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

Dear Members of the Audit and Review Committee:

We write on behalf of our client Gary M. Beer, Chief Executive Officer of Smithsonian Business Ventures (“SBV”), regarding the review of Mr. Beer’s compensation and reimbursable expenditures for the fiscal years 2000 through 2005 conducted by Cotton & Company (“Cotton”) and transmitted to you with recommendations by the Smithsonian’s Office of Inspector General (“OIG”).

We write separately because although the facts are largely undisputed – including the fact that this is a case about misplaced records and not misappropriated funds – the OIG’s recommendations rest on the legally unsupportable premise that Mr. Beer should be held personally responsible for the Smithsonian’s failure to locate years old accounting records. The OIG would have Mr. Beer reimburse the Institution for \$26,155.36 in concededly legitimate business expenses that were approved and reimbursed by SBV’s controller at the time the expenses were incurred, because the supporting documentation is incomplete in 2007. The OIG would also have the Institution reclassify another \$65,234.72 of approved reimbursed expenses as ordinary income taxable to Mr. Beer as if he personally benefited from the expenditure of funds – again because of purported deficiencies in the supporting documentation.

There is no evidence that any of the expenses at issue were incurred for Mr. Beer’s personal benefit and all evidence that is now available shows that they were incurred during routine business travel, for business dinners, and other obvious business purposes. However, because some records have not been located, the OIG attempts to foreclose Mr. Beer’s ability to rely upon a forensic accountant’s reconstruction of the records to support the expenses as well as his own testimony and that of others. The OIG asserts that the Internal Revenue Code mandates this approach, but in fact IRS regulations not only allow reconstruction of expenses, they also expressly provide that “[w]here the business purpose is evident from the surrounding facts and circumstances, a written explanation of such business purpose will not be required.”¹

¹ Treas. Reg. § 1.274-5T(c)(2)(ii)(B).



In addition to being erroneous as a matter of law, the OIG's recommendation that Mr. Beer reimburse the Institution and bear the personal tax consequences of the lost or misplaced records is injurious to Mr. Beer's reputation, as it creates the false impression that Mr. Beer abused his position at the Smithsonian for personal gain. It is inconsistent with the Regents' mandate for the Agreed Upon Procedures review and with the review conducted by Cotton. The OIG has taken upon itself the role of tax analyst and made conclusions regarding the sufficiency of documentation that are contradicted by the sworn statement of SBV's former controller. The OIG's approach may cause Mr. Beer to become unnecessarily embroiled in a tax proceeding in an effort to clear his reputation and demonstrate to the IRS that the sums are not taxable income. The Audit and Review Committee should reject the OIG's recommendations in their entirety or, at the very least, should direct that Mr. Beer have the opportunity to demonstrate the sufficiency of the documentary and other support on a transaction by transaction basis before any report is finalized and released to the public.

Background

This review was requested by the Board of Regents after the Institution received a FOIA request from the *Washington Post*, and has been ongoing for nearly a year. Although the review began with a seemingly simple and straightforward purpose – to determine whether Mr. Beer's travel and reimbursable expenses were valid business expenses incurred in furtherance of the SBV's mission and whether they were properly accounted for – it has devolved into an inquisition. The OIG seeks to have the Institution blame Mr. Beer for virtually every lost or misplaced receipt, missing box and incomplete expense report that relates to these expenses, regardless of the facts.²

It is important to emphasize that there is *no* evidence that Mr. Beer personally benefited from any of the expenses reviewed. To the contrary, Mr. Beer has advised both the OIG and Cotton that all expenses he submitted for reimbursement were reasonable and valid business expenses incurred in furtherance of the missions of both the Smithsonian and SBV – and there is

² The OIG applies a double standard to its treatment of clerical errors and omissions. It does not credit Mr. Beer for the \$990 underpayment of his bonus in 2001, which it acknowledges occurred and was due to a clerical error. (OIG July 9 Letter p. 4) The OIG also dismisses as "unfortunate but not of any consequence" the discrepancies between the Smithsonian's internal compensation records and the amounts reported as income on the W-2 form provided to Mr. Beer. (*Id.*) The records suggest an underpayment to Mr. Beer of \$26,842 of compensation for 2002. Mr. Beer is prepared to accept the OIG's explanation with respect to the discrepancy in the 2002 compensation records but is puzzled by the OIG's refusal to acknowledge the explanations he, his former controller and the forensic account have provided with respect to the documentary and other support for his expenses.



