



Smithsonian Institution

Office of the Inspector General

July 3, 2008

Audit and Review Committee
Smithsonian Board of Regents
Washington, D.C. 20560

Re: Review of the Former Secretary's Expenses, No. A-08-01a

Dear Members of the Audit and Review Committee:

Attached please find the Independent Accountant's Report on Applying Agreed-Upon Procedures to review the former Secretary's expenses for fiscal years 2006 and 2007.¹ The report and this letter follow up on last year's report and letter covering the former Secretary's expenses and compensation for fiscal years 2000 through 2005.²

In this transmittal we offer comments and recommendations based on our oversight of the independent accountant's review. We are pleased to note that as a result of this review, the Institution has received \$3,000 in reimbursement from the former Secretary and has now properly reported as taxable income certain of the former Secretary's wife's travel expenses that the Institution had paid.

Our comments follow the order of the attached report.

Transaction Testing

To help ensure the accuracy and completeness of the Schedule of Expenditures prepared by the Office of the Chief Financial Officer, the independent accountant both traced the reconciliations from the Schedule to the Smithsonian general ledger (which is prepared by the Comptroller), and tested transactions outside the universe of the Schedule. The independent accountant did not identify any transactions outside the Schedule that should have been included in the Schedule.

¹ A separate report on a review of the expenses of the former Chief Executive Officer of Smithsonian Business Ventures for fiscal years 2006 and 2007 is forthcoming.

² Letter from the Inspector General to the Audit and Review Committee, Jan. 16, 2007; Independent Accountant's Report on Applying Agreed-Upon Procedures, Dec. 22, 2006. We do not cover the former Secretary's compensation in this review.

Unsupported Expenditures

The independent accountant found that \$961 of expenditures out of the \$217,095 total in the Schedule, or less than one-half of one percent, lacked sufficient documentation (receipts). All these unsupported expenses involved delivery services and, to the extent discernible from contemporaneous documents and the current notes of office assistants, they were for official purposes, such as delivering materials to Regents and other Smithsonian officials. Accordingly, we make no recommendations concerning these expenses, other than that the Office of the Secretary be more diligent in retaining receipts and noting the purpose of such delivery costs.

Unauthorized Expenditures

The independent accountant identified \$7,529, or approximately 3.5 percent of the total in the Schedule, as unauthorized expenditures. We discuss each category of unauthorized expenditures separately.

Alcoholic Beverages

As was the case in the first review, the independent accountant noted various instances when the former Secretary was reimbursed for purchases of alcoholic beverages while traveling or otherwise conducting official business, such as entertaining donors. The funds for those expenditures came from the Institution's 401 trust fund account, which according to the applicable policy could not be used for that purpose. However, these expenditures would have been authorized had they been paid out of the 402 trust fund account. Moreover, the amounts involved are minimal (a total of \$140). Accordingly, we make no recommendation regarding these expenditures, other than that the Office of the Secretary be more careful in using the proper accounts.

Gifts

The independent accountant identified \$4,048 in expenditures on gifts. Because the official policy on the use of trust funds in effect at the time prohibited the use of funds from any trust account for "gifts of any purpose ... for SI staff, volunteers, donors, etc.," the independent accountant classified this amount as unauthorized.

As in our first report, we make a distinction between different types of gifts: those to volunteers and donors and those made for reasons of protocol, on the one hand (totaling \$2,874), and those made to Smithsonian staff, on the other (totaling \$1,174). Although the policy allowed no gifts whatsoever, we continue to believe that it is appropriate for the Secretary and other senior Smithsonian officials to recognize and encourage the support of donors and volunteers, including those who serve, unremunerated, on the Institution's various boards. Indeed, in our first report, we recommended that the Regents direct the Institution to revise its policy "to allow the Secretary and other officials to use [trust] funds for token gifts on behalf of the Institution to donors, board members and volunteers." We also suggested that "[i]n all instances, the Institution should be acknowledged as the source of the donation or gift." We made the latter suggestion because there were instances when the Secretary gave gifts that indicated they were from him and his wife without specifying that the Smithsonian had paid for them.

