



# Smithsonian Institution

Office of the Inspector General

July 19, 2007

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

Dear Members of the Audit and Review Committee:

Enclosed please find the Independent Accountant's Report on Applying Agreed-Upon Procedures to the compensation and expenses of the Chief Executive Officer (CEO) of Smithsonian Business Ventures (SBV), which was conducted at Secretary Small's and your request. The procedures covered fiscal years 2000 through 2005 for the CEO's compensation, and fiscal years 2001 through 2005 for his expenses.<sup>1</sup>

*Nature of the Review.* This review was not an audit but an agreed-upon procedures review (AUP). In an AUP, the requestor – in this case the Office of the Inspector General (OIG) – determines the scope, transactions and criteria, rather than the independent accountant doing so. SBV provided the initial schedule (list) of transactions from its accounting systems, a schedule that included all expenditures of the office of the CEO. Because the scope of the review covered only the CEO's individual expenses, the schedule was adjusted accordingly. The Inspector General (IG) personally reviewed and approved all such adjustments.

*Challenges in Conducting the Review.* This review was protracted and difficult. At the start, there was little supporting documentation with which the independent accountant could work. After exhaustive searches and significant efforts by SBV to find original records and alternative support such as electronic calendars and duplicate charge card statements, SBV was able to reconstruct documentation for most of the CEO's expenses. Further complicating the process were the numerous issues associated with SBV's handling of the CEO's business expenses, such as the direct payment by SBV of the CEO's Smithsonian-issued travel card, which was against policy; personal use of the card by the CEO, also against policy; and advance payments of the travel card balance by SBV that were not directly related to the amounts owed. Finally, after receiving an earlier draft of our transmittal, you requested that we explore the tax implications of our conclusions in more detail.

*Summary of Results.* In this transmittal letter, we offer comments based on our oversight of the independent accountant's report. We first review the verification of

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<sup>1</sup> All parties agreed that any records relating to expenses for fiscal year 2000 would have been limited and costly to locate. We did not believe it would be an efficient use of limited resources to have them reconstructed.

the CEO's compensation. We then focus on the CEO's business expenses, which totaled approximately \$202,000 for fiscal years 2001 through 2005. Unfortunately, although most of the expenses were likely incurred for Smithsonian purposes, much of the documentation failed to meet Smithsonian requirements or Internal Revenue Service (IRS) standards for deductible business expenses. We conclude, as we explain below, that approximately 13 percent of the expenses were unsupported, 59 percent were inadequately supported, and 16 percent were unauthorized. We also observed misuse of the Smithsonian travel card, weak internal controls at SBV regarding the CEO's expenses, and a lack of enforcement of Smithsonian policies by the Institution.

We recommend that the Board of Regents request the Acting Secretary to (1) direct the CEO to reimburse the Institution for \$26,155.36 in unsupported expenses; (2) report as taxable income those expenses of the CEO that were inadequately supported (\$28,578.94 for tax year 2003, \$14,248.13 for 2004, and \$22,407.65 for 2005) and revise the Institution's tax filings accordingly; (3) strengthen the Institution's policies regarding the use of car service; (4) direct the CEO to reimburse the Institution for \$3,542.78 in unauthorized expenses; (5) direct the CEO to reimburse the Institution for any outstanding personal expenses on his Smithsonian-issued travel card; and (6) strengthen the Institution's travel policy regarding the payment of actual expenses, rather than per diem, for employee travel.

## I. Introduction

In 1998, the Smithsonian Board of Regents, recognizing that furthering the Institution's mission depends heavily on private funding, sought to consolidate the Institution's disparate business activities to improve their management and increase their contributions to the Institution's unrestricted trust funds. An outside consulting firm suggested that bringing them under a single, new management structure modeled on the private sector could considerably increase income. The Board of Regents thus authorized the Secretary of the Smithsonian to consolidate most of the business activities into Smithsonian Business Ventures to increase unrestricted trust funds by expanding existing businesses, initiating new businesses, and improving management and operational efficiency.

The Board of Regents authorized the hiring of a CEO to lead SBV, with the understanding that the CEO would be recruited from the business sector and that compensation for the CEO and key managers of this new business entity would be competitive with the commercial market, even though it would be greater than compensation at other units of the Institution. The CEO assumed SBV's top position in August 1999, and SBV became a fully functioning, separate entity within the Institution in FY 2000. SBV currently consists of several business units: Magazines; Retail (museum stores, concessions, and theaters); Catalogue; Product Development and Licensing; and Journeys (travel). In 2005 and 2006, SBV expanded its businesses to include a joint publishing venture with Harper-Collins and a long-term joint venture with Showtime Networks called Smithsonian Networks. In FY 2006, SBV had a total of 480 employees (full-time equivalents), including the CEO, executives and division managers. SBV's annual revenues since its inception have ranged from a low of \$143 million in FY 2003 to a high of \$172 million in FY 2005 in nominal dollars; its

annual contribution to the Institution's unrestricted trust funds has ranged from roughly \$17 million in FY 2002 to \$30 million in FY 2005<sup>2</sup> in nominal dollars.

A written delegation from the Smithsonian Secretary governs the CEO's expenditures on behalf of SBV.<sup>3</sup> Pursuant to that delegation, SBV established its own financial system and its own human resources functions, including a separate compensation system.<sup>4</sup> Under that delegation, the CEO also has authority:

- (3) To expend Smithsonian Business Ventures Trust Funds in accordance with applicable law and guided by reasonable business practices and with consideration for the fiduciary obligations of the Smithsonian as a trust instrumentality of the United States.  
....
- (5) To establish, after consultation with the [SBV] Board and approval by the Secretary, a Smithsonian Business Ventures travel policy which would include a separate system for travel arrangements and reporting and reimbursement of travel expenses, and which would be consistent with the Smithsonian Institution's standards of conduct.

SBV is legally a unit of the Smithsonian, and SBV employees are trust employees of the Smithsonian.

## II. Verification of the CEO's Compensation

*CEO's Base Pay.* In verifying the compensation paid to the SBV CEO for fiscal years 2000 through 2005, the independent accountant was unable to reconcile the CEO's earnings for calendar years 2000 through 2002, as set forth on the schedule of compensation provided by the Smithsonian, to his IRS W-2 forms. The independent accountant was unable to do so because the Smithsonian – which handled SBV's personnel functions until the end of 2002 – did not have the CEO's Earnings and Leave Statements (E&LS) for those years. The E&LS are maintained electronically by the National Finance Center (NFC), the Smithsonian's payroll service provider, but accessible only for the immediate prior three years. The CEO was also unable to provide copies of his E&LS from 2000 through 2002.

Because these records were not available, the Smithsonian's Comptroller calculated total compensation amounts based on compensation calendars provided by the NFC. These calendars are based on pay periods that do not correspond exactly with calendar years or fiscal years, because each two-week pay period ends on a Saturday. What that means is that the end of a calendar year or fiscal year could fall at any point within a pay period, making exact calculations difficult. A further complication is that

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<sup>2</sup> This figure excludes an extraordinary gain of more than \$6 million that year.

<sup>3</sup> In contrast, the Secretary's expenditures were governed by his employment agreement and by Smithsonian trust fund policies.

<sup>4</sup> For details on this separate compensation system, see our recent audit, *Executive Compensation at Smithsonian Business Ventures, Phase I*, Report Number A-06-02 (Jan. 19, 2007).

the actual cash pay date for a given pay period (which determines the reporting period to which the payment applies for tax purposes) is different from the last day of the pay period, making payments at the end of the fiscal year or calendar year difficult to determine without reviewing the actual E&LS. Therefore, the amounts provided on the schedule that the independent accountant reviewed were estimates for those reporting periods, not the actual amounts paid during those periods.