no contrary suggestion in the Cotton report.³ Mr. Beer's responsibilities as SBV CEO included the supervision and development of business in multiple cities. Accordingly, in order to fulfill his duties to the Smithsonian he spent considerable time traveling. A significant portion of his travel time was spent in New York on *Smithsonian Magazine* affairs and in pursuing new business opportunities such as licensing and joint venture arrangements.

SBV's former controller and acting CFO Robert Schelin, who spent 20 years as an auditor and investigator for the Smithsonian OIG before joining SBV (where he served for virtually the entire period under review), has provided a sworn declaration describing the process he developed and followed for documenting and tracking Mr. Beer's business expenses.⁴ Mr. Schelin did so in order to ensure that the expenditures were reasonable and had a valid business purpose. He prepared a spreadsheet in which he kept track of Mr. Beer's travel expenses and also reviewed and collected supporting documentation such as annotated credit card statements, credit card receipts, itemized hotel statements or restaurant receipts, airline ticketing documents and car service invoices or statements. (Schelin Dec. ¶ 8) He states firmly and unequivocally that in his view all expenses submitted were reasonable, in furtherance of SBV's mission and supported contemporaneously by adequate documentation. (*Id.* ¶ 11) His declaration indicated that documentation was kept and existed as of April 2005 – the date Mr. Schelin left his employment at the Smithsonian. (*Id.* ¶¶ 7-9)

When the review began in the summer of 2006, Smithsonian and SBV staff members were unable to locate much of the documentation related to the expenses, including Mr. Schelin's records. To this day, no one knows where these records are. What we do know is that SBV's records, including its accounting records, were moved from a warehouse in Newington to Iron Mountain, an outside records management vendor. We have been advised that the move encompassed approximately 800 boxes of documents. We understand from SBV's current accounting staff that the index lacks detail and the box labels are duplicative and imprecise. In the late summer of 2006 Mr. Beer was advised that SBV and Smithsonian accounting staff had been unable to locate accounting records for the Agreed Upon Procedures Review. However, because the searches were conducted under the supervision of others, Mr. Beer does not know

³ The Cotton report also confirms that Mr. Beer received no outside income such as housing allowances, honoraria, loans or cash advances, housing or relocation expenses, or personal automobile allowances.

⁴ Both Mr. Beer and Mr. Schelin advised the OIG that they did not believe that SBV was subject to Smithsonian travel policies as a result of the Secretary's delegation of authority to Mr. Beer. Rather, it is SBV's position that it had the authority to develop its own travel policies "guided by reasonable business practices and with consideration for the fiduciary obligations of the Smithsonian," standards which it believes were satisfied here. (Statement of Authority of Chief Executive Officer of Smithsonian Business Ventures, June 20, 2000).



which of the hundreds of boxes were searched or whether the records may be in boxes that have been improperly labeled.

Because staff could not locate the records, SBV retained a forensic accountant to assist in the reconstruction of records pursuant to IRS guidelines, and a thorough reconstruction was performed. As a result of the reconstruction, the vast majority of the business expenses have documentary support that establishes that the expenses were legitimate business expenses incurred in furtherance of SBV's mission. The Agreed Upon Procedures, however, were never revised to reflect the fact that records were lost or misplaced, and accordingly Cotton evaluated the expenses against a standard that was impossible to satisfy – *i.e.*, whether the incomplete documentation that could be located or reconstructed *in 2007* met Smithsonian policies for contemporaneous documentation. The issue of whether the records satisfied IRS standards for substantiation of business expenses in circumstances where the original records have been lost or misplaced is *not* one that Cotton was asked to or did address.

During the course of the review, Mr. Beer objected to the Agreed Upon Procedures because the procedures ignored the reality of the lost or misplaced records and urged the OIG, which was responsible for directing Cotton to use those procedures, to revise them. The OIG declined to do so, although it provided Mr. Beer with the IRS guidelines for reconstructing lost records and Mr. Beer and SBV proceeded with the reconstruction in the belief that OIG viewed the reconstruction as a productive and acceptable course of action. Mr. Beer cooperated fully with the review and spent many hours responding to the OIG's and Cotton's information requests.