We are pleased to report that on March 28, 2007, the Deputy Secretary issued an interim clarification of the Institution's gift, alcoholic beverages and food policy, which stated that unrestricted trust funds may be used to purchase gifts for volunteers and donors. This policy, which the Institution reaffirmed in February, 2008, sets forth clear and sensible guidelines regarding gifts funded by the Smithsonian and is a significant improvement.³

The previous prohibition, however, was in effect for the period covered by this review. Nonetheless, we do not find the \$2,874 in expenditures on gifts for donors, Regents, and other volunteers, or the gift made as a matter of protocol to the President of Panama (where the Institution has a long-standing presence) inappropriate, although some of the gifts may have been more than token.

The former Secretary also made a dozen gifts during the period under review, totaling \$1,174, to Smithsonian staff, primarily in the form of flowers and plants on special occasions. We do not believe that the Institution should have been underwriting these gifts, as most were more than token gifts. The then-policy prohibiting such gifts was appropriate in such instances. Indeed, the revised (current) policy only allows token gifts (gifts of nominal value, such as plaques) to staff. But given that the flowers and similar gifts were not for the personal benefit of the Secretary and given that the Institution has reaffirmed the

³ We continue to believe that the Institution still needs to add an explicit requirement that the Institution be identified as the source of any gifts paid for with Institution funds.

prohibition on more than token gifts to staff, we make no recommendation regarding this amount.

National Board Tour of India and Travel to Bhutan

The independent accountant identified a \$3,000 refund that the Secretary received from a tour company that he did not return to the Smithsonian, although the Smithsonian had reimbursed him the full amount of the tour (over \$50,000).

On receipt of a draft of the attached report, the Smithsonian Comptroller sought, and received, reimbursement from the former Secretary for the full amount of the refund.

We would like to comment on two additional matters raised by this transaction. First, this trip was one of several where the Secretary's wife accompanied him. As noted in our first report, having the Institution pay for the Secretary's wife's travel may have tax implications, unless she served in an official capacity that was demonstrated in advance. The Office of General Counsel, having been alerted to this issue by our previous report and by the Independent Review Committee, has already reviewed Smithsonian-paid travel for spouses of Smithsonian executives. As a result of that review and of a draft of this report, the Comptroller has issued appropriate tax forms for the costs of all the former Secretary's wife's travel that did not qualify as official Smithsonian business and therefore had to be treated as taxable income.⁴ Accordingly, we consider whatever tax issues that may have been raised by this particular trip to India and Bhutan to have been resolved.

The second matter is the method of payment involved here. Smithsonian – and federal – travel rules require that employees use their government-issued travel credit cards to pay for official travel, unless they have a written exemption. In this instance, the former Secretary, who did not have a written exemption, used his personal credit card to pay the tour operator, a total of \$50,000 for him and his wife, after the \$3,000 refund. (He did use his Smithsonian-issued travel card, or the Smithsonian paid directly, for other travel-related expenses.) Not only did charging these costs on the personal credit card violate explicit travel rules, it also raises the question whether the former Secretary used Smithsonian resources

⁴ The Comptroller has issued tax forms for the costs incurred by the former Secretary's wife that were reflected on the travel vouchers and for her portion of the tour costs that the Secretary charged on his personal credit card.

(official travel) for private gain through rebates, frequent flyer miles or other perks on his card. He likely benefited in a not insubstantial way from charging \$50,000 on his card and then being reimbursed by the Institution.

Based on our current work on executive travel,⁵ we believe that this practice is atypical. Nonetheless, the Institution should more vigorously police the use of personal credit cards for official travel expenses.

