencies identified, these internal controls do not provide a reasonable assurance that HPLF is complying with laws and regulations as they relate to non-profit organizations. (**AUDIT OBJECTIVE #1**)

The most significant issues noted were:

- HPLF was not sufficiently knowledgeable about the restrictions on the endowment funds until 2011 nor did HPLF consistently allocate earned interest/dividends and unrealized gains/losses. The Texas Property Code, Uniform Prudent Management of Institutional Funds Act (TXUPMIFA), requires an organization (HPLF) to know the fair market value of each endowment fund on a quarterly basis. (**See Finding #1**)
- HPLF does not review HPL expenditures for compliance with applicable donor restrictions. (**see Findings #1 and #2**)



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CONCLUSION 2 –

Based on the results of the procedures performed, there were *inadequate and/or ineffective internal controls over the gathering and reporting of financial and operating data*. Because of the deficiencies identified, these internal controls do not provide a reasonable assurance that the data is accurate or reliable nor do they ensure that donor intentions on restricted funds are being followed. **(AUDIT OBJECTIVE #2)**

The most significant issues noted were:

- As of June 30, 2011, \$763,265 was spent from the Permanent Fund that had not been recorded in the Fund Balance Analysis (FBA). The total fund balance of \$19,383,738 was not properly supported by the existence of cash/investment assets (\$18,620,473) and therefore, the restricted fund balances, (consisting of endowment and temporarily restricted funds), are not accurate. **(see “Financial and Information Trends” section and Finding #1)**
- HPLF expenditures are not categorized by the correct functional classification as required by FAS No. 117 and Statement of Position (SOP) 98-2. The misclassified expenditures/expenses result in financial statements that are not accurate.⁸ **(see Finding #3)**

CONCLUSION 3 –

Based on the results of the procedures performed, there were *inadequate and/or ineffective internal controls over operations*. Therefore, the internal controls as currently in place do not provide a reasonable assurance that HPLF is using their resources efficiently or economically. **(AUDIT OBJECTIVE #3)**

The most significant issues noted were:

- General and Management costs have been increasing, while the long-term donations have been decreasing. This is also reflected in the decreasing percentage of spending on activities that are directly related to providing end-user services (“Program”) when looking at the average spending per dollar of donation. Further, since the hiring of paid executive staff, additional accounting, marketing, legal and consulting services have been incurred on an ongoing basis, contributing to the increased Management, General, and Administrative (MG&A) expenditures. **(see “Financial Information and Trends” and Finding #3)**
- HPLF does not take an active role in the tracking and maintaining of restricted fund balances. *This is partially reflected in a growing interfund payable from the General (Operating) Fund to the Permanent Fund and has also resulted in a growing operating deficit in the General Fund.* **(see “Financial Information and Trends” and Finding #1)**

CONCLUSION 4 –

Based on the results of the procedures performed, *appropriate documentation does not exist to support management activities and decision-making*. **(AUDIT OBJECTIVE #4)**

The most significant issues noted were:

- There were several significant decisions made and actions performed by HPLF management that were not supported by Board Minutes. The undocumented actions included the following:
 - Bonuses paid to HPLF employees;
 - Benefits paid to HPLF employees’;
 - Removing HPL employees’ signature authority over the Operating account; and
 - Changing endowment corpus amounts and the decision to classify two endowment funds as “committed.” **(See Finding #4)**

⁸ The term ‘not accurate’ is not the same concept as the term ‘materiality misstated’ as used in a financial statement audit.

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SUMMARY COMMENTS

As various options of corrective action are contemplated by responsible management, it is imperative to consider:

- Financial Information and Trends as presented;
- Past history of remediation efforts/actions taken to adequately address significant internal control deficiencies;
- Need for simplicity in the organizational structure that will provide clarity of who the relevant intermediary(ies) and ultimate beneficiaries are to the constituency and potential donors; and
- Need for synergetic relationships that are essential to be successful in achieving a common goal.

ACKNOWLEDGEMENT AND SIGNATURES

The Audit Team would like to thank HPLF management and board, HPL, and the Legal Department for their cooperation, time and efforts throughout the course of the engagement. While the audit process proved to be challenging at times, members of the HPLF Board showed significant interest and concern for remediation of issues identified, especially during the reporting phase of the project.

A handwritten signature in blue ink that reads "Courtney E. Smith".

Courtney E. Smith, CPA, CIA, CFE
Audit Manager

A handwritten signature in blue ink that reads "David Schroeder".

David Schroeder, CPA, CISA
City Auditor



FINANCIAL INFORMATION AND TRENDS –

The following section shows relevant financial information and trends of HPLF. The data was derived from a combination of the general ledger and journal detail provided by GHCF and HPLF for the period identified in the scope and objectives, as well as the audited financial statements from the relevant period. The information intends to provide quantitative data for operational analysis, performance, and indicators of predictors based on the most recent two to five fiscal years (see **GRAPHS 1 - 3**).

Comparing the audited financial statements from fiscal years ending June 30, 2010, to June 30, 2011, note an increase in both an Interfund Payable/Receivable and a General Fund deficit. The Interfund balances show a growing portion of the Permanent Fund that is being “borrowed” against with no concrete plan to replenish and triggers the increasing deficit in the “Unassigned” (Unrestricted) balance in the General Fund (See **TABLE 1** below).

TABLE 1 - Highlights of Financial Statements and Supporting Schedules
(Excerpts from the June 30, 2011 and 2010 Audited Governmental Balance Sheet and Statement of Net Assets and supporting schedules.)

	2011		2010	
Fund Balance Analysis (detailed supporting schedule that tracks donor fund balances and should represent a balance of unspent dollars)		\$ 19,383,738		\$ 16,008,381
Investments (Balance Sheet asset supported by account statements that show the existence of cash/investments)		\$ 18,620,473		\$ 15,569,728
Difference (Shown as a Recievable in the Permanent Fund and a Payable in the General Fund)		\$ 763,265		\$ 438,653

NOTE: The **Difference** creates an Interfund Payable/Receivable because the details of money spent is not clearly supported by the schedule of endowments on the Fund Balance Analysis (FBA). This results in the deficit (negative) Unrestricted Fund Balance. If this trend continues, there will not be sufficient unrestricted funds to cover operating costs and may violate donor restrictions .