The focus of the so-called Agreed Upon Procedures Review has changed repeatedly, creating a moving target for Mr. Beer's efforts to respond. Until Mr. Beer received the first draft of the OIG's recommendations in late May 2007 he had no inkling that the OIG intended to recommend that he reimburse the Institution or that sums be reclassified as ordinary income taxable to him. Indeed, it was his belief that the purpose of the review was to determine whether the expenses were legitimate business expenditures – a proposition as to which he never had any doubt as to the outcome. In the late May draft, the OIG recommended that Mr. Beer reimburse \$5,595 in expenses, and that the Board of Regents review further whether an additional \$24,206 should be reimbursed and whether \$130,654 should be reclassified as ordinary income. On May 24, 2007, Mr. Beer submitted a response to the OIG's draft detailing numerous factual and legal errors in these recommendations, and shortly thereafter, the OIG indicated that it intended to subtract \$4,559.60 from the \$5,595 recommended for repayment, leaving (based on the OIG's figures) less than \$1,000 for reimbursement. The OIG also indicated that it intended to further review its draft in light of Mr. Beer's May 24 response.

On July 9, Mr. Beer received OIG's current draft, which no longer recommends that the Board of Regents further review the facts and legal issues. Confronted with the arguments in the



May 24 response that both the Agreed Upon Procedures and the OIG's prior analysis failed to properly address the issue of the lost or misplaced records as a matter of tax law, the OIG has now changed course again and decided -- based upon a new legal theory -- that the forensic accountant's reconstruction is just not good enough and should be ignored along with Mr. Beer's statements as to business purpose. Once again, in its venture into tax law, the OIG has gotten it wrong.

I. The OIG's Treatment of the "Unsupported" and "Inadequately Supported" Expenses Is Wrong as a Matter of Tax Law and Practice.

According to IRS regulations, when records substantiating business expenditures have been lost or misplaced through circumstances beyond a taxpayer's control, the taxpayer has the right to substantiate the expenses through a reasonable reconstruction of his expenditures.⁵ While acknowledging this legal rule, the OIG rejects its application here on the theory that the Smithsonian should *presume as a matter of law* that the lost or misplaced records were not "adequate" under IRS standards. The OIG cites three reasons for its presumption – none of which withstand scrutiny.

The first justification cited by the OIG is that the existing records reflect an inconsistency in the level of documentation, with Mr. Beer not always recording contemporaneously the business purpose of the expense. (OIG Draft p. 10) This is another way of saying that if an executive fails to write a business purpose on the receipt or expense report at the time the expense is incurred, that executive cannot later provide that information to the IRS. This argument is flatly contradicted by the law. IRS regulations expressly provide that "[w]here the business purpose is evident from the surrounding facts and circumstances, a written explanation of such business purpose will not be required."⁶ Specifically, no written statement of the business purpose of a meal is required if this purpose is "evident from the business relationship to the taxpayer of the persons entertained and other surrounding circumstances."⁷ Thus, even if it were possible to extrapolate from existing records the content of the lost or misplaced records (and the OIG cites no authority for that legal proposition), the absence of an articulated business purpose on the document would not lead the IRS to automatically reject the documentation.

The OIG's second justification – that there is no discernible pattern to the loss of records – is similarly without merit. The OIG cites no legal authority for the proposition that the pattern of lost or misplaced documents can sustain inferences about the adequacy of their content. In the present circumstances, drawing the inference the OIG seeks to draw would be egregiously

⁵ Treas. Reg. § 1.274-5T(c)(5).

⁶ Treas. Reg. § 1.274-5T(c)(2)(ii)(B).

⁷ *Id.*



illogical and unfair. Given that there are 800 boxes of SBV records, an inadequate index and poorly labeled boxes, it is not surprising that there is no pattern to what is missing. It appears that the people who prepared the records for storage did a poor job of organizing the documents. It may be that records identified for Iron Mountain storage were located after much of the indexing had been completed and due to time pressures were randomly inserted into boxes. It may well be that the documents are in boxes that Iron Mountain has but which have not been searched. Whatever happened to cause the records to be lost or misplaced, there is no evidence that it was Mr. Beer who failed to comply with Smithsonian record-keeping policies that require the retention of records for six years.