Excess Lodging Costs

The independent accountant found that the Secretary had exceeded 300 percent of the federal lodging per diem during a March 2007 trip to Los Angeles. However, as noted in our earlier report, the Regents asserted in writing (6 years afterwards) that the former Secretary's employment agreement entitled him to premium travel in all regards (notwithstanding clear language in the agreement relating solely to first-class air fare), and therefore expenditures for car service and premium hotel accommodations did not fall in the unauthorized expenditures category. That being the case, we have to follow the same rule here.

We do believe, however, that the expenditures on this trip were excessive: \$170 per night above 300 percent of the federal lodging per diem for two nights' hotel in Los Angeles; and \$920 total in car service. (That he incurred excessive expenditures at that time is somewhat surprising, given that the trip happened after our first report was issued and after media and congressional scrutiny of his spending had begun.)

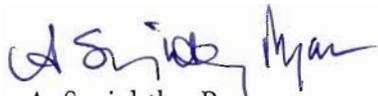
As a result of governance reforms over the last year, the Acting Secretary and his successor, like all other Smithsonian officials and employees, are now required to follow the Institution's travel rules, which in turn adhere to federal limits. Moreover, our office will be conducting regular reviews of the Institution's oversight of executive travel. Thus, we are confident that the likelihood of such excesses in the future has been substantially diminished.

* * * * *

⁵ We are currently auditing the Institution's oversight of executive travel (number A-08-02).

Please do not hesitate to contact me at 202.633.7050 or sprightley@oig.si.edu if you have any questions or would like any further information.

Very truly yours,

A handwritten signature in blue ink that reads "A. Sprightley Ryan". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

A. Sprightley Ryan
Inspector General

cc G. Wayne Clough, Secretary
John E. Huerta, General Counsel
Alison McNally, Acting Under Secretary for Finance and Administration
Alice C. Maroni, Chief Financial Officer
Andrew J. Zino, Comptroller



Cotton & Company LLP
635 Slaters Lane
4th Floor
Alexandria, VA 22314

P: 703.836.6701
F: 703.836.0941
www.cottoncpa.com

INDEPENDENT ACCOUNTANT’S REPORT ON APPLYING AGREED-UPON PROCEDURES

March 28, 2008

To the Audit and Review Committee of the Board of Regents:

Cotton & Company LLP has performed the procedures enumerated below, which were agreed to by the Smithsonian Institution Office of the Inspector General solely to assist you in determining if travel, office, entertainment, fundraising, and other expenditures incurred by the former Secretary of the Smithsonian were reasonable in the context of a business expense related to the Smithsonian mission. The Smithsonian Chief Financial Officer (CFO) was responsible for preparing the Schedule of Expenditures of the Office of the Secretary.

We conducted this agreed-upon procedures engagement in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of procedures described below either for the purpose for which this report has been requested or for any other purpose.

OBJECTIVES

The objectives of the engagement were as follows:

1. Review reconciliation of the Schedule of Expenditures for each fiscal year to the year-end general ledger, identifying the accounts included in the Schedule and any adjustments to those accounts.
2. Test 50 transactions from similar accounts not included on the Schedule of Expenditures to determine if those expenditures should have been included on the Schedule.
3. Determine if transactions included on the Schedule of Expenditures were properly accounted for.
4. Determine if transactions included on the Schedule of Expenditures were valid business expenses related to the Smithsonian mission or not incurred in accordance with Smithsonian policies and guidance.

BACKGROUND AND SCOPE

The Audit and Review Committee of the Board of Regents requested an independent third-party review of the former Secretary’s expenditures. The Smithsonian contracted with Cotton & Company to test the

Schedule of Expenditures for Fiscal Years (FY) 2006 and 2007, prepared by the Smithsonian's Chief Financial Officer (CFO). The Schedule of Expenditures does not include compensation paid to the Secretary during that period.

The Secretary resigned from the Smithsonian on March 27, 2007. The Schedule of Expenditures represents expenses incurred by the former Secretary during FY 2006 and 2007. The Secretary's FY 2006 expenditures were charged on the Smithsonian's accounting records to Department 110000, Office of the Secretary. In FY 2007, the Smithsonian established Department 112000, to record only expenditures on behalf of or to the Secretary. All of the Secretary's FY 2007 expenditures on the Schedule were charged to Department 112000.

