

United States Senate
Committee on Finance



Sen. Chuck Grassley · Iowa
Ranking Member

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For Immediate Release
Monday, February 26, 2007

Grassley works to safeguard Smithsonian resources

WASHINGTON — Sen. Chuck Grassley is asking for an accounting from the board governing the Smithsonian of lavish expenditures by the Smithsonian's top officer and attempts to conceal those expenditures from public view, even while the Smithsonian relies on federal support and tax-exempt donations to run its operations.

Grassley has been conducting a broad-based review of tax-exempt organizations to look out for the credibility of tax-exempt status since 2001.

"The Smithsonian is a cherished American institution. We can't let its resources be squandered. Those resources need to go to sustain the museums and collections, not to some executive's champagne lifestyle," Grassley said.

Grassley is the Ranking Member of the Senate Committee on Finance, where tax policy is considered. He was Chairman of the Committee from 2003-2006 and in early 2001. The text of Grassley's letter to Chief Justice John G. Roberts Jr., who serves as Chancellor of the Smithsonian Institution, follows here.

February 21, 2007

The Honorable John G. Roberts Jr.
Chancellor of the Smithsonian Institution
The Smithsonian Institution
1000 Jefferson Drive, SW
Washington, DC 20560

Dear Chief Justice Roberts:

I am writing to you in your capacity as Chancellor of the Smithsonian Institution, a public charity that receives not only taxpayer funding, but also benefits from very generous tax benefits.

As you know, under statute, Congress over a hundred years ago directed that the Chief Justice should serve on the Board of Regents of the Smithsonian and it has been traditional that the Chief Justice serve as Chancellor.

I appreciate that your responsibilities as Chief Justice are enormous. The responsibilities of caretaker of our nation's treasures are much different but also of great importance. Again, I write to you because the statute governing the Smithsonian gives you these responsibilities. Thousands of families from Iowa come to Washington, D.C. every year and a highlight of their trip is visiting the Smithsonian and seeing first-hand the story of our country. These families often spend years saving money to make this trip so they can share this once-in-a-lifetime opportunity with their children.

It is for these reasons that I am extremely concerned about the actions of the Board of Regents at the Smithsonian in regards to compensation and expenses by Secretary Lawrence Small. I am worried about what appears to be an "anything goes" culture by the Smithsonian Secretary and his staff that allow his champagne lifestyle to be subsidized by the taxpayer. In FY 2006, the taxpayers provided approximately \$715 million dollars in appropriations, grants and contracts to the Smithsonian directly and then through the tax code the taxpayer subsidizes additional gifts and contributions to the Smithsonian. Given that money is fungible, the taxpayer is paying directly or indirectly for the Secretary's lifestyle regardless of what account is being used.

However, far more concerning is that the Smithsonian Board's response and actions to this "anything goes" culture seems to be rubber stamping the actions of Secretary Small and turning a blind eye to very serious issues raised by the Inspector General (IG).

Finally, I'm worried about the efforts of the Secretary's office to hide what is happening at the Smithsonian. The IG's letter to me, dated February 7, 2007, states that senior Smithsonian officials have stated that the documents I will discuss below are "confidential." This effort to hide embarrassing documents reminds me of the generals at the Pentagon who wanted to label everything classified when it came to \$400 hammers and \$640 toilet seats. Based on my counsel's review, there is no justification for this limitation – the public has a right to know what is happening at their Smithsonian. Please provide me all legal analysis from the Smithsonian's lawyers that justified the claim that these documents should be confidential.

The actions outlined below would be troubling at any public charity, but particularly at the Smithsonian – America's museum. It is vital that the Smithsonian watch closely every penny it has. For example, there is a real need for funds to address the chronic leaks at the Smithsonian that have damaged several buildings and exhibits according to the Government Accountability Office. Every penny wasted or spent on high living is money that can't be spent to maintain and preserve America's treasures.