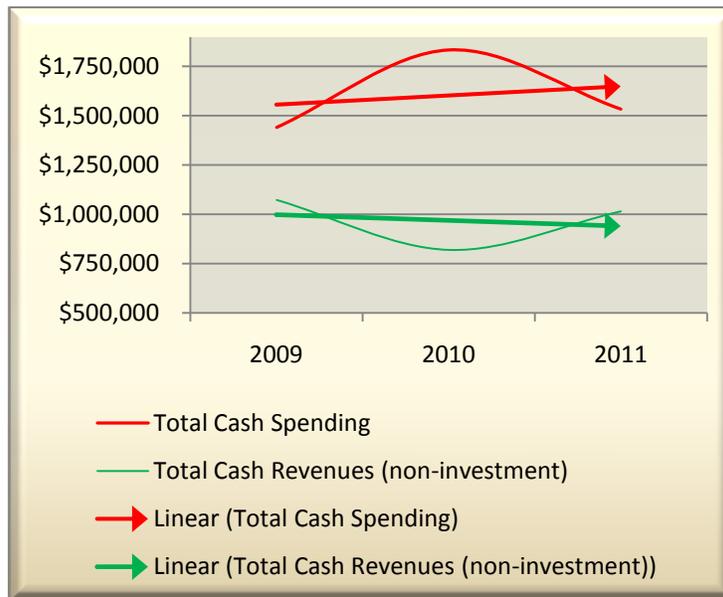
	2011		2010	
	General Fund	Permanent Fund	General Fund	Permanent Fund
ASSETS:				
Cash	\$ 405,081		\$ 382,061	
Investments	\$ 65,418	\$ 18,620,473	\$ 61,336	\$ 15,569,728
Interfund Recievable		\$ 763,265		\$ 438,653
TOTAL ASSETS	\$ 470,499	\$ 19,383,738	\$ 443,397	\$ 16,008,381
LIABILITIES:				
Interfund Payable	\$ 763,265		\$ 438,653	
Accounts Payable (including accruals and funds held for others)	\$ 84,815		\$ 69,255	
TOTAL LIABILITIES	\$ 848,080		\$ 507,908	
Nonspendable and Restricted Funds		\$ 17,259,768		\$ 13,974,820
Committed Funds		\$ 2,123,970		\$ 2,033,561
Unrestricted Fund Balance	\$ (377,581)		\$ (64,511)	
TOTAL LIABILITIES AND FUND BALANCES	\$ 470,499	\$ 19,383,738	\$ 443,397	\$ 16,008,381



GRAPH 1 – TOTAL CASH SPENDING RELATED TO TOTAL CASH REVENUES⁹

GRAPH 1 shows the overall trend in the change to net assets, which also reflects the mid- and long-term financial effects based on spending decisions and the strategy to generate revenue. Opposing trends in spending vs. revenues is a signal for long-term depletion, inefficient or ineffective spending, and potential insolvency and inappropriate spending if corrective strategy and contingencies are not implemented. A higher overall spending vs. revenue does not always indicate a problem (the composition of spending provides a clearer view of that aspect – see **GRAPHS 6 AND 7 in Finding #3**).

DESCRIPTION	DEFINITION AND CALCULATION
Total Cash Spending (Red Arrow/Line)	Total Expenses <i>less</i> In-Kind Expense (Amortization and/or Depreciation, Etc.).
Total Cash Revenues (Green Arrow/Line)	Total Revenues <i>less</i> Investment Gains/Losses (realized, unrealized, interest, and dividends) and In-Kind Gifts/Contributions.



⁹ The lines containing arrowheads and labeled as “Linear” are mathematically calculated trend lines based on the actual data as reflected by the smoothed lines.

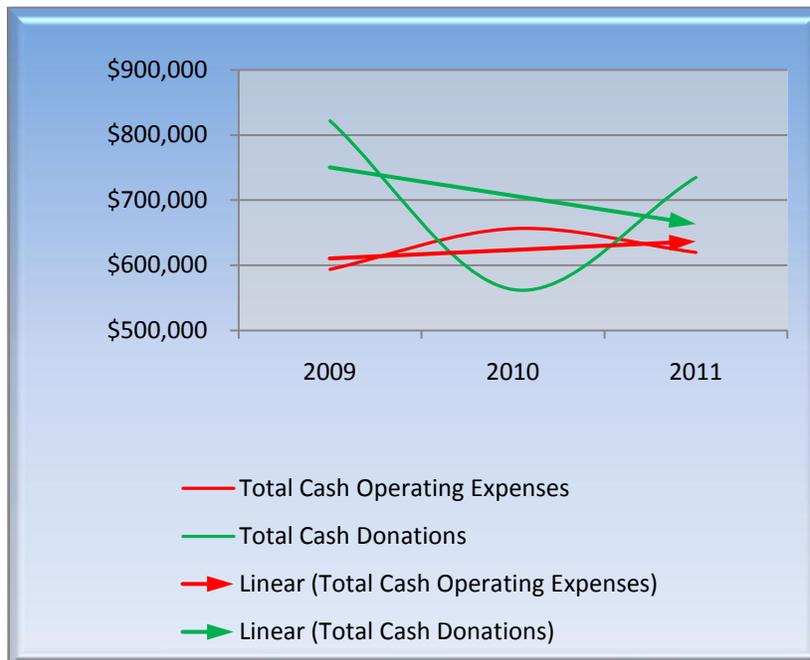


GRAPH 2 – OPERATING EXPENSES VS. CASH DONATIONS

GRAPH 2 shows the efficiency of HPLF to generate current unrestricted donations that sufficiently cover its operating costs (decision-making for both of these financial measurements are under the direct control of HPLF). Trend lines moving in opposing directions (*decreasing Cash donations, with increasing Cash Operating Expenses*) can signal:

- Inefficient operational spending of MG&A
- Insufficient new donations resulting from fund-raising efforts¹⁰

DESCRIPTION	DEFINITION AND CALCULATION
Total Cash Donations (Green Arrow/Line)	Total Revenues <i>less</i> Investment Gains/Losses (realized, unrealized, interest, and dividends), In-Kind Gifts/Contributions, and Revenue activity generated by HPL and the Friends of the Houston Library.
Total Cash Operating Expenses (Red Arrow/Line)	Total Expenses <i>less</i> Grant Funding and Depreciation/Amortization.



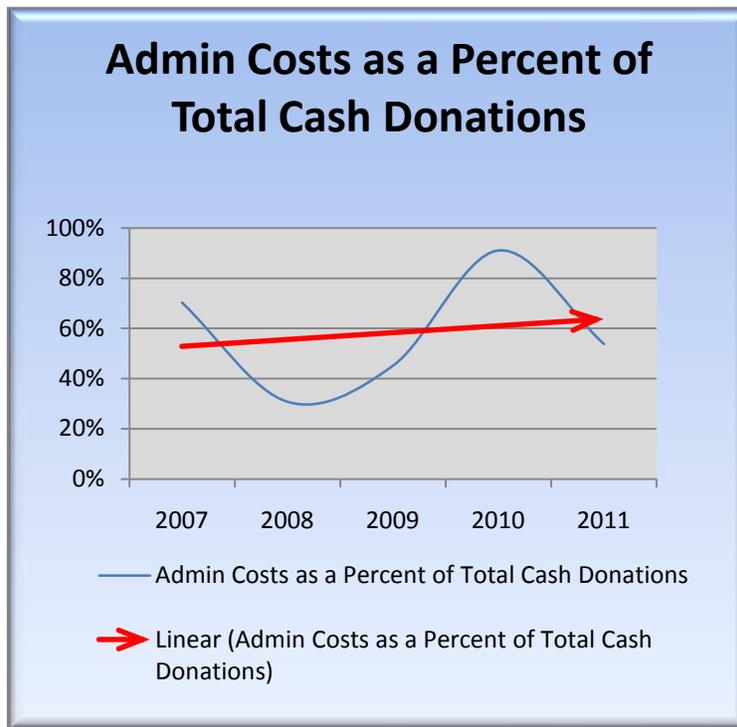
¹⁰ Fund-raising is also influenced by inherent risks (such as economic conditions).



GRAPH 3 – ADMINISTRATION COSTS AS A PERCENTAGE OF TOTAL CASH DONATIONS

GRAPH 3 shows the donated liquid assets as consumed by administrative activities. A trend of increase can be another indicator of inefficient or ineffective spending and potential insolvency if appropriate strategy and contingencies are not implemented.