To meet the requirements of this agreed-upon procedures engagement, Cotton & Company reviewed schedules prepared by the Smithsonian CFO as well as supporting documentation. In addition, we reviewed policies and procedures, references, handbooks, and memorandums provided by the Smithsonian as guidance to assist us in addressing the agreed-upon procedures. A comprehensive list of policies and guidance is provided in Appendix A. We provided periodic status updates to the IG and Smithsonian staff as well as the draft report documenting agreed-upon procedures results.

The Smithsonian identified 202 transactions totaling \$217,095 in the Schedule of Expenditures. The Smithsonian did not include expenses of \$685,298, charged to Department 110000 in FY 2006 and 2007, in the Schedule because these were not expenditures made on behalf of or to the Secretary. We tested the Secretary's expenditures totaling \$217,095, as well as a sample of excluded expenditures totaling \$233,635. Documentation provided to support these expenditures included Citibank statements, vendor invoices, receipts, itineraries, and expense vouchers.

AGREED-UPON PROCEDURES AND RESULTS

A-1. Trace transactions for each fiscal year from the Schedule of Expenditures to the general ledger. Identify all Office of the Secretary expense accounts and/or transactions that are not included in the Schedule of Expenditures.

We obtained the Smithsonian's reconciliations of the Schedule of Expenditures to its general ledger for FY 2006 and 2007, and traced all amounts to these records. We identified Office of the Secretary expenses of \$685,298 that were not included in the Schedule of Expenditures because these were not expenditures made on behalf of or to the Secretary.

A-2. Trace 50 expenditure transactions that were not included in the Schedule of Expenditures, to source documentation and identify any transactions that were made on behalf of, or to the Secretary.

From the universe of excluded Office of the Secretary expenditures, we selected 50 transactions totaling \$233,635. We tested these transactions to source documents. We did not identify any transactions made on behalf of or to the Secretary.

A-3. Trace all expenditures reported on the Schedule of Expenditures to source documentation and determine if expenditures were properly accounted for. Document all exceptions.

The Schedule of Expenditures included \$217,095 of the former Secretary's expenditures incurred from October 1, 2005, through August 1, 2007. We traced these transactions to source documentation. The Smithsonian could not provide sufficient source documentation to support \$961 of delivery expenses for

which there were credit card statements, but not receipts. There was thus not enough evidence to substantiate the business purpose and validity of these expenses.

A-4. Review supporting documentation for all transactions and identify expenses not fulfilling the Smithsonian mission or not incurred in accordance with Smithsonian policies and guidance provided by Smithsonian staff. Document all exceptions.

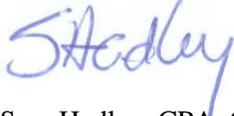
We identified expenditures of \$7,529 that did not appear necessary to fulfill the Smithsonian mission or were not incurred within limits prescribed by Smithsonian policies. We therefore identified these expenditures as unauthorized. Smithsonian policies and guidance provided to us are identified in Appendix A. Detail for these expenditures and the reason why each was identified as unauthorized are provided in Appendix B.

B-1. Obtain a management representation letter from Smithsonian management to confirm to the best of their knowledge that representations were accurate and pertained to the period under review.

We obtained a management representation letter from current Smithsonian management. We did not obtain management representations from the Secretary because he is no longer employed at the Smithsonian.

We were not engaged to and did not conduct an examination, the objective of which would be the expression of opinions on the schedules described in the first paragraph. Accordingly, we do not express such opinions. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. This report is intended solely for the information and use of the Office of the Inspector General and the Smithsonian, and is not intended to be and should not be used by anyone other than these specified parties.