I requested and received from the acting IG three documents:

- 1) Cotton & Company (Cotton) "Independent Accountant's Report on Applying Agreed-

Upon Procedures,” dated December 22, 2006;

2) IG letter to the Audit and Review Committee of the Board of Regents, dated January 16, 2007; and

3) Report of the Audit and Review Committee’s Review of the Secretary’s Expenses

Based on this review, I would appreciate your response to the following issues:

A. Private Planes and False Statement to Media Regarding Secretary Small’s Travel Costs

One of the unauthorized travel costs is for a charter flight from San Antonio, which the IG notes on page 2 of her report cost \$14,509. In footnote A on Schedule B-2 of the Cotton report, it states:

The Smithsonian travel policy states that travelers should select “the mode of transportation that is most advantageous to SI [Smithsonian Institution] when cost and other factors are considered..”, and that special conveyances (such as private aircraft) may be used if authorized. SI could not provide authorization for these flights. Justification for the San Antonio charter indicated that there were commercial flights available, but the charter flight was chosen because of concerns about potential flight delays.

The IG notes in her report on page 2 (“Unauthorized Travel Transactions”) that the total cost was excessive and recommended that the Board consider whether the Secretary’s flight was reasonable and, if not, to ask the Secretary to reimburse the Institution for the difference between first-class airfare and cost of the charter flight and ask the General Counsel to review the tax implications, if any, of reimbursement.

In the Audit and Review Committee report, the Audit Committee failed to mention that the IG found the total cost was excessive. In addition, in a troublesome pattern and practice for the Board that I will comment on at the end of my letter, the Audit Committee states, that even if the travel wasn’t approved, it would have approved it if it had been presented for prior approval. It is my understanding that the Audit and Review Committee report was drafted by the Secretary’s office based on an outline provided by the Audit Committee. Are you troubled by the Secretary’s office playing an important role in drafting a document that reviews the propriety of the Secretary’s own actions? Does this raise questions in your mind about the Board’s independence? Please explain how board members are selected and who nominated, proposed or actively supported every citizen board member since January 1, 2000. Please explain why the Board would ever approve private aircraft travel when commercial flights are available at a fraction of the cost? The claim that there could have been a potential flight delay is a red herring that if accepted would justify private flights at all times.

The Board then followed the Audit Committee recommendation and voted to reaffirm its

approval of first-class travel for all travel by the Secretary and, in certain circumstances, by the Secretary's spouse. This is incomprehensible. First-class air travel is extremely rare for charities and is certainly not standard or best practice for charities. For example, recently, board members and the head of the Getty Museum have respectively resigned, in part, because of first-class air travel by the Getty's chief executive. The Panel on the Nonprofit Sector (The Panel) in its recent report to Congress: "Strengthening Transparency Governance Accountability of Charitable Organizations" made the following point on this matter: "As a general practice, charitable funds should not be used for premium or first-class travel." The Panel goes on to note that charities do not have the benefit of Federal travel rates in response to a proposal that charities should be limited to the Federal rates when it comes to travel costs. While this is true for many charities, it is not true for the Smithsonian.

Do you believe that the Smithsonian has a duty to show leadership of following the best practices in the charity field or is it acceptable for the head of the Smithsonian to receive perks and benefits that are widely rejected by the vast majority of charities? Please provide a detailed accounting of all travel costs as well as actual and planned itineraries (including lodging, meals, cars, etc.) for the Secretary and his wife since he began in office. I ask that the Board review the Panel's recommendations on best practices and advise me what recommendations the Board will follow.

Sadly, the Smithsonian board's blessing of private jet travel and first-class airfare is not even the most troubling aspect of this private jet matter. *The Washington Post* reported the following two stories:

On August 7, 2001:

Smithsonian Secretary Lawrence M. Small, who has sustained public criticism for cutting jobs and programs while catering to corporate donors at the belt-tightened institution, has been raising eyebrows recently with his occasional use of executive jets, reports *The Post's* Jacqueline Trescott. **But Small wants everybody to understand that he pays for the luxury transport out of his own pocket.**

The former Fannie Mae president, who earned \$4.2 million in 1999, his last year at the government-subsidized financial powerhouse, now makes a comparatively paltry \$330,000 a year. But that hasn't stopped him from establishing a discretionary fund with his own money "to pay for extraordinary expenses," said a Smithsonian spokesman.