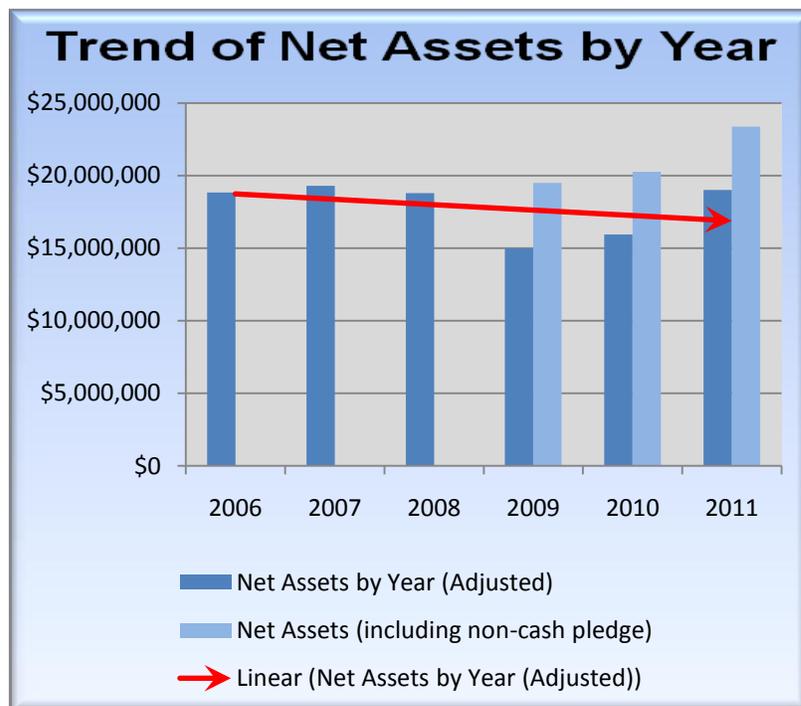
DESCRIPTION	DEFINITION AND CALCULATION
Administration Costs (Management and General Expenditures)	Total Expenses associated with the ongoing functions of HPLF <i>including</i> salaries (<i>not including those specifically identified as fund-raising</i>), benefits, consulting and contractors, outsourced functions of accounting, payroll, legal fees, HPLF training, etc.
Total Cash Donations	Total Revenues <i>less</i> Investment Gains/Losses (realized, unrealized, interest, and dividends), In-Kind Gifts/Contributions, and Revenue activity generated by HPL and the Friends of the Houston Library.





GRAPH 4 – TREND OF NET ASSETS BY YEAR

GRAPH 4 represents Net Assets as reported on the financial statements between FY2006-FY2011. Net Assets reflects the 'equity' or value of the foundation and is an indicator of fund-raising performance, investment returns, and operating efficiency. Total Net Assets held in trust on behalf of HPL and the City as of June 30, 2006, was \$18,833,596¹¹, while the Total Net Assets as of June 30, 2011, were \$23,359,944. The \$4.5 million change in net assets between FY2006 and FY2011 was due to a non-cash pledge (commitment) from Microsoft for software of approximately \$4.3 million, with the remaining amount being attributable to fluctuations in the market value of investments. When considering cash and in-kind gifts already received (Adjusted), the trend shows that there has been no overall increase in the last six fiscal years to Net Assets. When evaluating **GRAPH 4** along with Administrative Spending (Finding #3), a flat trend line can indicate lack of significant donation activity and/or operational inefficiency.



¹¹ FY2006/2005 Audited Comparative Financial Statements.



DETAILED FINDINGS, RECOMMENDATIONS, MANAGEMENT RESPONSES AND ASSESSMENTS OF RESPONSES

FINDING #1 – ACCOUNTING FOR AND VALUATION OF ENDOWMENT FUNDS

BACKGROUND:

In 2007, HPLF began to take over various finance, accounting, and management responsibilities that had previously been performed by HPL staff. One of these was tracking the endowment balances and ensuring that funds disbursed were spent in accordance with donor and Board imposed restrictions. This would also include allocating earned interest and dividends, unrealized gains/losses, and any additional cost between the endowments. Endowment balances are tracked on a key accounting document titled "Fund Balance Analysis" (FBA) and is used as the primary support for the financial statement presentation.

In order to perform these functions, HPLF needs to know the restrictions associated with each endowment. At the time of the transition there is documentation supporting the fact that some HPL staff had knowledge of the various endowment restrictions. It is not clear if this knowledge was requested by HPLF from HPL staff or if it was ever forwarded to HPLF.

In 2010, a retired Certified Public Accountant (CPA) volunteered his services to HPLF and researched each endowment to determine the restrictions and corpus amounts. His work was finalized and used during the FY11 annual audit.

HPLF has a fiduciary responsibility to know the donor restrictions imposed on the endowments, ensuring the funds are spent according to those restrictions, and ensuring that endowment balances are accurate.

HPLF is also required to follow the Texas Property Code Chapter 163 Uniform Prudent Management of Institutional Funds Act (TUPMIFA) when managing the endowment funds. A section within TUPMIFA limits the amount of expenditures that can be made from an individual endowment on an annual basis. The expenditures cannot be greater than a percentage of the fair market value of an endowment fund. Section 163.005 (d) and (e) document in detail the requirements:

- An endowment fund with a calculated fair market aggregate value of \$1 million or more is limited to expenditures of 7% of the fair market value. If expenditures are greater than 7% there is a rebuttable presumption of imprudence.
- An endowment fund with a calculated fair market aggregate value of less than \$1 million is limited to expenditures of 5% of the fair market value.
- Both are based on the fair market value of an endowment calculated at least quarterly and averaged over the three years immediately preceding the year the expenditure is made.



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FINDING:

As of June 30, 2011, \$763,265 was spent from the Permanent Fund that had not been recorded in the FBA. Therefore the total fund balance of \$19,383,738 was not properly supported by the existence of cash/investment assets (\$18,620,473) (**See also TABLE 1 in the Executive Summary/Financial Information and Trends Section, page 7**). To balance the financial statement, a current liability of \$763,265 is recognized at June 30, 2011. The difference has been increasing over the last three fiscal years representing a cumulative effect that has also created a General Fund deficit of \$377,581. If the proper adjustments are not made timely, HPLF is at an increasing risk of spending donor restricted money inappropriately and not being compliant with TUPMIFA.

Outlining the root causes, as noted in the bullets below, HPLF management has not been maintaining an active role in managing individual fund balances for purposes of tracking endowments on the FBA. (**See also Finding #2**)

- Until FY2011, HPLF was not aware of the restrictions associated with each endowment. (**See also Finding #2**)

Because HPLF did not know the fund restrictions or understand what affected the balances, there is a high risk of non-compliance with donor intent and relevant regulations.

The annual limits on expenditures apply to funds whose restrictions are set by the donor rather imposed by the Board. Without knowing this information HPLF could not ensure that they were in compliance with TUPMIFA from FY08 – FY10.

- HPLF does not consistently allocate earned interest/dividends and unrealized gains/losses.

For FY2008 through FY2010 the net return on investments were losses and no allocations were made, while in FY2011, the net effect was a gain and an allocation was made. Because HPLF did not allocate net losses to the endowment funds, they did not know the fair market value of each fund and could not ensure that they are in compliance with TUPMIFA.

- HPLF does not have the FBA accurately aligned with the underlying investment/bank accounts.