Given these facts, the discrepancies noted in the first two tables of section B-1 of the independent accountant's report do not indicate that the CEO was underpaid; he was paid according to the data maintained by NFC, with correct reporting of those payments represented by the W-2 amounts. The W-2s are prepared by the NFC. That the W-2's did not reconcile exactly to an estimate based on imperfect information is unfortunate but not of any consequence.<sup>5</sup>

*CEO's Bonuses.* The other compensation issue noted by the independent accountant related to the computation of the CEO's bonuses in accordance with his employment contract. The independent accountant noted two discrepancies, as reported in the table in section B-2 of the report. First, the independent accountant was not able to verify a portion of the CEO's bonus award for fiscal year 2004 because SBV was unable to provide the SBV Compensation Committee's recommendation and associated support for the "operational goal incentive" portion of the CEO's bonus for that year, in the amount of \$24,395 (out of a total bonus paid of \$208,075). Second, according to the independent accountant's calculations, the CEO should have received \$990 more in his bonus for fiscal year 2001 (which totaled \$116,393) than he did. It appears the mistake in computation stemmed from the transposition of two digits for the financial goal incentive number. SBV's human resources office confirmed the error. In both instances, however, the SBV Board and the Secretary did approve the total bonus amounts, and the Regents approved them as well.

Accordingly, we make no recommendations regarding the CEO's compensation for the period reviewed.

Finally, we note that, for the period covered by this review and consistent with his employment contract, SBV did not report any housing allowances, honoraria, loans or cash advances, housing or relocation expenses, or personal automobile allowances paid to the CEO.

### III. The CEO's Expenses

#### A. Background

SBV did not have a written policy regarding business expenses for the period covered by this review. The CEO asserts that SBV did have a policy, albeit unwritten, that differed from Smithsonian policy. This expenses policy, as described by the CEO and by a former SBV controller, consisted initially of the CEO submitting his Citibank charge card statements to the controller, along with relevant receipts or other

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<sup>5</sup> The same issue arose in our review of Secretary Small's compensation: the Institution did not have E&LS for the early years covered by the review. However, the Secretary had retained copies of those documents and was able to provide them for the reconciliation.

supporting documentation, and with a check to cover personal charges he identified that he incurred on the Citibank card. At some point, the CEO's Citibank statements were mailed directly to SBV. Throughout the period covered by this review, the controller would pay the balance due directly to Citibank and book the payment as an expense as soon as it was paid, even if complete documentation supporting each individual charge was not provided. Several times, the controller paid lump-sum amounts to the CEO's Citibank account, amounts that did not correspond to particular charges. The controller or, in some instances, the SBV Chief Financial Officer would review the CEO's expenditures to determine if they represented valid and reasonable business expenses and to authorize payment.

We were not provided any documentary evidence that the SBV Board was consulted by SBV on this unwritten policy; that SBV obtained the approval of the Secretary for this policy; or that SBV reviewed the policy to ensure that it was consistent with the Smithsonian's standards of conduct, as required by the CEO's delegation of authority (see page 3, above). Accordingly, in our judgment, and in the judgment of the Smithsonian's General Counsel, during fiscal years 2001-2005, SBV did not have an official travel and expenses policy, even though the CEO had the authority to develop one. Therefore, the Smithsonian's travel policy applied to travel expenditures by the CEO. We instructed the independent accountant to apply that policy when reviewing the CEO's travel expenses.

For all expenditures, the CEO must adhere to the principles set forth in paragraph (3) of his delegation of authority. Thus, in reviewing his expenses, we looked to (1) Internal Revenue Service rules regarding business expenses; (2) our understanding of reasonable business practices; and (3) the fiduciary obligations of the Smithsonian. Although SBV is a business, its purpose – to generate unrestricted funds for the Smithsonian – is a charitable one. As a trust instrumentality of the United States and as a charitable organization under the Internal Revenue Code, the Smithsonian must ensure that expenditures on behalf of the Institution are reasonable. The expenses also must be properly documented; be for a Smithsonian purpose; and not be lavish or extravagant.

*IRS "Accountable Plan" Rules.* Under IRS rules, for business expenses reimbursed by an employer to be excluded from the employee's taxable income, they must be reimbursed under an arrangement that is an "accountable plan."<sup>6</sup> To be an accountable plan, the expenses arrangement must meet all three of the following requirements:<sup>7</sup>

- *Business Connection.* The arrangement must provide advances, allowances or reimbursements only for expenses that are allowable as income tax deductions, and that are paid or incurred by the employee in the course of conducting business for his employer.

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<sup>6</sup> Treas. Reg. § 1.62-2.

<sup>7</sup> Treas. Reg. § 1.62-2(c)(2)(i). These rules would have applied even if SBV had an approved travel and expenses policy.

- *Substantiation.* The arrangement must require that every element (such as amount, time, place, and business purpose) of each expense be substantiated within a reasonable time.
- *Excess Payments Returned.* The arrangement must require the employee to return within a reasonable time any amounts paid to him as advances that exceeded the expenses he substantiated. Advances must be reasonably calculated not to exceed anticipated expenditures and be paid near the time the expenses are incurred.

If the employer's expenses arrangement does not meet all three requirements, it will be considered a nonaccountable plan, and *all* expenses reimbursed or advanced under that arrangement must be reported as taxable income. The Smithsonian's travel policy, which is essentially the same as the Federal Travel Regulation (FTR), meets all three requirements for an accountable plan. The unwritten expenses arrangement described by the CEO and the former SBV controller does not.<sup>8</sup>

If the employer's expenses arrangement is an accountable plan, but particular expenses do not meet all three requirements, then those expenses will be treated as having been paid under a nonaccountable plan. In other words, the accountable plan requirements are applied on a transaction-by-transaction or employee-by-employee basis. Any expenses deemed to have been paid under a nonaccountable plan must be reported as taxable income.<sup>9</sup>

## B. Results of Review

Because the Smithsonian's travel policy meets the accountable plan rules, we focus our analysis on those transactions that the independent accountant identified as unsupported or inadequately supported, or as unauthorized, and whether those expense transactions met the requirements of the accountable plan rule.

The independent accountant reviewed a total of \$202,659 of the CEO's expenses for fiscal years 2001 through 2005. The independent accountant separated the transactions into two groups: transactions on the CEO's Smithsonian-issued Citibank travel card (\$145,734 total), and non-Citibank transactions (\$56,925 total). This distinction was useful because there was a dearth of supporting documentation, the CEO used the Smithsonian-issued Citibank travel card for personal expenses, and much of the CEO's Citibank travel card expenses had to be reconstructed. Within those two groups, the independent accountant classified each transaction as either (1) supported and authorized, or (2) unsupported, inadequately supported, or unauthorized. Those transactions in the latter categories appear in the independent accountant's report as exceptions noted in four separate schedules attached thereto.

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<sup>8</sup> For example, paying Citibank statements that had both business and personal expenses before receipt of substantiating records and paying amounts in excess of the balance due (both of which we discuss in detail later in this letter) constituted advances to the CEO for nonbusiness expenses, meaning the arrangement does not fulfill the business connection requirement. Thus, had the Smithsonian travel policy not applied, *all* expenses paid under the arrangement described by SBV would be treated as taxable income, whether they were supported or not.

<sup>9</sup> Treas. Reg. § 1.62-2(c)(5).

Below, we offer comments and recommendations on the CEO's (1) unsupported expenses and inadequately supported expenses; (2) his unauthorized expenses; and (3) personal expenses for which he has not reimbursed the Institution. Finally, we offer some observations on the nature of the expenses he incurred.

## Unsupported and Inadequately Supported Expenses

### *Unsupported Expenses*

The independent accountant found that \$5,476.71 of the CEO's expenses was unsupported because the CEO provided no documentation whatsoever for these expenses. See Schedule B-2 to the independent accountant's report.