One day in May, for instance, Small dipped into the fund to pay \$14,600 to fly on a Learjet 35 for a round trip between Washington and San Antonio. His reason? He needed to attend a Texas groundbreaking for the Museo Americano Smithsonian, dedicated to Latino culture and art, then get to a Board of Regents meeting on the Mall. **As long as it's his cash, we guess he can spend it however he pleases.** [emphasis added]

And the second story on August 9, 2001:

Now we know why Smithsonian Secretary Lawrence M. Small was so eager to be on time for a Board of Regents meeting in May that **he spent \$14,600 of his own money to charter a Learjet from San Antonio, as we reported in Tuesday's column.** It turns out that Small owes the Smithsonian regents big-time, and understandably doesn't want to keep them waiting. We hear that back in January they raised his salary from the \$330,000 we reported to a more substantial \$480,000. [emphasis added]

Then the truth. The IG report on p. 2, footnote 3 states:

We note that a Washington Post account a few months after the trip cites an Institution spokesperson as saying that the Secretary paid for the trip from a discretionary fund with his own money. **That characterization is inaccurate.** [emphasis added]

Thanks to the IG report we now know that the spokesman for the Smithsonian was not telling the truth to *The Washington Post*. However, even more troubling is that the Smithsonian leadership, and it appears at least some of the Board, knew through the IG report, that false information was provided to the public, and yet nothing has been done to hold individuals accountable or to make sure that the truth is provided to Congress and the public.

So we have two failures to provide the public and the Congress the truth. First, senior leadership of the Smithsonian provided false information to the press and effectively Congress and the public. No efforts were made by the Smithsonian to correct the false impression provided to the public that Mr. Small paid for a private jet.

Second, at least some of the Smithsonian Board was most recently notified by the IG that the Smithsonian had provided false information to the press on a highly sensitive manner. The Board has taken no action and, in fact, the Audit and Review Committee's report, drafted by the Secretary's office completely fails to mention the fact that the IG office found that senior Smithsonian leadership provided false information to the press. Instead, the Smithsonian sought to label all of these documents "confidential."

Do you believe this is acceptable behavior by the Smithsonian or the Board? Do you believe that the Smithsonian and its Board have a responsibility of honesty and candor with the press, the public and the Congress? Please provide since September 28, 1999 a listing of all monies deposited in the "discretionary fund" cited above as well as the discretionary fund cited in the employment agreement (or any fund that is under the sole or primary control of the Secretary including the "401" and "402" accounts); the source of those monies; and what those funds were spent on. Please provide a copy of all information (including emails, notes, etc.) that relate to the Smithsonian's responses to *The Washington Post* inquiry on the air travel cited above.

B. Housing Allowance and Misrepresentation of IG Position by Board

The Secretary's salary and pension has nearly doubled from approximately \$380,000 when he first began in 2000 to \$722,000 today. This does not include the Secretary's housing allowance of \$193,022, which brings the Secretary's total compensation package to \$915,698. The housing allowance, as noted in B-2 on p. 4, pays for utilities, insurance, real estate taxes, grounds service, housekeepers and maintenance. In addition, the Smithsonian pays for something termed "mortgage interest or equivalent cost of home ownership." The Secretary owns his home, so basically the taxpayers are paying and subsidizing for him the cost to the Secretary for living in his house.

The costs incurred and imputed (e.g., paying the Secretary to live in a house he owns) paid to the Secretary subject to the lesser of 50% of total costs (imputed and incurred) or a ceiling of \$179,322 in 2005. Thus, in 2005, the Secretary received \$179,322, effectively covering all \$139,103 costs for living at the house and then paying the Secretary another \$40,000 to live in a house he owns.

Cotton notes, in an asterisk in section B-2 on p. 4, that the imputed cost of the house is based on a \$3,488,005 estimated market price of the Secretary's home and an average interest rate of 8.32%. Cotton did not test this calculation. However, the IG raises several questions about this housing allowance. First, the agreement doesn't explain how the imputed interest is to be calculated. Second, the IG raises concerns about the way the calculations were made, in footnote of p. 6:

For example, had an adjustable rate mortgage been used to impute the mortgage interest, the overall costs could have been lower. The calculations prepared by the Office of the Secretary used a 30-year fixed rate mortgage rate of 8.32 percent from January, 2000. In 2000, the average 1-year ARM was 7.04 percent, and interest rates declined steadily to an average of 3.9 percent in 2004, then increased in 2005 to 4.49 percent. Alternatively, refinancing might have been an option; average 30-year fixed mortgage rates declined significantly from 2000 (when they averaged 8.05 percent) through 2005 (when they averaged 5.87 percent).