Interest/dividends and unrealized gains/losses were erroneously allocated to the Greenberg Endowment. The Greenberg Family donates an annual amount based on their trust account earnings. The donation to HPLF is not deposited in the investment account and therefore does not specifically generate earnings.

NOTE: In previous letters to management, the external auditor has noted the lack of HPLF's knowledge over fund restrictions and allocation of investment return as a material internal control weakness from 2007 – 2009.



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RECOMMENDATIONS:

- HPLF management should: (a) re-evaluate their FBA's from 2007 to present; (b) specifically identify the \$763,625 previously spent; (c) update the FBA by properly correcting the allocations and related endowment balances; and (d) adjust the Permanent Fund accordingly. In addition, HPLF management should:
 - Take an ownership role in the preparation, validity, accuracy and compliance of detailed activity, which is ultimately the tracking of individual endowment balances. They should be responsible for the allocation of expenses and when applicable, contributions to the endowments.
 - Determine the market value of each endowment balance on at least a quarterly basis and then average those balances over three years to ensure they comply with the TUPMIFA.
 - Work closely with HPL to develop a reporting mechanism sufficient enough to determine which funds have been spent by HPL. This should be performed on at least a quarterly basis to ensure compliance with the TUPMIFA.
 - Redesign the FBA to be properly aligned with underlying investment/bank account.

HPLF

RESPONSE:

"HPLF has been deliberate in funding annual grants to HPL from either non-Endowment funds or that portion of Endowment Funds that are known to be unrestricted under TUPMIFA, until an independent verification of donor intent could be conducted by thorough investigation of original source documents. This analysis has been completed, and the cumulative gains/losses were posted to individual accounts for FY11; disbursements for prior years will be posted to the individual accounts by December 31, 2012. Over these years HPLF has been fully appreciative of the importance of honoring donor intent, and wished to make an independent confirmation with this very labor-intensive investigation.

In 2007 HPLF hired its first-ever professional staff and began to incur management and administrative expenses; as in the past, all accounting continued to be performed by HPL staff. Actions to establish the framework for transitioning to a high-performing nonprofit organization included interviewing investment firms and independent CPA firms with strong non-profit credentials. Wachovia Securities was selected to provide investment consultation to the Finance Committee and Board (improving returns and substantially reducing fees) and Blazek & Vetterling was engaged to perform the FY2007 audit, and has since performed independent audits through Fiscal Year 2011, all of which resulted in clean opinions.

HPL financial staff remained responsible for all HPLF's financial accounting until the beginning of Fiscal Year 2009, when accounting for operational expenses was outsourced to the Greater Houston Community Foundation (GHCF). HPLF has planned to employ a part-time accounting professional later this fiscal year, and will begin to transition away from GHCF.

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HPLF staff, Greater Houston Community Foundation staff, and HPLF directors have worked with HPL steadily over the past four years to improve understanding and management of the Endowment Funds. Progress, though slower than all would have preferred, has been significant. An exhaustive 18-month study by HPLF staff and volunteers of previously-lost historical records was completed in August 2011 and enables a high level of confidence in the restrictions applicable to Endowment Fund balances as of June 30, 2011 and going forward.

HPLF management accepts the Recommendations and, specifically, commits to the following remediation steps by December 31, 2012:

- Reevaluate the Funds Balance Analyses since 2007, identify endowment funds previously spent, update the FBA and adjust the Permanent Fund accordingly.*
- Assume responsibility for ownership of tracking individual endowment balances, including allocation of HPL spending and when applicable, contributions to the endowments.*
- Determine the market value of each endowment balance and, going forward, on a quarterly basis ensure compliance with TUPMIFA.*
- Work with HPL to develop a reporting mechanism sufficient to determine which endowment funds have been spent by HPL and ensure compliance of same with TUPMIFA.*
- Redesign the FBA to facilitate reconciliation to the underlying investment balances.”*

HPL

COMMENTS:

“HPL agrees with the recommendations.

HPL affirms that it has worked with HPLF staff and directors to ensure understanding of the Endowment Funds and donor intent. HPL had only an initial meeting with the Greater Houston Community Foundation staff to turn over financial documents

HPL maintains that information relating to donor intent was comprehensive and never lost and was provided to the HPLF Finance Committee at their request in 2006. A comparative analysis of the data given to HPLF by HPL in 2006 with the results of the HPLF exhaustive 18 month study completed in 2011 has not been shared by HPLF to substantiate their observations.”

ASSESSMENT OF

MANAGEMENT RESPONSE:

The commitment contained in the response adequately addresses the issue and proposes to remediate.



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FINDING #2 – REVIEW AND RECORDING OF PROGRAM EXPENDITURES

BACKGROUND:

Up through June 30, 2008, the accounting functions of the HPLF were being performed by HPL personnel. Beginning July 1, 2008, the accounting responsibilities were outsourced to the Greater Houston Community Foundation (GHCF). GHCF is a 501(c)(3), that provides management and accounting services to an array of foundations in the Houston area.¹² At approximately the same period of time, HPLF set up a separate bank account at Wells Fargo (Agency Account) which was designated for expenditures made by HPL in administering program activities as funded by HPLF. HPL prepares monthly expenditure reports that represent program spending and submits them to the HPLF.

We judgmentally selected and reviewed two monthly expenditure reports prepared by HPL as submitted to HPLF.

FINDING:

- A. HPLF is not performing detailed reviews of expenditures for compliance with applicable donor stipulations. In addition we noted that neither HPLF nor GHCF is reconciling the cash outflows from the HPL Agency Account to detailed expenditures as reported by HPL.
- B. GHCF has been recording the funds transferred to the HPL Agency Account from the HPLF Operating Account as a single expenditure called “Grants to HPL” in their general ledger without proper adjustment based on actual expenses. A balancing entry is made to a contra-asset account (“Funds held for others”) based on the cash balance in the Agency account. This represents unspent funded program dollars from the HPLF Operating Account and donations received directly by HPL.

RECOMMENDATION:

- HPLF should utilize the detailed bank reconciliation performed by HPL along with the monthly expenditure report as a basis for review and to ensure their fiduciary duty of honoring donors’ intent. They should also select expenditures periodically to review for adequate support. (*Similar to the controls that exist to ensure proper spending of the FINRA funds.*)
- The transfer of funds from the Operating account to the Agency account should be recorded as a journal entry between the two related assets and not offset with a contra-asset account. With the bank reconciliation and the expenditure reports, detailed journal entries should be made to properly recognize the expenses as incurred.

¹² While HPLF’s fiscal year-end is June 30th, GHCF maintains HPLF’s general ledger on a December 31st year-end and is then forced to merge information together to be able to prepare financial statements on behalf of HPLF.



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HPLF

RESPONSE:

"The Establishment of the Agency Account was discussed and approved by the City of Houston in a telephone conference call with HPLF staff, board members and HPLF's auditors on October 31, 2008; City of Houston participants in this call were the City Controller, as well as staff from the City Controller's Office and City Legal Departments. All parties to the call approved the purpose of the Agency Account: to make it possible for HPLF to treat HPL like a typical grantee of a philanthropic entity.

These procedures were intentionally designed to enable HPLF to focus primarily on external fundraising and other strategic objectives of the new organization, as opposed to monitoring numerous expenditures, many relatively small, that were under the control and oversight (as previously approved by HPLF) of the HPL Director.