Based on our additional analysis, we conclude that the amount of unsupported expenses is actually \$26,155.36, or 13 percent of the total expenses reviewed. We derived this number as follows: First, we eliminated \$4,559.60 from the independent accountant's \$5,476.71 figure for the four "SoFA" or statement of financial activity transactions in Schedule B-2. While these entries may not have been properly supported, our experience with SBV accounting systems, as well as our review of similar transactions that were fully documented and that we eliminated from the scope of this review, lead us to conclude that these were not payments to the CEO but were intercompany transfers. Accordingly, we do not treat them here as unsupported, which leaves \$917.11 in expenses for which there was no documentation.

Second, in our judgment, transactions with only minimal documentation (such as an entry on a charge card statement) but no receipts or other evidence of the expense, and any other transactions for which the CEO could not identify a business purpose, are unsupported. Accordingly, we took three types of transactions from the "inadequately supported" and added them to the "unsupported" category: (1) those Citibank travel card transactions where entries on a Citibank statement were the only support (i.e., no receipt and no business purpose were provided), totaling \$9,432.12; (2) those non-Citibank transactions for which, although there was a charge card statement entry, a monthly invoice or other document, there was no receipt and no business purpose provided, totaling \$10,607.49; and (3) those non-Citibank transactions for which there were receipts but no business purpose provided, totaling \$1,375.19. Finally, we also added those charges for car service that lacked a receipt and lacked a business purpose, totaling \$3,823.45 (the independent accountant classified all car service charges as unauthorized).<sup>10</sup> Attachment 1 to this transmittal shows our calculations.

### *Inadequately Supported Expenses*

The independent accountant characterized \$126,742.04<sup>11</sup> in expenses as inadequately supported. Inadequately supported means that although there was some documentation related to the expenses, such as copies of charge card statements,

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<sup>10</sup> We discuss the car service transactions on pages 14-15 of this letter.

<sup>11</sup> This figure is the sum of inadequately supported transactions in Schedules B-1 and B-3.

calendars, itineraries, expense reports of varying detail, or the recollection of the CEO,<sup>12</sup> that documentation was insufficient. The independent accountant noted for each expense on the schedules of inadequately supported expenses (Schedules B-1 and B-3) whether it lacked a receipt, or lacked a business purpose, or lacked both. (Those that lacked both a business purpose and a receipt, or that lacked a business purpose, we categorized as “unsupported” and included them in the amounts above.)

Based on our additional analysis, we conclude that the amount of inadequately supported transactions totals \$119,622.44, or 59 percent of the total expenses reviewed. We derived this number as follows: As explained above, we recategorized certain of the transactions as unsupported and so eliminated them from the total of inadequately supported expenses. We then added those car service transactions for which the CEO provided a business purpose but was unable to provide receipts (\$21,441.75). Finally, we eliminated those expenses \$75 and under for which the CEO was able to specify a business purpose (a total of \$7,146.55 over the review period), as neither Smithsonian policy nor IRS regulations<sup>13</sup> require receipts in those circumstances.<sup>14</sup> Attachment 1 to this transmittal shows our calculations.

### *Treatment of Unsupported and Inadequately Supported Expenses*

The CEO objects to categorizing as unsupported those expenses for which SBV provided any documentation. He also objects to categorizing as inadequately supported those for which he was able to provide alternative documentation<sup>15</sup> indicating the business purpose of the expense, but was not able to provide receipts. He asserts that he had adequate documentation at the time of each expenditure, that he provided that documentation at the time to prove the expense, and that the documentation has since been lost or destroyed. The CEO points to the declaration by the former SBV controller, who stated that he reviewed the CEO’s expenses for reasonableness and that he kept files with receipts or other supporting documentation for those expenses. The former controller also stated in his declaration that, to the best of his knowledge, “all expenses submitted for reimbursement by [the CEO] throughout my tenure with SBV, were reasonable and valid business expenses incurred in furtherance of the missions of both the Smithsonian and SBV.”

Under IRS rules *each element* of every travel and entertainment expense must be substantiated.<sup>16</sup> For travel expenses, there must be adequate records to substantiate (1) the *amount*, which means the amount for each separate expenditure (meals, lodging, transportation, etc.); (2) the *time*, which means the dates of departure and of return,

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<sup>12</sup> We considered categorizing as “unsupported” those transactions whose only support were an entry on a Citibank statement and the CEO’s recollection, but decided to keep those transactions in the “inadequately supported” category. As explained in more detail below, in our view the inadequately supported transactions within the statute of limitations should be treated as income to the CEO.

<sup>13</sup> Treas. Reg. § 1.274-5(c)(2)(iii)(A)(2).

<sup>14</sup> We did not eliminate expenses \$75 and under from those transactions we categorized as “unsupported” because no business purpose was provided for those transactions. Under Smithsonian travel policy, no receipts are needed for such expenses, but the expenses must be explained on a travel voucher.

<sup>15</sup> The CEO spent over \$130,000 of SBV resources to hire a consulting accountant to assist in reconstructing and reconciling support, primarily based on copies of charge card statements as well as on documents such as calendars, itineraries and summary expense reports.

<sup>16</sup> Internal Revenue Code § 274(d). Smithsonian travel policy documentation rules mirror the IRS’s.

as well as the number of days spent on business; (3) the *place*, which means the destination; and (4) the *business purpose*, which means the business reason or nature of the business benefit derived or expected.<sup>17</sup> For entertainment expenses (such as business dinners), there must be adequate records to substantiate (1) the *amount*, which means the amount for each separate expenditure (meals, other entertainment); (2) the *time*, which means the date of the entertainment; (3) the *place*, which means the name, address and designation of the type of entertainment; (4) the *business purpose*, which means the business reason or the nature of the business benefit derived or expected; and (5) the *business relationship* to the person entertained, which means the occupation or other information about the person entertained sufficient to establish that there is a business relationship.<sup>18</sup>

These elements may be established either by (1) adequate records or, if adequate records do not exist, by (2) other sufficient evidence corroborating the taxpayer's statement.<sup>19</sup> Adequate records are records created at or near the time of the expense containing specific details regarding each element of each expenditure. There are two requirements for adequate records: first, that "[a]n account book, diary, log, statement of expense, trip sheets, or similar record must be prepared or maintained in such manner that each recording of an element of an expenditure ... is made at or near the time of the expenditure."<sup>20</sup> Second, in addition to the account book or similar record, there must also be documentary evidence that, in combination with the account book or similar record, substantiates each element described above.<sup>21</sup>

It is clear that for both the unsupported and the inadequately supported transactions, adequate records do not exist. As noted earlier, the CEO claims that his records were lost or destroyed, which under IRS rules would entitle him to reconstruct his expenses and substantiate them that way. To be able to do so, he must prove that: (1) the records he had (but that are now lost) were adequate records, and (2) those records were destroyed or lost in a casualty beyond his control.<sup>22</sup> Only when he meets these two requirements may he substantiate the elements of each expense with reconstructed records.

Turning to the second requirement first – whether the CEO has proved that the records were destroyed or lost in a casualty beyond his control – it is possible that the IRS would not accept loss from a move or through inadvertence on the part of SBV as a casualty beyond his control.<sup>23</sup> Nonetheless, we will assume that the loss was such a casualty.

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<sup>17</sup> Treas. Reg. § 1.274-5T(b)(2).

<sup>18</sup> Treas. Reg. § 1.274-5T(b)(3).

<sup>19</sup> Treas. Reg. § 1.274-5T(a)-(c).

<sup>20</sup> Treas. Reg. § 1.274-5T(c)(2)(ii).

<sup>21</sup> Treas. Reg. § 1.274-5T(c)(2)(i).

<sup>22</sup> Treas. Reg. § 1.274-5(c)(5); *Campbell v. Commissioner*, 164 F.3d 1140 (8<sup>th</sup> Cir. 1999); *Gizzi v. Commissioner*, 65 T.C. 342 (1975).