The IG notes that with these different assumptions "the Secretary's costs would not have met the threshold necessary to receive the full amount of the housing allowance" – *i.e.* the Secretary would have received a lower housing allowance.

The IG then recommends that the "Board of Regents consider revising the Secretary's employment agreement to make the housing allowance a single yearly payment with no documentation of expenses or minimum amount required to qualify for the allowance; **or, specify more clearly in the agreement what costs qualify for the allowance and what record keeping and reporting are required.**" [emphasis added]

The Audit Committee in its report to the Board states only that the IG recommended "to make the [Secretary's] housing allowance a single yearly payment with no documentation of expenses or minimum amount required to qualify for the allowance." That statement (drafted by the Secretary's office as noted above) completely misrepresents the IG's recommendation and

ignores the fact that the IG recommended a second option – the one in bold above – which provides a much closer watch of the taxpayers’ money. In addition, the Audit Committee gives no indication to the Board that Cotton didn’t verify the costs and the IG raised concerns about how the costs were calculated. Do you think the Audit Committee’s actions were appropriate in terms of representing the IG’s findings and recommendations?

However, instead of bringing to the Board the points raised by the IG, the Audit Committee suggested, and the Board approved, increasing the Secretary’s housing allowance from \$186,495 to \$193,022, payable biweekly and adjusted annually by the Board of Regents. Please provide all material that justified the original calculation of the housing allowance in 2000, particularly the imputed costs. Please provide the justification that the Board relied on for the \$193,022 increase as well. Finally, Cotton was engaged in this work to assist in determining whether costs were “reasonably” related to the Smithsonian mission. Explain, and provide all supporting material, that was relied on to support the Board’s finding that this housing allowance is reasonable prior to its vote this January.

The Schedule of Housing Allowances, according to Cotton (see footnote 3, p. 4), was prepared by the Smithsonian. Please provide a copy of that schedule as well as all drafts or internal documents related to that schedule. Please detail maintenance, repairs, improvements that cost over \$2,000 on the house or grounds since Mr. Small became Secretary. Please provide a list of all official Smithsonian entertainment that the Secretary has done at his house. Please include a list of those attending each event and the business purpose.

The Smithsonian in its FY 2004 Form 990 on Schedule 10, notes that it is defraying the costs of housing “as is the practice at other major educational institutions where the CEO’s responsibilities include substantial amounts of fundraising and business entertainment in his home.” What is the independent justification for comparing the Secretary’s housing allowance to an educational institution as opposed to a museum? The purpose of a housing allowance at a university is so that the university President is near the campus and accessible to students (as well as fundraising). My understanding is that the Secretary’s home is not at all close to the Smithsonian mall.

In addition, I find the educational comparison suspect on its face and suggests a results-driven analysis as opposed to an objective review of best practices. Please inform me how many students receive undergraduate and graduate degrees from the Smithsonian. In addition, please provide justification and support that the Secretary’s “substantial” use of the home is equal to that of a major education institution where the individual owns the home. Please also provide the amount of housing allowance that is provided at each of these major educational institutions as well as the housing allowance for museums that receive similar amounts of charitable contributions as the Smithsonian.

Finally, it is my understanding that both the Secretary and Deputy Secretary serve on corporate boards, where they receive additional pay. This is a significant departure from standard practice in the government. Please inform me, for the last six years, what boards they served on, the compensation they receive (including stock options, grants, etc.), the hours and exact days

spent serving on these boards, and please detail any contract, grant or other relationship these corporations have with the Smithsonian.

C. Reasonableness of Costs and Expenditures

The purpose of the Cotton report was to evaluate compensation of the Secretary and determine if travel and other reimbursable expenditures incurred by the Secretary “were reasonable in the context of a business expense related to the Smithsonian mission.” The scope of the Cotton report is in keeping with the employment agreement which allows for reimbursement by the Smithsonian for “reasonable costs for official travel and official entertainment, consistent with its policies for such expenditures.” The amount of these costs for expenditures by the Secretary from date of employment through only September 30, 2005 was an eye-blinking \$846,312.