With respect to transfers to the Agency Account of funds to be allocated to restricted Endowment balances, HPLF management accepts the Recommendations and, specifically, commits to the following remediation steps as soon as practicable but no later than December 31, 2012:

- HPLF will utilize the detailed bank reconciliation performed by HPL, along with an improved and more detailed monthly expenditure report (to be developed in concert with HPL), as a basis for review, and will also select periodic expenditures to review for adequate support.*
- Ensure that detailed journal entries properly recognize expenses as incurred."*

HPL

COMMENTS:

"HPL agrees that program expenditures should be allocated to the individual fund balances. This was the process utilized by HPL prior to the consolidation of funds by HPLF. (Please see HPL response to Comments at finding #1)."

**ASSESSMENT OF
MANAGEMENT RESPONSE:**

The commitment contained in the response adequately addresses the issue and proposes to remediate.



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FINDING #3 – MISSTATED CLASSIFICATION OF FUNCTIONAL EXPENDITURES/EXPENSES

BACKGROUND:

As a 501(c), non-profit, governmental component unit of the City of Houston, HPLF is subject to specific accounting and financial reporting pronouncements in recording financial transactions and preparing their financial statements. The Government Accounting Standards Board (GASB) is responsible for establishing accounting standards for activities and transactions of state and local government entities, while the Financial Accounting Standards Board (FASB) is responsible for activities and transactions of all other entities. In general, if GASB has not issued a pronouncement on a particular matter, then governmental entities can seek parallel guidance from the related FASB pronouncements.

HPLF has retained a professional services CPA firm to audit and attest to the proper presentation of the financial statements of HPLF since the fiscal year ended June 30, 2007. This includes the comparative financial statements for the fiscal years ended June 30, 2011 and 2010.

One of the primary comparative statements is titled “*Statement of Governmental Funds Revenues, Expenditures, and Changes in Fund Balances and Statement of Activities*” (*Statement of Activities*). Information in this financial statement is categorized by Expenditures (Expenses) and Revenues. Within those two categories, information is further broken down by type. The GASB does not specifically outline functional classification; however, FASB Statement on Accounting Standards No. 117, *Financial Statements of Not for Profit Organizations* (FAS 117) requires the classification of expenses by functional category. Functional categories and their related definitions per FAS 117 are as follows:

- Program Services (Programmatic Expenditures) – “*the activities that result in goods and services being distributed to beneficiaries, customers, or members that fulfill the purposes or mission for which the organization exists...the major purpose for and the major output of the organization*”¹³
- Supporting Activities
 - Fundraising – “*publicizing and conducting fund-raising campaigns; maintaining donor mailing lists; conducting special fund-raising events; preparing and distributing fund-raising manuals; instructions; and other materials; and conducting other activities involved with soliciting contributions from individuals; foundations, government agencies; and others*”¹⁴
 - Management and General - “*oversight, business management, general recordkeeping, budgeting, financing, and related administrative activities, and all management and administration except for direct conduct of program services or fund-raising activities*”

HPLF’s *Statement of Activities* for the year ended June 30, 2011, contains the functional expenditure categories/classifications: “Programmatic, Fundraising, Management and General, and Investment Management Fee”.

¹³ Statement of Financial Accounting Standards No. 117 Financial Statements of Not-for-Profit Organizations ¶127

¹⁴ Statement of Financial Accounting Standards No. 117 Financial Statements of Not-for-Profit Organizations ¶128



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In making assertions of accuracy and completeness of financial information, HPLF management is required to provide adequate supporting documentation that is used to prepare the financial statements and related schedules (e.g. *Functional Allocation Schedule*). The external auditors then test management's assertions and produce the final audited financial statements that render an opinion on the material fairness of their presentation. (See excerpt below)

Houston Public Library Foundation

Statement of Governmental Funds Revenues, Expenditures, and Changes in Fund Balances and Statement of Activities for the year ended June 30, 2011

	GENERAL FUND	PERMANENT FUND	TOTAL	ADJUSTMENTS (NOTE 7)	STATEMENT OF NET ASSETS
EXPENDITURES / EXPENSES:					
Programmatic	\$ 1,040,929		\$ 1,040,929	\$ 245,784	\$ 1,286,713
Fundraising	228,040		228,040		228,040
Management and general	223,186		223,186		223,186
Investment management fees		\$ 16,059	16,059		16,059
Total expenditures / expenses	1,492,155	16,059	1,508,214	245,784	1,753,998
REVENUES:					
Investment income	646	3,602,707	3,603,353		3,603,353
Contributions	54,501	521,672	576,173	29,043	605,216
Special events (net of direct donor benefits of \$18,575)	133,049		133,049		133,049
Book sales	257,926		257,926		257,926
In-kind contributions				256,396	256,396
Transfers	732,963	(732,963)			
Total revenue	1,179,085	3,391,416	4,570,501	285,439	4,855,940
CHANGES IN FUND BALANCES / NET ASSETS	(313,070)	3,375,357	3,062,287	39,655	3,101,942
Fund balances/net assets, beginning of year	(64,511)	16,008,381	15,943,870	4,314,132	20,258,002
Fund balances/net assets, end of year	\$ (377,581)	\$ 19,383,738	\$ 19,006,157	\$ 4,353,787	\$ 23,359,944

See accompanying notes to financial statements.

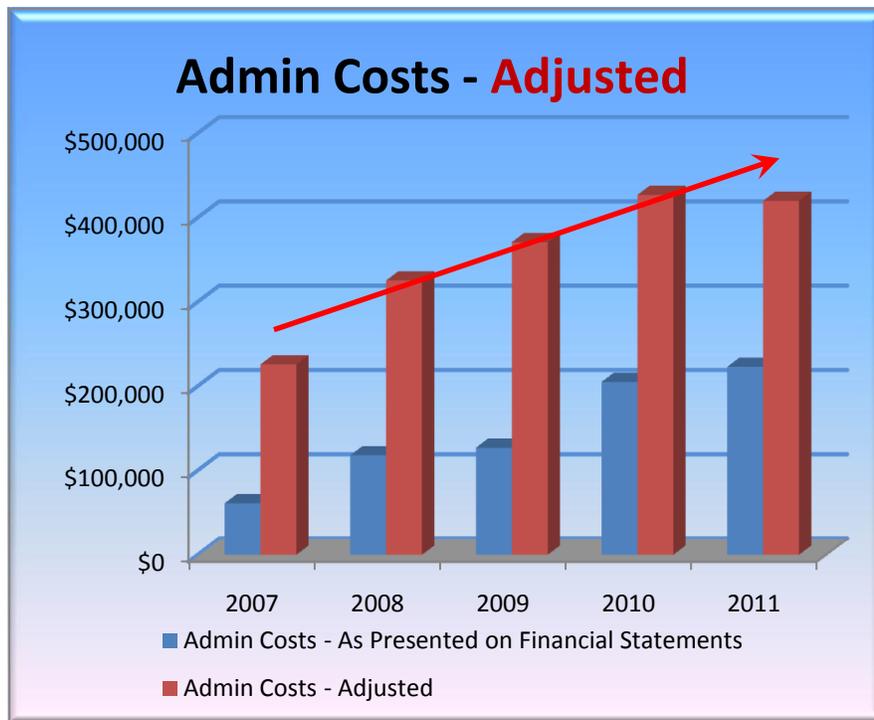


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FINDING:

- HPLF does not have policies and procedures that guide the classification of Foundation expenditures and identify proper substantiation.
- The documentation provided by HPLF did not adequately support nor delineate the process by which functional classifications were made as required by FAS No. 117. The financial statements were, therefore, based on an unsupported worksheet (*Functional Allocation Schedule*) that inaccurately classified and under-reported a significant percentage (approximately 43% for FY2011) of Management and General Expenses (Administrative) by presenting them as Programmatic Expenses. This leads the financial statement reader to incorrectly perceive both a higher funding to HPLF *and* lower HPLF operating costs. (See *Graphs 5, 6, and 7, which show the impact of the misstatement.*)

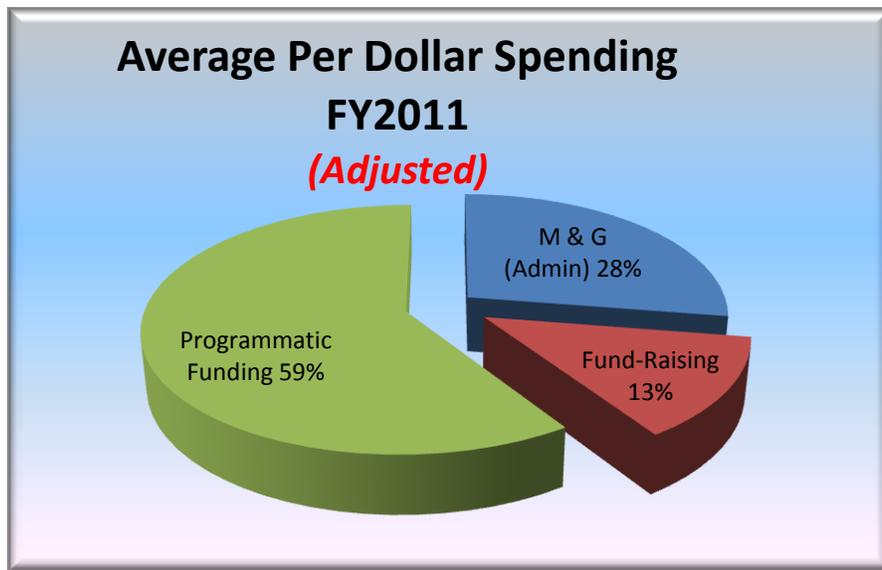
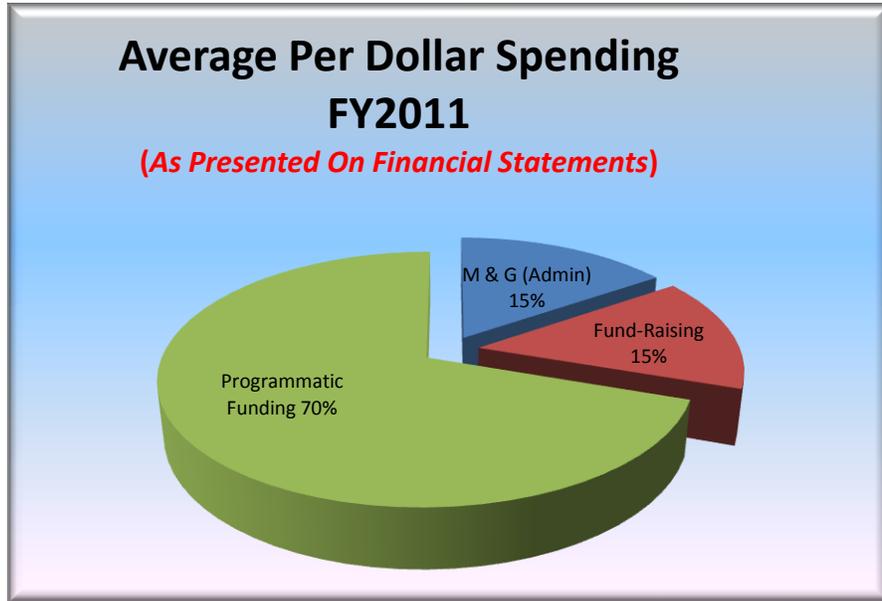
GRAPH 5 – TREND OF ADMINISTRATIVE COSTS¹⁵



¹⁵ The “Adjusted” Admin Costs represents total expenses associated with the ongoing functions of HPLF including salaries (except those specifically identified as fund-raising), benefits, consulting and contractors, outsourced functions of accounting, payroll, legal fees, training, as obtained directly from the detailed general ledger.



GRAPHS 6 AND 7 – AVERAGE PER DOLLAR SPENDING¹⁶



¹⁶ The “Adjusted” Programmatic Funding represents; (a) total actual dollars transferred from HPLF primary operating bank account to HPL agency account which are used to spend on program activities and (b) invoices paid by HPLF for program activity as remitted by HPL. NOTE: for FY2011, (b) represented approximately \$5,000.

The “Adjusted” M&G (Admin.) classification represents total expenses associated with the ongoing functions of HPLF including salaries (except those specifically identified as fund-raising), benefits, consulting and contractors, outsourced functions of accounting, payroll, legal fees, training, as obtained directly from the detailed general ledger.



RECOMMENDATION:

- Policies and procedures should be developed to assist staff members in identifying and maintaining sufficient and appropriate documentation for accurate financial reporting, (including functional expense classifications) and allows for effective financial statement analysis.
- Adequate and substantiated supporting documentation should be maintained by HPLF to enable accurate record-keeping of expenditures. This would ensure properly categorized functional classifications as defined in authoritative guidance and provide stakeholders with reliable financial information.

HPLF

RESPONSE:

“Over the course of this audit it has become clear that HPLF management and the City auditors have a differing perspective on the “program” of HPLF. HPLF’s annual classification of functional expenditures has been reviewed by highly experienced independent auditors during the yearly audit process and subsequently reflected in HPLF’s audited financial statements.

HPLF management accepts the Recommendations and, specifically, by December 31, 2012, will develop policies and procedures to assist HPLF staff members in identifying and maintaining sufficient and appropriate documentation for accurate financial reporting (including functional expense classifications).

Notwithstanding the foregoing, HPLF management believes that certain activities of the Foundation’s staff constitute programmatic functions and we reserve the right to use such designations where we deem it appropriate.”

HPL

COMMENTS:

“HPL agrees with the recommendation that procedures delineating appropriate designations to HPLF expenditures should occur. We believe further that it is more suitable for HPLF and the Office of the Controller to determine if current HPLF procedures are indeed appropriate for classifying and assigning HPLF expenditures and if current procedures are in compliance with laws governing non-profit organizations.

Please note that HPL staff plans, coordinates, markets and implements, all HPL specific programs, events and activities.”



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**ASSESSMENT OF
MANAGEMENT RESPONSE:**

- According to Statement of Position 98-2 “*Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund-Raising*” the item “i” below ***does not constitute program activities***.¹⁷ Effective for years beginning on or after December 15, 1998, the SOP applies to all fundraising activities of Non-Profit Organizations (NPOs) and to state and local government entities.
- HPLF is governed by the original ordinance that created the HLB, which has not changed since its inception. Because HPLF’s mission is to *support* HPL, the ***mission and objectives of HPL are paramount to define “program” activities***.