<sup>23</sup> The IRS has ruled both for and against taxpayers who have claimed that moves or office problems caused their loss. For example, in *Davis v. Commissioner*, T.C. Memo 2006-272, the court allowed deductions where the taxpayers' accountant lost the documents but the taxpayers presented credible reconstructions; in *Villarreal v. Commissioner*, T.C. Memo 1998-420, the court deemed it a casualty beyond the taxpayer's control where his accounting firm misplaced his records during an office move. On the other hand, in *Gizzi*, the court ruled that it was not a casualty beyond the taxpayer's control when his records were inadvertently thrown out. In *Kelly v. Commissioner*, T.C. Memo 1996-529, the

That leaves the first requirement: the CEO must prove that the records that were lost were adequate records for IRS purposes in the first place. We do not believe he has done so. As noted earlier, under IRS standards, adequate records are records created at or near the time of an expenditure that establish every element of that expenditure. That means the records (whether an account book or something similar) prove the amount, date, place, and business purpose for each expense. There are three reasons that the available evidence does not persuade us that there were adequate records – that there was substantiation for every element of every expense – from the outset. First, the original records that do exist do not consistently substantiate each element, and the controller accepted less than the IRS (or Smithsonian) would when he approved and paid for the CEO’s expenses. Second, there is no discernible pattern to the loss. Third, SBV’s handling of the CEO’s expenses strongly suggests that the records did not meet IRS standards for adequate records.

An examination of some of the expense reports and receipts provided to the independent accountant for this review show inconsistent levels of documentation. In some instances, all elements of an expense were recorded at or near the time of the expenditure (for example, expense reports that list the date, place, amount, business purpose of a dinner, and the names of those attending). But in other instances, no business purpose was recorded. Instead, there was a notation such as “business dinner,” with no indication of what business was conducted. This inconsistency existed between as well as within expense reports. This level of substantiation was accepted by the former controller, and the corresponding charges were paid by SBV.

Furthermore, the former controller’s declaration does not establish that the CEO was required to substantiate every element of every expense. The former controller did not state that he required substantiation for the amount, date, place, or business purpose (and business relationship, in the case of entertainment such as a business dinner) for every single expense. The former controller also did not state that he had reviewed and approved *every* expense incurred by the CEO.<sup>24</sup> And while the former controller undoubtedly believed that all the CEO’s expenses were reasonable and valid, we also note that the controller was the CEO’s subordinate.<sup>25</sup>

Second, there is no discernible pattern to the loss of records. It is not as if certain months of records were missing, or that records relating to one particular vendor were missing. It appears to be a random pattern. That may be attributable to poor recordkeeping, but it also suggests that there were not particular files or boxes misplaced. In any event, it is the taxpayer’s burden to maintain records and the obligation of Smithsonian units to retain all relevant business records for at least six years.

Third, SBV’s handling of the CEO’s expenses also undermines confidence that records that would be adequate under IRS standards existed. The practice of paying advances

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court expressed doubt that a taxpayer’s loss of records in the course of an office move would constitute a casualty beyond his control that would entitle him to reconstruct his records.

<sup>24</sup> For example, in his declaration he stated he “frequently” approved travel expenses for the CEO. He also stated that he recalled reviewing monthly bills for car services, but did not state that he reviewed or approved every use of car service by the CEO.

<sup>25</sup> The former controller currently serves as a consultant to SBV.

on the CEO's Citibank card is especially notable. One memorandum from the CEO's then-executive assistant to the former controller dated December 12, 2004, stated: "I called Citibank this morning. The balance due on [the CEO's] account is 7,237.09, which is due by Jan 6<sup>th</sup>, 2005. Do you want to issue a check for \$10,000? The last payment received on the account was in the amount of 1,477.95 received on Oct. 21<sup>st</sup>, 2004." A handwritten notation below, signed and dated the same day by the former controller, reads: "Approved for Payment; Bills to be reconciled." This memorandum indicates little concern for timely and full substantiation.

SBV was also paying the CEO's Citibank card directly, rather than having him pay the balance and reimbursing him as required by policy, and before having substantiated the expenses charged. Indeed, it is unclear whether the controller's office had even seen the Citibank statement when the controller authorized the payment described in the memorandum quoted above.

Attachment 2 to this transmittal lists every Citibank statement during the review period and breaks down the amounts owed, amounts paid, credits, and beginning and ending balances, as reconstructed and reconciled by the CEO's consulting accountant. It shows that SBV made lump-sum payments on the CEO's travel card eight times in the 60 months reviewed. If adequate documentation had been available, there would have been no need to make such payments. Moreover, if adequate documentation had been available, the amounts of the lump-sum payments would have corresponded closely to the balances due on those statements, but they generally did not. If adequate records had been available, there would have been no need for the travel card to carry a *credit* balance almost 60 percent of the time covered by this review.

Under IRS standards, where records are not adequate for a particular element of an expense, then that element may be proven by the "other sufficient evidence method," which requires the taxpayer to establish that element by both his own statement containing specific information in detail regarding that element, *and* other corroborative evidence.<sup>26</sup> To substantiate the amount, place or date, the corroborative evidence must be direct evidence; for the business purpose or business relationship, circumstantial evidence is acceptable, but it must still be specific and detailed.<sup>27</sup> The level of proof needed for this method of substantiation is difficult to meet for numerous expenditures of relatively small amounts, as is the case here. And whether the evidence meets the standard is very fact-specific. In our judgment, the CEO's other evidence is not sufficient.

The CEO relies heavily on the declaration of his former controller. In that declaration, however, the controller made general statements about the procedures he used to pay for the CEO's expenses. He provided no details about the dates, amounts, or places involved for each expenditure.

Many of the reconstructed supporting documents, for example for the CEO's numerous trips to New York City, where SBV has offices, did not contain specific details regarding the nature of each trip. Similarly, with regard to dinners with other SBV executives or with SBV Board members, the CEO often only provided the names, not specific information regarding the nature of the business discussed.

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<sup>26</sup> Treas. Reg. § 1.274-5T(c)(3)(i).

<sup>27</sup> Treas. Reg. § 1.274-5T(c)(3)(i).

The CEO also places great weight on the entries on his Citibank statements. A charge card statement, which may indicate the general nature of the expense because it specifies a vendor, cannot, however, prove each element of an expense. It does not demonstrate the specific amount, date and essential nature of the transaction. For example, a single hotel charge on a statement does not separate the charges into meals or the number of nights' lodging, as IRS regulations require. Moreover, there could be charges for in-room movies, laundry, and the like. We are not saying that the CEO incurred such charges. We are saying that we cannot determine the cost of lodging alone based solely on a charge card statement entry. Similarly, a restaurant charge on a statement may show the date and the amount, but it does not show how many individuals were involved or what the business purpose was, as IRS rules require.

Turning to the inadequately supported expenses, even combining charge card statement entries with other evidence such as calendars or itineraries indicating a business purpose for the trip or meal is not, in our judgment, sufficient. IRS regulations require direct evidence to substantiate the amount, place, and date of each expense. That would mean for business dinners, for example, for which the evidence is the charge card statement and the CEO's recollection, the CEO would have to present further specific evidence (even if circumstantial) of the position of the person entertained and the business purpose. Those instances where the CEO provided a calendar or itinerary or expense report are also not enough, in our judgment, because they cannot document the exact amount, or the number of nights at a hotel, or the number of individuals who attended a business dinner.

We note that the CEO, in violation of Smithsonian policy and the travel card agreement, regularly used his Smithsonian travel card for personal expenses (generally for relatively small amounts), so the fact that these expenditures were on his official travel card or involved a vendor he often used for business purposes does not permit the inference that all these expenditures were for business and not for personal use (for example, restaurant and hotel charges). Indeed, the CEO used some of the same vendors or types of vendors for personal use that he did for business purposes.<sup>28</sup> As noted in a commonly used tax law reference, "[t]he detail required by the regulations is important because it is the basis upon which an allocation between personal and business expenses can be made."<sup>29</sup>

In sum, in our judgment, we do not believe the CEO has substantiated those transactions that we have identified as unsupported (those lacking documentation, or those with only minimal documentation that did not demonstrate a business purpose) as business expenses. We believe the CEO should reimburse those amounts to the Institution.