The OIG's third justification – that the former controller's practice of making advances to pay the credit card statement "undermines confidence" that adequate records existed – expressly ignores Mr. Schelin's sworn declaration, which states that he prepared a spreadsheet in which he kept track of the expenses and reviewed and collecting supporting documentation such as annotated credit card statements, credit card receipts, itemized hotel statements or restaurant receipts, airline ticketing documents and car service invoices or statements. (Schelin Dec. ¶ 8) While the OIG may believe that the former controller did not follow best practices or even Smithsonian Institution policies, that is hardly a justification for assuming that the process he followed and the records he collected and maintained were inadequate for IRS purposes, which is the standard that the OIG purports to follow.

The IRS regulation allowing for reconstruction of lost records would become meaningless if the IRS subjected taxpayers to the exacting standards of proof the OIG applies to Mr. Beer. It does not. In fact, IRS regulations provide for alternate means of proof where the taxpayer "substantially complie[s]" with the adequate records requirement. For example, in *Davis v. Commissioner* (cited in footnote 10 of the OIG's letter), the taxpayers' testimony that they gave their accountant "a box of documents" that "substantiated many of the figures" on their tax return was considered sufficient to allow reconstruction of the expenses.⁸ Similarly here, the undisputed facts are that Mr. Schelin – a 20 year veteran of the Smithsonian Institution, including its OIG – in his capacity as SBV controller collected, reviewed and filed documentation to support Mr. Beer's travel expenses. There is no reason to assume that SBV's practices did not satisfy IRS requirements.

More importantly, even if SBV failed to keep adequate records of the expenses, IRS regulations would still permit Mr. Beer to reconstruct his expenditures. Inadequate recordkeeping by an employer does not mean that expenses may never be accounted for, only

⁸ T.C. Memo. 2006-272 at *2-*3, *13. See also *James v. Commissioner*, T.C. Memo. 1980-99 (taxpayer established he kept adequate records through his own and witness's testimony that he "was in the habit of obtaining receipts" and "maintained an appointment book to record business expenditures").



that the employee cannot rely on his employer's accounting. As noted above, both Mr. Beer and Mr. Schelin have described Mr. Beer's contemporaneous submission of documentation for his expenses. OIG's attempt to hold Mr. Beer personally liable for records lost by his employer, without allowing him to personally reconstruct the expenses, is inconsistent with the law and manifestly unfair.

**II. The Facts Do Not Support the Amounts the
OIG Identifies for Reimbursement or Reclassification.**

"Unsupported" Expenses Identified for Reimbursement

The OIG's recommendations concerning allegedly "unsupported" expenses disregard the findings of Cotton, the independent accountant. Of the \$26,155.36 the OIG identifies as "unsupported" and therefore requiring reimbursement, only \$917.11 was identified as "unsupported" by Cotton. Of that \$917.11, only \$320.85 even went to Mr. Beer. \$104.55 of that represents transactions of less than \$75, the IRS threshold for requiring written documentation of non-lodging expenses.⁹ A total of \$316.65 went to the Smithsonian's caterers, obviously to pay for meals that occurred in connection with business meetings on Smithsonian premises. \$600.66 is comprised of 18 small payments in 2002 to Elaine Gill, Mr. Beer's administrative assistant at the time. Although SBV was unable to reconstruct the documentation for such small payments more than four or five years after the fact, Mr. Beer believes that Ms. Gill was likely reimbursed for her intermittent purchase of office supplies or modest carry-out meals. All of the payments to Ms. Gill and indeed, all but about \$300 of the entire \$917 – regardless of who it went to – was paid in 2001 and 2002 – outside the IRS three-year statute of limitations.¹⁰