It’s important to see the distinction between:

- i. HPLF activities that ***generate good will*** or attempt to promote the purpose of HPL and ***generate financial support*** vs.
 - ii. ***Spending of resources to implement activities that serve HPL*** and the constituent group the donor intended to benefit from the gift.
- The documentation provided by HPLF did not adequately support the allocations used. Salaries for Executive Staff not involved in program implementation were allocated without any methodology for the estimates made and the other percentage allocations had no basis for how they were determined.
 - The work performed by the external auditors did not include substantive testing or verification of the classifications, but rather were accepted as presented by management.

¹⁷ AICPA Statements of Position (SOPs), were issued by the AICPA's Accounting Standards Division from 1974 to 2009. The SOPs were meant to influence the development of [accounting](#) standards and to propose revisions to the AICPA's Audit and Accounting Guide (AAGs) series. Audit and Attest SOPs were issued to revise or supplement the AICPA's Audit and Accounting Guides, provide implementation guidance for specific types of audit and attest engagements, and guidance in specialized areas of audit and attest. These SOPs have the same authority as the AAGs.



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FINDING #4 – UNDOCUMENTED HPLF BOARD APPROVAL**BACKGROUND:**

The primary purpose for Meeting Minutes of a Board of Directors is to serve as the official record of key decisions made by a quorum of votes (the City's website indicates a minimum of 10 Board Members need to be present for a quorum). Meeting Minutes reflect the fulfillment of the Board's fiduciary duties, as well as their attention to detail regarding compliance with donor intent and legal obligations. Information contained within the minutes may not be an exact recording of each word spoken but should be comprehensive enough to enable someone who did not attend the meeting to understand the activities that took place and determine what decisions were made.

FINDING:

- On January 14, 2011, the President of HPLF and one other employee were paid a bonus. The HPLF could not provide documentation (i.e. Board minutes) indicating Board resolution of criteria, metrics or approval of the action. In addition, HPLF has not adopted a formal employee incentive compensation policy for its employees.

NOTE: HPLF did provide copy of email dated August 4, 2011, from the Board Chairman indicating that FY11 bonuses were discussed and agreed to on November 22, 2010, at a meeting of the HPLF Executive Committee consisting of a total of five board members.

- The HPLF could not provide minutes or other documentation indicating Board approval granting benefits to Foundation employees. In addition, HPLF has not adopted a formal employee benefit policy.
- There was no formal Board resolution noted in the minutes giving HPLF management the authority to remove HPL staff as Authorized Signers on the Operating bank account however HPLF's bank addendum allowing for the addition or removal of authorized signatures states that each person signing the Addendum to Certificate of Authority adding or deleting signatures:

“certifies that the account owner has taken all action under its organizational documents, if any, including passage of resolutions by its board of directors, trustees, or other governing body, required to make these modifications and to authorize the undersigned to execute and deliver this addendum.”

- There was no formal Board resolution in the minutes noting the reason for the change in either the Endowment corpus amounts or the decision to classify two Endowment funds as “Committed.”



RECOMMENDATION:

- The Board should ensure that all major decisions are supported by formal resolutions approved by a quorum and noted in the Board minutes to include, but not limited to the following:
 - All decisions related to employment compensation activities should be included in the formal board minutes;
 - In addition benefit packages must be properly approved and recorded in Board minutes;
 - Changes in financial management, signature authority, board or executive membership, etc; and
 - Changes in Endowment corpus amounts and classification.
- The Foundation should draw up policies adopting/defining employee benefits.

HPLF

RESPONSE:

“HPLF management accepts the Recommendations and, specifically, by December 31, 2012, will draw up policies adopting/defining employee benefits. Moreover, effective immediately, the Board will ensure that all major decisions are supported by formal resolutions approved by a quorum and noted in the Board minutes.”

HPL

COMMENTS:

“The Controller’s Office and HPLF are best suited to determine the appropriate procedure to follow in this matter.”

ASSESSMENT OF

MANAGEMENT RESPONSE:

The commitment contained in the response adequately addresses the issue and proposes to remediate.



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FINDING #5 – DONATIONS NOT DEPOSITED OR RECORDED

BACKGROUND:

Both HPLF and HPL receive donations directly. When contributions are given directly to HPL, they log, make copies and send them to the HPLF for deposit, who then signs a document acknowledging receipt from HPL and records the funds as contribution revenue.

We reviewed HPLs log of donations received from July, 2007, through May, 2011, and selected the entire population of 55 checks/cash contributions for testing. We then traced them to HPLF's contribution list or to a deposit in the HPLF operating account.

FINDING:

Internal controls over recording and depositing donations are not always effective and do not provide reasonable assurance that all donations received are recorded and deposited.

Six of 55 (11%) of checks/cash contributions sent to the HPLF were not entered into Raiser's Edge and thus not recorded as contributions and were not deposited into the Operating account. In one instance, a donor sent a replacement check noting that the original check had not been cashed. Another check and money were discovered by HPLF staff approximately 17 months after they were received. The whereabouts of four checks is still unknown. The total amount of contributions initially received but not deposited was \$680.

RECOMMENDATION:

HPLF management should maintain a list of contributions sent from HPL and enter this information into the donor database (Raiser's Edge). They should then include this in the reconciliation of the Operating Bank Account and the corresponding revenue accounts.

HPLF

RESPONSE:

"HPLF management accepts the Recommendation and, specifically, commits to the following remediation steps by May 30, 2012:

- HPLF will work with HPL to improve current procedures, and will document those procedures in writing.*
- HPLF will revise current internal procedures to ensure that contributions sent from HPL are entered correctly into Raiser's Edge, and reconciled to the Operating Account and corresponding revenue accounts. These procedures will be documented in writing."*

HPL

COMMENTS:

"HPL agrees with the recommendation and will work with HPLF to develop a mutually agreeable timeline to address the findings."

ASSESSMENT OF

MANAGEMENT RESPONSE:

The commitment contained in the response adequately addresses the issue and proposes to remediate.



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FINDING #6 – DEPOSITS NOT RECORDED AS CONTRIBUTIONS IN THE DONOR TRACKING DATABASE

BACKGROUND:

As HPLF receives donations of checks, monies, or credit cards directly, they prepare the funds for deposit and enter the contributor's name into their donor database (Raiser's Edge). Each month HPLF's accountants (GHCF) match the deposits made into the HPLF Operating bank account to a downloaded report from the database. The database is HPLF's historical record of donations from all of their contributors and is a source that can be used for future fund raising efforts.¹⁸

We reviewed 18 months of deposits from the period of July 2009 through June 2011. The total deposit amount tested was \$1,292,836.

FINDING:

Not all deposits were recorded as contributions in the donor database and in two cases, contributions shown could not be associated with a deposit. (*Revenue associated with the donations was properly recorded*)

- \$240,979 (19%) of deposits were not recorded as contributions in the donor tracking database, and
- \$507 of contributions could not be associated with a deposit.

NOTE: In letters to management, the external auditor noted the lack of HPLF's reconciliation process between the donor database to the general ledger as a material internal control weakness from 2007 - 2009.

RECOMMENDATION:

- HPLF management should perform monthly reconciliations of the Operating account, which would include matching the donor database activity to deposits ensuring that they have been properly recorded as contributions. For adequate segregation of duties, these periodic reconciliations should be performed by someone other than the person who initially recorded them.
- HPLF management should also create a policy and procedure that defines the types of contributions to be entered into the database.