Unfortunately, it seems clear that the Board then redefined what should be reviewed for “reasonableness” as only those items that were unauthorized or without support. That is, if anything was authorized it was presumed to be reasonable. Under this logic, since \$640 toilet seats were authorized by DoD, they must be considered reasonable. This doesn’t pass the laugh test in Iowa.

Even more troubling is that it is my understanding that the Secretary’s office and the Board worked together to interpret the Secretary’s employment agreement as widely as possible to make sure it covered as many matters as possible as being authorized and therefore, under the Board’s “reasonable” by definition. This is hinted at in p. 2 from Cotton:

To the extent that the Secretary’s employment agreement did not address, or was ambiguous regarding, reimbursement of certain expenditures, we obtained clarification from the Secretary’s office and the Board of Regents on the intent of that agreement.

And in page 5 from the IG:

The terms of the Secretary’s employment agreement posed numerous challenges to the review of his expenses and, in particular, of his housing allowance. To avoid similar issues in the future and, more importantly, to clarify the agreement’s terms, we suggest that the Board of Regents and the Secretary revisit the agreement, with the assistance of the Institution’s General Counsel.

The Audit Committee made no mention of this recommendation by the IG. Do you intend to revisit the agreement as recommended by the IG? Please inform me who drafted the original agreement and that person’s legal background. Please provide me all material that the Board was provided in regards to the original decision to hire Mr. Small. As mentioned earlier, Mr. Small’s salary has basically doubled in recent years, what is the Board’s justification in terms of Mr. Small’s expected performance and accomplishments at the time he was hired that justify this doubling of salary?

Thus, the scope of the “reasonableness” test was limited to only those items that were unauthorized or without supported documentation. Even with this self-limited scope, I am shocked at what the Smithsonian is spending its money on when it comes to food, flowers, alcohol and other items. I find it unconscionable that, at a time when the Smithsonian can’t find the money to fix a leaky roof, it can find the money to spend \$212 for flowers for an individual, \$334 for lunch for the Secretary and guest, \$2700 for Cosmos Club membership for the Secretary and his wife, and \$27,000 in car service for the Secretary. Please provide me a detailed accounting of all similar spending incurred by the Secretary not covered by this report, *i.e.* after September 30, 2005.

I should note that the IG also views that some transactions “might be considered lavish or extravagant.” The audit report, drafted by the Secretary’s staff, noted the IG’s finding but dismissed it out of hand stating, “we did not find any of the expenses reviewed to be unreasonable.” This is not a response. This is insulting to the American people, the taxpayers who provide hundreds of millions of dollars to the Smithsonian every year. I cannot explain to my constituents why they need to pay more taxes so that, to take one example, the Secretary and his direct reports can enjoy in September 2002 a dinner for \$1,368, eating off china and linen rented for the occasion for \$775.20 while enjoying a \$300 flower arrangement and alcohol of \$186.04. Is it too much to ask that, when the nation’s treasures are being damaged by leaky roofs, senior management at the Smithsonian should conduct its business on regular plates while enjoying a \$20 bouquet?

D. Unauthorized Spending

I am concerned that both the IG and the Audit Committee gloss over the fact that there are several hundreds of dollars in private meals that Mr. Small reimbursed the Smithsonian. It is only **after** the investigation into expenses was initiated that Mr. Small reimbursed the Smithsonian – see footnote 6 on page 4 of the IG letter. These include meals in 1999 as well as a series of lunches, including a \$200 lunch in 2004. These are footnoted in the Cotton report under F and H under Schedule B-2. What is the Smithsonian policy for disciplining staff who have made such personal charges and failed to inform and/or timely reimburse the Smithsonian?

The audit report, drafted by the Secretary’s office, makes no mention of the fact that the Secretary charged hundreds of dollars of personal costs to the Smithsonian and did not reimburse those costs until after the Cotton audit findings. Do you think that is appropriate? Is this information not of interest to the Board of Regents? Do you think it was proper that the Board of Regents voted to acknowledge that “none of the expenditures were solely for the Secretary’s personal benefit?”