- We recommend that the Board of Regents request the Acting Secretary to direct the CEO to reimburse the Institution \$26,155.36 for his unsupported business expenses.

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<sup>28</sup> For example, in reconstructing and reconciling the CEO's Citibank statements, the CEO's consulting accountant noted two instances of personal car service charges from firms that he used for SBV business, as well as a number of personal airline tickets.

<sup>29</sup> 519 Tax Management Portfolio 2d p. A-177.

We reach a different conclusion regarding those transactions that we have identified as inadequately supported. We are not saying they had no business purpose. Rather, we are noting that there is a dearth of documentation, especially receipts. And while some records may have been lost or destroyed, the available evidence does not persuade us that there was adequate supporting documentation for every expense from the start. And even if the CEO could prove that the records that were lost were adequate records by IRS standards, which we do not believe he can do, in our view the reconstructed records he provided for the independent accountant's review did not rise "to the level of credibility of a contemporaneous record."<sup>30</sup>

That being said, it is our judgment that the documentation for those transactions that we have identified as inadequately supported do show that most of the expenditures were likely in furtherance of the SBV mission. In other words, we believe they had a business purpose. However, as explained above, they were not substantiated to the level required by federal tax regulations. The IRS treats expenses that are not fully substantiated as if they were reimbursed under a nonaccountable plan, which means that they must be treated as taxable income. We therefore believe that the inadequately supported expenses should be treated as income to the CEO.

Because of the 3-year statute of limitations,<sup>31</sup> we believe there would be no tax liability for transactions before calendar year 2003 (the CEO filed his 2003 income tax returns in October 2004). Attachment 1 to this transmittal sets forth our calculation of the CEO's expenses, by calendar year, that should be treated as income.

The Smithsonian is a nonprofit entity under section 501(c)(3) of the Internal Revenue Code. The CEO is a "disqualified person" at the entity under the tax code because he is a senior executive. Those expenses that the SBV CEO did not substantiate would be considered an "automatic excess benefit" under the tax code because they were compensation that was not paid as compensation for services.<sup>32</sup> In other words, the employee received payment without providing equivalent services. If a nonprofit provides such a benefit to a disqualified person, it is supposed to provide contemporaneous written substantiation of its intent to treat that payment as compensation. By filing the appropriate tax information forms, the Institution may avoid the intermediate sanctions that would be imposed for having paid an excess benefit to the CEO.

- We recommend that the Board of Regents request the Acting Secretary to direct the Institution to treat as taxable income the CEO's inadequately supported expenses in the amount of \$28,578.94 for tax year 2003, \$14,248.13 for tax year 2004, and \$22,407.65 for tax year 2005, and file the appropriate federal tax information forms.

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<sup>30</sup> *Aregoni v. Commissioner*, T.C. Summary Opinion 2005-65, p. 8.

<sup>31</sup> Internal Revenue Code § 6501.

<sup>32</sup> It is called an "excess benefit" because the amount paid to the disqualified person exceeds the benefit (the performance of services) received by the nonprofit organization.

## Unauthorized Expenses

The independent accountant identified \$33,265.03,<sup>33</sup> or approximately 16 percent of the total reviewed, as unauthorized expenditures because they did not conform to Smithsonian policies.

The CEO disputes the characterization of most of these transactions – amounting to \$29,722 – as “unauthorized” because they represent expenditures on car service, both in the metropolitan Washington area and while on travel. The independent accountant characterized these expenses as such (note A to Schedule B-4) because there was no authorization for them, as required by Smithsonian travel policy. The CEO states that SBV’s unwritten travel policy permitted him to use the car service routinely. Other Smithsonian executives (not in SBV) were aware of his use of car service and they, too, used car service regularly. The former SBV controller has stated that he believed that having SBV executives use car service, rather than wait for alternative means of transportation, was appropriate, and that he would review car service bills for reasonableness before approving them. We note that there was no evidence of advance written approval of the use of car service by the controller or anyone else in SBV, nor any written authorization to do so by the Secretary or the Board of Regents.<sup>34</sup>

Apart from the questions of documentation and approval, we would also note that use of car service may in certain circumstances qualify as an excessive expenditure. For example, \$55 for car service from LaGuardia airport to downtown Manhattan may seem reasonable. But \$920 for car service for a group of SBV and Smithsonian executives to and from New York airports and within Manhattan may or may not be. Whether it is reasonable would depend on a variety of factors, such as availability of taxis, scheduling, and the number of passengers. For those instances where it is not reasonable, the amount that is excessive would be the difference between the cost of the car service and what the cost would have been for a taxi, for example, for each trip. It would not be practical or an efficient use of our limited resources to conduct the necessary research first to determine for the approximately 160 transactions whether each use was appropriate and then, for those that were not, determine the excess amount.

Consequently, while the use of car service was unauthorized, given the circumstances, we make no recommendation regarding these expenditures, other than to the extent they were either unsupported or inadequately supported (and thus are included in amounts discussed above). In other words, we make no specific recommendation regarding the \$4,457 in car service expenses that were fully documented.

Smithsonian travel policy, as updated in June 2007, states that the use of car service must be “advantageous” to the Institution.<sup>35</sup> Even with this update, which was in response to the Board of Regents’ Governance Committee Report of June 14, 2007,

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<sup>33</sup> Of these expenditures, \$25,265 lacked receipts and/or documentation of the business purpose and are therefore included in what we categorized as unsupported and inadequately supported amounts.

<sup>34</sup> Car service was an authorized expense for the Secretary of the Smithsonian because the Board of Regents allowed it, as explained in their Representation Letter to the independent accountant, and as ratified at their January 29, 2007 meeting.

<sup>35</sup> On June 18, 2007 the Board of Regents’ Governance Committee voted to have the Smithsonian travel policy apply to SBV.

the policy provides little useful guidance. The Institution needs to spell out the standards that apply to the use of car service.

- We recommend that the Institution revise the travel policy and expenses policies to clarify that all employees should take the most economical and appropriate means of transportation under the circumstances, and to specify that car service may be used only in exceptional circumstances and must be justified and authorized in writing in advance.

The remaining transactions – those not involving car service – that the independent accountant characterized as unauthorized included reimbursement for two parking tickets (\$40) and three instances where hotel charges exceeded the exception in the Federal Travel Regulation and Smithsonian policy that allows travelers who receive actual expenses, rather than per diem, to incur costs up to 300 percent of the per diem limits<sup>36</sup> (\$712), a total of \$752. The independent accountant also noted \$2,791 in duplicate transactions that SBV could not prove had not been paid twice and therefore were unauthorized.

- We recommend that the Board of Regents request the Acting Secretary to direct the CEO to reimburse the Smithsonian for the \$3,542.78 in unauthorized transactions.

#### Unreimbursed Personal Expenses on the Smithsonian Citibank Travel Card

In reconstructing documentation on behalf of the CEO for the Citibank payments, the accountant SBV contracted with to assist in assembling and reconstructing the CEO's documentation determined that as of the end of fiscal year 2005 the CEO had not reimbursed SBV for around \$5,000 of personal expenses on his Smithsonian-issued travel card. While there may be tax consequences associated with this unreimbursed amount, because the Institution in essence provided an interest-free loan of that amount to the CEO, the considerable effort required to allocate the amounts to specific tax years and determine the appropriate interest that would apply to each personal expenditure would be significantly out of proportion to the few hundred dollars of interest that he would likely owe. In any event, the CEO should pay the Institution back the outstanding principal amount. He recently provided a check for \$5,000 to SBV, pending further reconciliation of the accounts.

- We recommend that the Board of Regents request the Acting Secretary to direct the CEO to reimburse the Smithsonian for any personal expenditures on his Smithsonian-issued travel card that he has not yet reimbursed.

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<sup>36</sup> Although there was no documentation to support why the regular per diem limits were often exceeded, the independent accountant only questioned those that exceeded the 300 percent ceiling.