HPLF

RESPONSE:

"Of the \$240,979 (19%) cited above as deposits not recorded as contributions, \$223,559 (92.8%) is a single check dated 3/27/2008—this donation was not made to HPLF, rather to the Houston Metropolitan Research Center, and was, on the advice of Legal Counsel, transmitted by HPLF to HPL on 4/8/2008. HPL deposited the funds into the Operating Account (for subsequent application to the Julia Ideson Building archival project). This deposit by HPL to the Operating Account was identified on audit and properly recorded in the general ledger and Raiser's Edge

¹⁸ HPLF staff stated that for a period of time they had internet connection issues when recording contributions in their donor database and that the database would "drop" some names, however, a reconciliation process would have detected the errors. Further, if the database is incomplete and inaccurate its potential use is diminished.



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HPLF management accepts the Recommendations and, specifically, will implement the following remediation steps by May 30, 2012:

- *HPLF management will establish written procedures for monthly reconciliations of contributions received to the Operating Account and to Raiser's Edge. For adequate segregation of duties, these reconciliations will be performed by someone other than the person who initially receives or records the contribution.*
- *HPLF will refine and document in writing its policy regarding the types of contributions to be entered into the donor database."*

HPL

COMMENTS:

"HPL agrees with the recommendations."

ASSESSMENT OF

MANAGEMENT RESPONSE:

The commitment contained in the response adequately addresses the issue and proposes to remediate, *except* for the following:

The donation for \$223,559 was not in Raiser's Edge at the time of our testing. It was, however, shown on the FBA maintained by HPLF with approximately \$207,000 unspent restricted dollars.



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FINDING #7 – LACK OF SCHOLARSHIP FUND DISTRIBUTION**BACKGROUND:**

In May 2008, HPLF received a donation of \$50,000 to establish a scholarship fund in partnership with Mt. Horeb Missionary Baptist Church. The fund was to provide a student each year with a \$5,000 scholarship. It was suggested by the previous administration that the money be invested with other funds so that it would last longer than 10 years. The fund was not invested with the other endowments and thus its value has not increased.

FINDING:

No scholarships have been presented to a student since the donation was received in 2008. There is no evidence of communication between HPLF and the Church's pastor or their Board since 2008 in clarifying or modifying the criteria for scholarship awards.

RECOMMENDATION:

HPLF should distribute the scholarships per the donor stipulation. If guidance is needed, they should contact the Church's pastor or the Church Board to determine a criterion for dispersing the scholarship or obtain a release to modify or remove the gift restriction.

HPLF**RESPONSE:**

"HPLF made multiple attempts to determine Mt. Horeb's preferences regarding the scholarship award process.

HPLF concurs this matter needs to be resolved and will contact Mt. Horeb to determine the criteria and process to award the first \$5,000 scholarship for the 2012-2013 school year. If Mt. Horeb officials are not interested in pursuing the scholarship program, HPLF will seek a release from the donor to modify or remove the current gift restriction."

HPL**COMMENTS:**

"HPL agrees with the recommendation."

"Former Mayor Bill White secured this gift in honor of the renovation of the African American Library at the Gregory School and specifically to provide scholarships for African American youth. HPL leadership is available to assist HPLF with communications to officials at Mt. Horeb to ensure the scholarship program is put in place to benefit its intended recipients. HPL would strongly oppose these funds being used for an alternative purpose. "

**ASSESSMENT OF
MANAGEMENT RESPONSE:**

The commitment contained in the response adequately addresses the issue and proposes to remediate.

APPENDIX

DEFINITIONS

GENERAL –

CONTRIBUTIONS, DONATIONS, GIFTS – Something voluntarily given to someone or an entity without expectation of a return; that something could be money, property, goods, services or anything of value while receiving nothing or something less than fair market value in return (Non-Exchange Transaction).

RESTRICTION (types and allowable purposes) – Conditions placed on the use of gifts made by donor(s) to an organization or the Board of Directors, which may be temporary or permanent.

ENDOWMENTS – The principal amount of gifts or bequests that are accepted subject to a requirement that its principal be maintained intact and invested to create a source of income for an organization; donors may require that the principal remain intact in perpetuity or for a defined period of time or until sufficient assets have been accumulated to achieve a designated purpose.

CLASSIFICATIONS OF FUND BALANCE –

NON-SPENDABLE – The portion of a donation/gift that cannot be spent (corpus) or is not in a spendable form (inventory, etc.). The classification may be temporary or permanent.

RESTRICTED – Amounts that are constrained or have conditions placed on them by donor(s) to an organization or by the governing body.

COMMITTED – Fund balance amounts restricted to a specific purpose by the highest level of management authority. The restriction can be removed using the same manner in which the committed imposed.

ASSIGNED – Amounts that are *intended* to be used for a specific purpose as designated by the governing body or designee.

UNASSIGNED/UNRESTRICTED – Amounts where no conditions are placed on the use of gifts (from donors). Recipient organizations may use this classification of gifts as they deem appropriate; free of donor restrictions. These are commonly the types of funds that pay for MG&A, and fund-raising costs.



Memorandum from Houston Public Library Foundation

Memorandum

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HPL Director

Susan Bischoff
HPLF President

To: Ronald Green
City Controller

From: Susan Bischoff, President
Houston Public Library Foundation

Date: March 30, 2012

Subject: Houston Public Library Foundation Performance Audit

Controller Green,

In regards to the performance audit conducted by the Controller's Office, we have reviewed the following audit findings and attest the Houston Public Library Foundation responses embedded in the report are those of HPLF management.

We recognize the nature of these discrepancies and their impact on the business process. We will work with your office and resolve these issues beginning April 16, 2012. Please see our expanded audit responses contained in the audit report for our plan of action.

Sincerely,

A handwritten signature in black ink that reads "Susan Bischoff".

Susan Bischoff
Houston Public Library Foundation

Cc: Cathryn Rodd Selman
Harriet Calvin Latimer
Jesse H. Jones II
Franklin D.R. Jones, Jr.



CITY OF HOUSTON

Library Department

Interoffice

Correspondence

To: Ronald Green
City Controller

From: Dr. Rhea Brown Lawson
Library Director

A handwritten signature in blue ink, appearing to read "Rhea Lawson", positioned to the right of the "From:" field.

Date: March 29, 2012

Subject: **HOUSTON PUBLIC LIBRARY
PERFORMANCE AUDIT**

Memorandum from Responsible Management

In regards to the performance audit conducted by the Controller's Office on the Houston Public Library Foundation (HPLF), we have reviewed the following audit findings:

- **FINDING #1** – ACCOUNTING FOR AND VALUATION OF ENDOWMENT FUNDS
- **FINDING #2** – REVIEW AND RECORDING OF PROGRAM EXPENDITURES
- **FINDING #3** – MISSTATED CLASSIFICATION OF FUNCTIONAL EXPENDITURES/EXPENSES
- **FINDING #4** – UNDOCUMENTED HPLF BOARD APPROVAL
- **FINDING #5** – DONATIONS NOT DEPOSITED OR RECORDED
- **FINDING #6** – DEPOSITS NOT RECORDED AS CONTRIBUTIONS IN THE DONOR TRACKING DATABASE
- **FINDING #7** – LACK OF SCHOLARSHIP FUND DISTRIBUTION

We have provided responses for each of the findings. This correspondence acknowledges that the comments embedded in the report under "HPL comments" are those of the Houston Public Library (HPL) management.

Memorandum from Management