E. Bend the Rules; Break the Rules; Change the Rules

As I stated at the beginning of this letter, I am deeply troubled by the “anything goes” culture of the Smithsonian’s Secretary and senior management. This is a constant refrain in the material I reviewed. For example, in the discussion of unauthorized non-travel transactions (dinners, flowers, alcohol, etc.), the IG letter states:

According to the Secretary's staff, they believed that all these expenditures were allowed under Smithsonian policy or that the Secretary could waive any policy if it applied.

The IG, in footnote 5, comments: "We are aware of no written authority for the Secretary to waive Smithsonian policies."

But, instead of enforcing the rules, the Audit Committee and the Board of Regents, change the rules to conform with the actions of the Secretary. The Board, after the fact, blesses private jet travel by the Secretary and waived the requirement that the \$5700 trip to Cambodia taken by the Secretary's wife be authorized in advance.

The Board blessed all the meals that were provided to staff, despite the finding by Cotton that this was contrary to The 1999 Use of Trust Funds for Representational and Special Event Expenses, which required that "Trust funds may not be used to cover costs of working luncheons involving only SI staff members . . . Smithsonian-provided meals are limited to occasions where they are judged essential to efficient, successful completion of the project." Then, guidance was changed to allow these meals. See Schedule B-2, footnote E of Cotton report. Once again, break the rule and then change the rule seems to be the culture at the Smithsonian. And again, the Board of Regents blessed all the actions that were taken that violated these rules without any consequences to any employee, much less the Secretary. In fact, the Board's response was to increase the Secretary's pay.

Please provide me all justification for this change in guidance and who proposed it and who approved it. Please provide me the list and costs of all staff meals (include all related costs, such as flowers, china, linen and alcohol) since December 1, 2004. Please also include the number of attendees for each meal.

A last example of this "anything goes" culture is with alcohol and gifts noted in Schedule B-2 footnotes G and J. Just focusing on alcohol, the Cotton report states:

Costs of alcoholic beverages served at dinners hosted by the Secretary were paid out of the 401 Fund. The 1999 Use of Trust Funds of Representational and Special Event Expenses does not list alcoholic beverages as an allowable expense, **while the 2004 version explicitly states that the 401 Fund cannot be used for alcoholic beverages.** (Emphasis added)

Once again, in footnote 6 on the same page we have the Secretary's staff trotting out its justification of breaking the rules:

The Secretary's staff believed that he was authorized to use Smithsonian funds to purchase alcoholic beverages and gifts because the FY 2004 and 2005 trust fund spending guidelines (issued by the Office of Planning, Management & Budget) state that "In addition to general authorized use of allocated central trust funds for representational and special event purposes, these funds are available to the Office of the Secretary to allow the Secretary to carryout [sic] his official duties." **We [Cotton] do not believe, however,**

that this language allows the Secretary to use the funds in ways otherwise not authorized by the policy. (Emphasis added)

And finally, to complete the circle, the Audit Committee recommended, and the Board approved, sweeping the unauthorized purchases of alcohol and gifts under the rug with no one being held accountable. This is the type of action I would expect from the boards of public corporations that are completely dominated by an out-of-control CEO – I expect more from the Smithsonian Board of Regents.

How much money did the Cotton Report and IG review cost? Do you believe this was a good use of funds if the result was going to be for the Board of Regents to bless all the actions of unauthorized spending and hold neither the Secretary nor anyone on his staff accountable and at the same time treating all costs as reasonable despite the IG's findings that many were lavish or extravagant? Please provide me the minutes of the meeting from when the Board voted on the Audit Committee's recommendations, what Board members were present and the vote on the Audit Committee's motion. Please provide me your views (and detailed examples) of why I should have confidence that the Board is doing its job of being a steward of the monies provided to the Smithsonian.

To be blunt, I have been conducting reviews of tax-exempt organizations for a number of years and the actions of the Smithsonian Board of Regents raise as many red flags as some of the worst boards I have investigated. The American people expect and deserve much better.

Thank you for your time and assistance. I request a full and complete response within 30 days provided on searchable cd rom.

Cordially yours,

Charles E. Grassley
Ranking Member

cc: Smithsonian Board of Regents
Chairman Baucus
Secretary Small
Acting Inspector General Ryan