- The remaining approximately \$25,000 the OIG now calls "unsupported" was classified as "inadequately supported" by Cotton. That means that according to the Agreed Upon Procedures, there was some documentation to support the expense. Most of the amounts are supported by documentation showing reimbursements to Mr. Beer for business-related charges on credit cards issued by Zions Bank and Citibank. \$10,412.49 of these expenses was charged on the Zions Bank credit card and date back to 2001 and 2002. During the review the OIG expressed concerns about the expense and time required for the forensic accountant to obtain and incorporate the Zions Bank statements because of the small amount of money involved. Due to the OIG's concerns about the expense of reconstruction of such a small sum, the forensic accountant did not even attempt to obtain or reconcile the Zions Bank statements. For the OIG to complain about the expense of reconstruction and then to seek to hold Mr. Beer personally responsible for the judgment that such reconstruction efforts would not be cost effective is

⁹ Treas. Reg. § 1.274-5(c)(2)(iii)(A).

¹⁰ I.R.C. § 6511(a).



unfair. Before the Institution decides whether to seek reimbursement for this amount, the Institution should seek the records from Zions Bank and have the forensic accountant do the same type of reconciliation as was performed with respect to the Citibank card. As it stands now, any conclusions regarding this amount are entirely speculative. Moreover, the entire amount is outside the IRS statute of limitations.

- A substantial portion of the remaining “unsupported” transactions relates to airfare and car services. SBV provided electronic receipts and credit card statements for many of the transactions the OIG has reclassified as “unsupported.” The amount, time and place of these expenditures is apparent from the documentation SBV provided. Under these circumstances, the IRS recognizes credit card statements as adequate substantiation of business expenses.¹¹ Mr. Beer also provided to the OIG numerous written statements as to business purpose which the OIG rejected. The OIG has not identified what additional documentation would be required to substantiate these expenses or why she rejected Mr. Beer’s statement of business purpose. Before the Regents direct the Acting Secretary to seek reimbursement from Mr. Beer, the Institution should order a systematic search of the 800 boxes in Iron Mountain custody. Mr. Beer is not the one who prepared the index or stuffed the boxes. He should not be the one to personally suffer the consequences of any clerical errors that caused records to be lost or misplaced.

***“Inadequately Supported” Expenses Identified for Reclassification
As Ordinary Income to Mr. Beer***

The OIG’s recommendation with respect to this \$65,234.72 suffers from the same factual defects as its discussion of the unsupported expenses. It fails to differentiate between expenses that went to Mr. Beer personally and those that went to others. It ignores the many expenses where the legitimacy of the expenses (which are supported by electronic receipts) is obvious – e.g. the monthly Doggett’s parking charge for Mr. Beer to park his car in the Smithsonian parking lot, the payments to Smithsonian caterers for in office meals and shuttle tickets to New York. The OIG is so eager to punish Mr. Beer because it believes that SBV should have had written policies and should have required more documentation that it has stretched beyond all reason to find the substantiation wanting. Before the Regents authorize anyone at the Institution to start filing amended tax documents, it should give Mr. Beer the opportunity to hire a private accountant to undertake a transaction by transaction review of the so-called inadequately supported documents and present the results to the Regents.

¹¹ See Private Letter Ruling 200304002 (Jan. 24, 2003).



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III. Conclusion

Mr. Beer has spent the last seven years devoting his time and energy to making SBV a success in the face of the events of September 11, the anthrax and sniper episodes, and the resulting dramatic decline in visitation to Smithsonian museums. SBV proactively managed the business to mitigate this major downturn in market, doubling revenue per visitor. The fact that documentary support for legitimate and approved business expenses has not been located is a far cry from personal impropriety. The Smithsonian cannot and should not permit the two to be merged in a manner that falsely and publicly smears Mr. Beer and the Institution itself. We urge the Audit and Review Committee of the Regents to undertake a fair and balanced review of this situation acknowledging that records have been lost or misplaced and allowing Mr. Beer to reconstruct them consistent with IRS standards. It would be manifestly unfair and injurious to Mr. Beer's reputation for this review and any final, public description of it to create the false impression that Mr. Beer has abused his position at the Smithsonian for personal gain.

Sincerely,

Leslie B. Kiernan
Paula M. Junghans
Counsel to Mr. Beer

cc: Cristián Samper, Acting Secretary
John E. Huerta, General Counsel
Sheila P. Burke, Deputy Secretary and Chief Operating Officer