## Nature of the Expenses

The CEO's expenditures consisted primarily of travel and meals (entertainment). Unlike the Secretary's non-travel expenditures, which were governed by his employment agreement and by Smithsonian policies regarding the expenditure of trust funds, the CEO's non-travel expenditures – absent express policy to the contrary – must only conform to the three requirements set forth in his delegation of authority from the Secretary (applicable law, business practice, and fiduciary duty).

While we did not see any expenditures that violated the law, and the majority did not violate policy, we question whether the CEO's expenditures were always in keeping with good business practices for a nonprofit organization or with his fiduciary obligation to the Smithsonian trust.

For example, the CEO's hotel charges exceeded federal lodging limits. He only provided receipts, which show daily rates, for 12 out of the more than 80 lodging transactions over the review period, and every one of the 12 exceeded the federal per diem limits by two or three times. Although Smithsonian travel policy and the Federal Travel Regulation allow travelers to receive reimbursement for actual expenses up to 300 percent of the per diem, the criteria under Smithsonian policy for doing so are so loose as to be almost meaningless: "[a]ctual expenses may ... be warranted because of mission requirements or any other reason approved by SI." Moreover, Smithsonian policy allowed authorization for actual expenses after the fact.<sup>37</sup> While these standards conform to the FTR, we believe that they do not adequately consider the fiduciary duty to the Smithsonian.

The Board of Regents' Governance Committee has undertaken a comprehensive review of Smithsonian travel and expenses policies, and the Regents' Executive Committee has recently approved interim policies that are more restrictive than current rules. We believe that the Institution should revise its travel policy to allow actual expenses (rather than per diem) only in exceptional, defined circumstances.

- We recommend that the Board of Regents request the Acting Secretary to revise the Institution's travel policy to establish stricter standards for when actual expenses, rather than per diem, may be authorized for travel.

The CEO occasionally charged to his travel card lunch and dinner meetings with other SBV executives in Washington D.C. and New York City.<sup>38</sup> Although the total amounts involved are not substantial (approximately \$2,100 over the 5-year period), and it is a common practice in for-profit businesses, we do not believe it is appropriate for the nonprofit Smithsonian to pay for a \$270 dinner for three SBV executives or a \$194 dinner for two SBV executives at high-end Washington restaurants.

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<sup>37</sup> In March 2007, the Smithsonian issued a clarification to its travel policy providing, among other things, that actual expenses (versus per diem) were allowed if authorized in advance, but did not explain under what circumstances that would be appropriate.

<sup>38</sup> He also frequently charged dinners with individual SBV Board members, but that may be more appropriate because SBV Board members receive no remuneration for their services. In addition, the CEO often had relatively expensive business meals with potential and existing business partners, a practice common in the for-profit world.

We also saw staff-only breakfasts, working lunches, and celebrations paid for by SBV, a practice that did not violate any applicable rules but that was not permitted elsewhere in the Smithsonian through most of the period of this review.<sup>39</sup> Again, we do not believe these practices are appropriate for an entity whose purpose is to generate funds for the charitable purposes of the Smithsonian. We are pleased that the Board of Regents' Governance Committee recently directed that SBV follow Smithsonian-wide policies, which we assume includes the rules allowing Smithsonian-funded staff-only meals only in limited circumstances.

The Acting Secretary is planning a comprehensive reexamination of the mandate, structure and operations of SBV. We believe that during this process, he and the Regents should carefully consider the implications of having a business organization modeled on the private sector that operates under different rules and expectations than the rest of the Institution. Some of the problems we observed during this review arose because SBV was set up to operate outside Institution practices without adequate oversight. Business practices from the private sector may have overshadowed the fiduciary duty to the Smithsonian Trust. One important part of the reexamination should be to decide which practices of for-profit businesses – or for-profit aspects of nonprofit organizations such as universities – regarding expenses, if any, SBV should retain. Best practices in the nonprofit sector suggest that decisions on expenses should be based only on how best to further the organization's charitable purposes.

#### IV. Internal Control Issues

A significant challenge in performing the agreed-upon procedures was the state of SBV's internal controls over business expenses. In addition to much of the underlying documentation not having been retained, we observed weaknesses related to the internal controls over expenses that undermine our confidence that all the unsupported and inadequately supported expenses were necessarily reasonable and appropriately justified. While these weaknesses may not have been solely the fault of the CEO, he is responsible for the overall control environment at SBV. Responsibility also rests with Smithsonian management, which did not always fully enforce or monitor compliance with its policies and thereby tacitly condoned some of the practices we describe below.

As the Independent Review Committee<sup>40</sup> noted in its recent report, “[i]n the nonprofit context, an essential element of good financial controls is a system for assuring that expenses are properly documented, support the organization's mission and are not lavish or extravagant . . . . Basic failures of internal controls put the Smithsonian and its Regents at risk of liability and adverse publicity.”

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<sup>39</sup> Until December 2004, the Smithsonian prohibited the use of certain unrestricted trust funds (the only ones that would be available for such discretionary uses) for staff-only meals. SBV was not covered by this policy, however, as its funds did not fall within those classifications. The policy changed in December 2004 to allow staff-only lunches under limited circumstances.

<sup>40</sup> In March 2007, the Board of Regents appointed an Independent Review Committee to provide an assessment of concerns surrounding executive compensation and expenses at the Institution.

## Lax Recordkeeping

The documentation for the majority of the expenses examined was not available initially, indicating poor recordkeeping practices. Smithsonian policies require that financial documents be kept for over 6 years.<sup>41</sup> That the majority of the supporting documentation for the CEO's expense transactions could not be located,<sup>42</sup> and that SBV had to reconstruct support by obtaining copies of Citibank statements and researching old electronic calendars, itineraries and other documents, suggest weaknesses in internal controls.

Whatever the cause, care was not taken to preserve these documents. Smithsonian policy states that "[a]ll documents created or received by employees of SI in the course of official business are records of the Institution, and none may be disposed of except in accord [with guidelines] established by the Smithsonian Archives." To our knowledge, SBV has not complied with this policy with regard to records related to the CEO's business expenses. Had SBV done so, it is less likely that the documents would have been lost.

## Lack of Written Policies and Procedures

SBV had no written policy setting forth standards for approval, substantiation requirements, or other basic rules for travel and other business expenses until June 2006 (after the period covered by this review). Written policies are necessary to ensure the consistent and continuous application of official procedures. Without written criteria, it is difficult to ensure expenses are proper and not fraudulent or wasteful. It is disturbing that an office with a fiduciary duty to the trust resources of the Smithsonian would fail to articulate in writing some basic rules for safeguarding those resources.<sup>43</sup>

The CEO states that there were unwritten rules, as detailed by the former controller in a declaration he made in April 2007. (As noted earlier, the Smithsonian travel policy still applied in any event.) According to that declaration, the unwritten policy consisted of the controller reviewing the CEO's travel card statements and other expense documentation for reasonableness, and collecting the necessary support (such as receipts) as the CEO provided it. According to the declaration, the CEO would note on the travel card statement which expenses were personal and "typically" include a check to Citibank for that amount. We note that the CEO charged personal expenditures (generally for relatively small amounts) on his Citibank travel card 22 months out of the 60 months reviewed. See Attachment 2 to this transmittal.

We spoke with the former controller for further clarification and he explained that he occasionally would pay the travel card balances as they were due before receiving full

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<sup>41</sup> For example, the Smithsonian Travel Manual states that "units are required to retain [official travel-related] receipts for at least six years and three months."

<sup>42</sup> This review began in August 2006. We received supporting documentation such as duplicate receipts as recently as May 1, 2007.

<sup>43</sup> The former SBV controller's declaration states that SBV lacked the time and resources to create written policies because of the start-up nature of SBV. SBV began in late 1999. Simple expenses policies may be downloaded from the internet or borrowed from other business concerns and modified as appropriate.

documentation for the actual expenses. He stated that he would usually – but not always – receive what he deemed to be adequate documentation within 90 days. The controller also explained that although he did require receipts or similar documentation from the CEO to support travel expenditures, he did not require the CEO to submit formal vouchers or expense reports, contrary to what was required of other SBV employees.