COTTON & COMPANY LLP



Sam Hadley, CPA, CGFM
Partner

APPENDIX A
REFERENCE MATERIAL AND GUIDANCE PROVIDED BY THE
SMITHSONIAN INSTITUTION

Use of Trust Funds for Representational and Special Event Expenses, FY 2005 401 Allocation
Memorandum

Smithsonian Directive (SD) 312, Travel, May 23, 2005

Smithsonian Institution Travel Handbook, May 23, 2005

APPENDIX B
SCHEDULE OF UNAUTHORIZED TRANSACTIONS

Fiscal Year	Vendor	Voucher I.D.	Exception Amount	Notes
2006	Lawrence M. Small	00262252	\$60	A
2006	Lawrence M. Small	00272415	5	A
2007	Citibank	00341485	68	A
2007	Citibank	00364101	7	A
2006	Lawrence M. Small	00262252	138	B
2006	Citibank	00270226	115	B
2006	Petty Cash	00271993	70	B
2006	Citibank	00276197	367	B
2006	Citibank	00276197	304	B
2006	Citibank	00282148	121	B
2006	Lawrence M. Small	00283768	133	B
2006	Petty Cash	00283916	273	B
2006	Citibank	00289010	119	B
2006	Petty Cash	00300894	152	B
2006	Citibank	00301476	318	B
2006	Citibank	00301476	952	B
2006	Citibank	00315306	289	B
2006	Citibank	00315306	121	B
2006	Citibank	00322002	242	B
2006	Lawrence M. Small	00323666	16	B
2006	Citibank	00325852	32	B
2007	Citibank	00341485	185	B
2007	Citibank	00357276	101	B
2006	Lawrence M. Small	00268574	3,000	C
2007	Lawrence M. Small	00360860	<u>340</u>	D
			<u>\$7,529</u>	

APPENDIX B
NOTES TO SCHEDULE OF UNAUTHORIZED TRANSACTIONS

- A. Costs of alcoholic beverages served at meals hosted by the Secretary were paid out of the 401 Fund, as was a hotel room service charge for an alcoholic beverage while he was on travel. The *Use of Trust Funds for Representational and Special Event Expenses* (updated December 1, 2004) states that the 401 Fund cannot be used for alcoholic beverages.
- B. The Secretary purchased various gifts (such as flowers, plants, ammonite, and framed documents) for Smithsonian employees, donors, and others. These gifts were charged against 401 and 402 Funds. The *Use of Trust Funds for Representational and Special Event Expenses* states that trust funds cannot be used for gifts for any purpose for Smithsonian staff, volunteers, donors, etc. Smithsonian representatives stated that a \$101 flower arrangement sent to thank a donor (2007 Citibank #00357276) was a fundraising expenditure. We included this cost in Schedule B, however, because we could find no policy exception to authorize fundraising gifts.

The Secretary also purchased a framed picture (\$367, 2006 Citibank #00276197) to present as a gift to the President of Panama. Smithsonian representatives stated that the Use of Trust Funds policy does not cover gifts given to visiting dignitaries, and that these charges are commonly allowed with Federal funding. Again, we could find no policy exception to authorize gifts to dignitaries, so the cost is included in Schedule B.

- C. The Secretary and his spouse accompanied the Smithsonian National Board on a tour of India in March 2006. The Secretary paid the tour company \$53,000 with his personal credit card, and was reimbursed by the Smithsonian. The tour company subsequently credited the Secretary's card \$3,000 to refund an overpayment. The Smithsonian, however, could not provide any evidence that the Secretary repaid these funds to the Smithsonian. In addition, Smithsonian travel policies require that employees use Government travel cards for travel expenses.
- D. The Secretary claimed actual lodging and meals for his travel. Smithsonian travel policies state that the Smithsonian follows the *Federal Travel Regulations* (FTR). Smithsonian travel policies permit travelers reimbursement of actual expenses up to 300 percent of the per diem rate (the maximum allowed by the FTR, paragraph §301-11.303). The Secretary's lodging for two nights in Los Angeles, California (March 2007) was \$500 per night; 300% of the FTR lodging for that locality was \$330. We classified the \$340 difference as unauthorized.