The former controller also stated that there were instances when the travel card statements were lost, and that while waiting for replacement statements, he would pay lump-sum advances to Citibank so that the CEO's account would not become delinquent. As Attachment 2 shows, such lump-sum payments were made on eight Citibank statements (or 13 percent of the 60-month period covered by this review), in amounts ranging from \$2,000 to \$10,000. We also note that the CEO's Citibank travel card carried a *credit* balance 36 months out of the 60 months reviewed (or 59 percent of the time), in one instance for over \$9,000. The lack of correlation between expenditures and payments made is troubling.

The former controller's declaration also stated that the Institution's external financial statement auditor, KPMG, would test supporting documentation for selected payments at SBV, and that he did not believe KPMG had ever questioned the adequacy of supporting documentation for the CEO's travel or other business expenses. We note that KPMG never performed an audit of SBV, only an audit of the entire Institution, of which SBV is but one part. KPMG did test internal controls over cash disbursements at SBV, but told us that it was not aware of having performed any specific testing of SBV travel or other reimbursable expenses. In any event, KPMG provided no opinion or assurances regarding such expenses or associated internal controls at SBV.

### Lack of Compliance with Travel Card Policies

SBV and the SBV CEO in many instances did not adhere to or enforce Smithsonian travel card policies. The CEO's Citibank travel card was Smithsonian-issued. The Citibank travel card is issued to the individual, and the individual is financially responsible for timely paying the charges on that card. The individual is then to be reimbursed for his or her documented expenses. The travel card agreement, which every cardholder signs, specifically states that the card is not to be used for personal expenditures. This rule was reiterated in the Smithsonian travel policy, as well as in regular Smithsonian-wide email announcements.<sup>44</sup> Moreover, the card is not supposed to be used for local expenditures. Nonetheless, SBV paid the CEO's travel card expenditures directly (less an amount identified by the CEO as personal expenses), rather than having the CEO pay it himself and then seek reimbursement.<sup>45</sup>

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<sup>44</sup> A Smithsonian-wide email announcement from the Office of the Chief Financial Officer dated February 7, 2003, states in the first paragraph: “[T]ravel cardholders are hereby reminded that they are financially responsible for all charges on the monthly statements they receive from Citibank and may only use their Smithsonian travel cards for expenses related to out-of-area travel on official Smithsonian business. . . . [U]se of a Smithsonian travel card for expenses not related to official out-of-area travel constitute[s] misuse and/or abuse of travel cards.” Such email announcements appear approximately twice a year.

<sup>45</sup> We also note SBV's questionable practice of paying the CEO's charge card statements with mixed personal and business expenses, directly, and in advance before all the documentation supporting those

In addition, the CEO used his card for personal expenses and for local business expenses, and SBV permitted him to do so.<sup>46</sup>

The Smithsonian's travel office warned SBV that these uses were improper, but never cancelled the card or imposed other sanctions for repeated violations of this policy, reportedly because SBV claimed not to be subject to the rules. Yet the various announcements and policies stated that misuse of the card could lead to disciplinary action. In other words, Smithsonian management allowed these misuses of the card to continue. We note that the Smithsonian does have internal controls for its travel card program and enforces the rules against others. A number of Smithsonian employees have been disciplined for violating the travel card rules.

In addition, the CEO used his own charge card for business expenses, and SBV paid that credit card company directly for those expenses that the CEO indicated were for business purposes (rather than reimbursing the CEO) until late fiscal year 2002. That use violated Smithsonian policy and, in our opinion, is not a reasonable business practice. While exceptions likely exist, expenses policies we reviewed from the private sector require the use of the organization's charge card, rather than personal credit cards, for business transactions.

SBV apparently applied a different (if unarticulated) standard to the CEO. According to our discussion with the former SBV controller, other SBV employees (with some exceptions in earlier years) were required to and did pay their travel cards directly and got reimbursed based on receipts and other appropriate documentation, and they generally did fill out expense reports and follow Smithsonian travel rules, with the exception that they often used the travel card locally.

Because of the internal control and documentation issues we have discussed, we will conduct a comprehensive review of the CEO's expenses for fiscal years 2006 and 2007.<sup>47</sup>

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expenses was available. Smithsonian policy and the travel card rules do not even contemplate this possibility.

<sup>46</sup> Had the CEO used his Citibank card only for business expenses, it might have been a more reasonable business practice for SBV to have paid Citibank based only on the statement, although it would still violate the travel card agreement and Smithsonian policies. We also note that the CEO used his Citibank card for other employees' expenses, also a violation of policy. We removed over \$5,000 worth of expenditures on the CEO's Citibank card from the scope of this review because once supporting documentation was found, it showed the expenses were on behalf of others.


<sup>47</sup> The CEO has announced he will not renew his employment contract, which expires in September 2007.

In summary, we believe it was inconsistent with reasonable business practice for an organization with annual revenues exceeding \$150 million not to have a written expenses policy, or at least some written standards regarding business expenses, until after 6 years of operation; to have a subordinate approve his superior's expenses without measuring them against an articulated standard; to allow repeated personal use of a business travel card; to pay off travel card statements that commingled business and personal expenses without complete documentation and often by lump-sum payments; and to have paid the CEO's card directly instead of reimbursing him for documented expenses. Such practices do not set the proper tone, especially for an entity that is part of a nonprofit organization.

More importantly, we question whether the SBV CEO, SBV management, and to some extent Smithsonian management, sufficiently considered the Smithsonian's nonprofit and trust status. Inattention to recordkeeping and substantiation of expenses do not indicate careful stewardship of the Institution's limited resources.

The CEO and Smithsonian management must exercise their fiduciary duty – their duty of care – by diligently safeguarding the organization's assets and financial transactions. Our observations during the course of this review suggest that significantly greater attention must be paid to this fundamental responsibility.

Very truly yours,

  
A. Sprightley Ryan  
Inspector General

cc     Cristián Samper K., Acting Secretary  
        John E. Huerta, General Counsel  
        Sheila P. Burke, Deputy Secretary and Chief Operating Officer  
        Gary M. Beer, Chief Executive Officer, Smithsonian Business Ventures

Attachment 1

**Unsupported Expenses (all years)**

Unsupported expenses total from B-2	\$ 5,476.71
LESS SoFA transactions from B-2	\$ (4,559.60)
Remaining unsupported expenses	\$ 917.11
PLUS (1) Citibank with no receipts/no business purpose from B-1	\$ 9,432.12
PLUS (2) Non-Citibank with no receipts/no business purpose from B-3	\$ 10,607.49
PLUS (3) Non-Citibank with no business purpose from B-3	\$ 1,375.19
PLUS (4) Citibank car service with no receipts/no business purpose from B-4	\$ 3,823.45
<b>Total Unsupported Expenses</b>	<b>\$ 26,155.36</b>

**Total Inadequately Supported Transactions (all years)**

Total Inadequately Supported from B-1	\$ 100,999.97
Total Inadequately Supported from B-3	\$ 25,742.07
Total Inadequately Supported Transactions	\$ 126,742.04
LESS (1) Citibank with no receipts/no business purpose from B-1	\$ (9,432.12)
LESS (2) Non-Citibank with no receipts/no business purpose from B-3	\$ (10,607.49)
LESS (3) Non-Citibank with no business purpose from B-3	\$ (1,375.19)
PLUS Citibank and non-Citibank car service with no receipts from B-4	\$ 21,441.75
LESS transactions \$75 and under from B-1, B-3, and B-4	\$ (7,146.55)
<b>Total Inadequately Supported Transactions</b>	<b>\$ 119,622.44</b>

**Inadequately Supported Transactions (Tax Years 2003-2005)**

	2003	2004	2005
Inadequately Supported (no receipts) from B-1	\$ 25,519.93	\$ 11,987.19	\$ 12,849.91
PLUS Inadequately Supported (no receipts) from B-3	-	\$ 0.06	\$ 2,625.00
PLUS Inadequately Supported (no receipts) from B-4	\$ 4,551.00	\$ 3,815.00	\$ 8,047.50
<b>Total Inadequately Supported</b>	<b>\$ 30,070.93</b>	<b>\$ 15,802.25</b>	<b>\$ 23,522.41</b>
LESS transactions \$75 and under from B-1 (no receipts)	\$ 1,122.99	\$ 1,496.12	\$ 972.26
LESS transactions \$75 and under from B-3 (no receipts)	-	-	-
LESS transactions \$75 and under from B-4 (no receipts)	\$ 369.00	\$ 58.00	\$ 142.50
Total transactions \$75 and under	\$ 1,491.99	\$ 1,554.12	\$ 1,114.76
<b>Total Inadequately Supported (less \$75 and under transactions)</b>	<b>\$ 28,578.94</b>	<b>\$ 14,248.13</b>	<b>\$ 22,407.65</b>

**Notes:**

Smithsonian travel policy does not require receipts for expenses \$75 and under so long as they are authorized. We therefore eliminated those transactions \$75 and under for which the CEO was able to prove a business purpose.

We calculated the 2003 inadequately supported (no receipts) figure starting with February 2003 dates. We did not include January 2003 figures in this total because all the expenses cited on the January 2003 invoice were incurred in 2002.

**Attachment 2**

**CEO's Citibank Travel Card Statements by Month  
FYs 2001 Through 2005\***

Citibank Invoice Date	Beginning Balance	SBV Payments			Credits	New Charges	Expense Included in New Charges	Ending Balance
		Personal Payments	Lump-Sum	Other				
10/12/2000	2,183.40			2,183.40	-	2,161.28		2,161.28
11/12/2000	2,161.28	22.73		2,138.55	470.40	6,382.77		5,912.37
12/12/2000	5,912.37			-	1,844.50	2,779.51	226.44	6,847.38
1/12/2001	6,847.38			6,847.87	-	2,100.42		2,099.93
2/12/2001	2,099.93			8,947.31	-	5,242.21		(1,605.17)
3/12/2001	(1,605.17)			10,484.82	437.50	3,508.47		(9,019.02)
4/12/2001	(9,019.02)			-	-	769.63		(8,249.39)
5/12/2001	(8,249.39)			-	138.80	1,057.19		(7,331.00)
6/12/2001	(7,331.00)			-	2,352.00	3,192.67		(6,490.33)
7/12/2001	(6,490.33)			-	406.00	1,548.51	96.54	(5,347.82)
8/12/2001	(5,347.82)			-	-	3,064.06	71.50	(2,283.76)
9/12/2002	(2,283.76)	207.04		-	-	2,521.65	160.58	30.85
10/12/2002	30.85			2,953.56	764.47	1,782.09		(1,905.09)
11/12/2001	(1,905.09)			-	888.50	2,291.03		(502.56)
12/12/2001	(502.56)	160.58		2,361.07	512.25	1,355.33		(2,181.13)
1/12/2002	(2,181.13)			-	260.50	1,112.65	244.00	(1,328.98)
2/12/2002	(1,328.98)	244.00	5,000.00	-	-	2,254.15	624.57	(4,318.83)
3/12/2002	(4,318.83)			-	-	1,232.78		(3,086.05)
4/12/2002	(3,086.05)	588.82		1,665.33	298.50	3,856.78		(1,781.92)
5/12/2002	(1,781.92)			3,856.78	196.00	2,000.76		(3,833.94)
6/12/2002	(3,833.94)			-	24.00	1,946.87		(1,911.07)
7/12/2002	(1,911.07)			3,727.63	47.00	5,577.19	217.35	(108.51)
8/12/2002	(108.51)			3,914.37	365.50	2,393.84	68.00	(1,994.54)
9/12/2002	(1,994.54)			3,215.57	-	3,596.84	54.00	(1,613.27)
10/12/2002	(1,613.27)			5,427.63	120.00	5,254.12	393.74	(1,906.78)
11/12/2002	(1,906.78)			10,466.73	-	3,797.25		(8,576.26)
12/12/2002	(8,576.26)			-	592.00	3,819.66		(5,348.60)
1/12/2003	(5,348.60)	447.74		-	-	1,202.84		(4,593.50)
2/12/2003	(4,593.50)			-	3,871.90	12,570.81		4,105.41
3/12/2003	4,105.41			11,203.47	44.00	1,373.13		(5,768.93)
4/12/2003	(5,768.93)			-	42.28	2,646.88	588.90	(3,164.33)
5/12/2003	(3,164.33)	1,019.00		-	371.00	2,530.00		(2,024.33)
6/12/2003	(2,024.33)			1,627.88	-	4,992.16	1,259.68	1,339.95
7/12/2003	1,339.95			-	-	3,106.57		4,446.52
8/12/2003	4,446.52			6,256.48	-	6,253.99	39.34	4,444.03
9/12/2003	4,444.03			-	-	4,597.63		9,041.66
10/12/2003	9,041.66		5,000.00	-	-	2,298.73	321.50	6,340.39
11/12/2003	6,340.39		10,000.00	-	136.50	1,047.53	220.00	(2,748.58)
12/12/2003	(2,748.58)		5,000.00	-	-	1,033.00		(6,715.58)
1/12/2004	(6,715.58)			-	-	3,473.51		(3,242.07)
2/12/2004	(3,242.07)			-	-	4,188.60	3,242.07	946.53
3/12/2004	946.53		5,000.00	-	162.10	405.22	65.22	(3,810.35)
4/12/2004	(3,810.35)			-	141.00	2,846.98		(1,104.37)
5/12/2004	(1,104.37)		5,000.00	-	-	892.24		(5,212.13)
6/12/2004	(5,212.13)			-	-	2,124.62		(3,087.51)
7/12/2004	(3,087.51)			-	77.60	1,408.73		(1,756.38)
8/12/2004	(1,756.38)			-	67.60	1,535.50		(288.48)
9/12/2004	(288.48)			-	-	1,550.95	145.95	1,262.47
10/12/2004	1,262.47		2,000.00	-	-	3,186.17	167.60	2,448.64
11/12/2004	2,448.64	73.00		1,477.95	565.30	6,334.15		6,666.54
12/12/2004	6,666.54			-	-	570.55	35.00	7,237.09
1/12/2005	7,237.09		10,000.00	-	156.70	2,362.68		(556.93)
2/12/2005	(556.93)	2,212.94		-	164.90	6,166.47		3,231.70
3/12/2005	3,231.70			2,405.98	156.90	3,633.38		4,302.20
4/12/2005	4,302.20			3,476.48	-	35.00		860.72
5/12/2005	860.72			895.72	-	2,650.03	594.00	2,615.03
6/12/2005	2,615.03			-	410.90	3,473.64		5,677.77
7/12/2005	5,677.77	594.00		2,056.03	442.60	3,335.14	627.26	5,920.28
8/12/2005	5,920.28			3,062.74	222.70	5,724.82		8,359.66
9/12/2005	8,359.66			2,001.75	687.32	2,275.00		7,945.59
10/12/2005	7,945.59			5,502.12	-	5,414.93		7,858.40
<b>Subtotal**</b>		<b>5,569.85</b>	<b>47,000.00</b>	<b>108,157.22</b>	<b>17,439.22</b>	<b>183,841.29</b>	<b>9,463.24</b>	

Note: Shaded figures in the "Ending Balance" column represent months when the card carried a credit balance.

\* This spreadsheet is based on a reconciliation and reconstruction conducted by a consulting accountant for the SBV CEO.

\*\* Subtotals do not match the amounts reported in the review because certain charges were not made on behalf of the CEO, and certain payments and charges were outside the time period covered by the review.