

INDEPENDENT REVIEW COMMITTEE  
Smithsonian Institution

Opening Statement of Charles A. Bowsler  
Chairman  
Independent Review Committee  
Smithsonian Institution  
Hearing before the Senate Rules Committee  
June 26, 2007

Thank you, Senator Feinstein. I am pleased to be here to summarize the findings of the Independent Review Committee of the Smithsonian Institution, which was appointed by the Board of Regents in March following numerous allegations in the media concerning the compensation and expenses of former Secretary Lawrence Small. Joining me as members of the Committee were A.W. "Pete" Smith, a retired executive with extensive experience in both the public and private sectors, and Stephen D. Potts, chairman of the Ethics Resource Center and former director of the U.S. Office of Government Ethics under both Presidents George H.W. Bush and William Jefferson Clinton. We were assisted by counsel from the law firms of Williams & Connolly and Arnold & Porter.

The Committee came to its task with a deep affection for the Smithsonian Institution. It is our hope that our work will help restore the people's trust in this venerable institution and bring to an end the adverse media attention of the past few months. The Committee recognizes that the Board of Regents, through its Committee on Governance, has begun the process of developing an initial set of reform measures.

In the 10 weeks of our investigation, we found that the root cause of the Smithsonian's current problems can be found in failures of governance and management. The governance structure of the Institution is antiquated and in need of reform. The relationship between the Board of Regents and Mr. Small as Secretary was contrary to effective oversight. At a time when organizations are expected to operate with increasing transparency, the operation of the Smithsonian had become increasingly secretive. Mr. Small created an imperialistic and insular culture in which the Secretary, rather than the Board, dominated the setting of policy and direction.

Mr. Small's compensation is an issue that demonstrates problems at the Smithsonian. The IRC found that Mr. Small was accorded compensation that went far beyond that which had been provided to previous secretaries. By improperly labeling additional compensation as a "housing allowance" and adding overly generous payments "in lieu of pension," Mr. Small's compensation was "packaged" so that its true dimensions were obscured. His actual compensation in his first year exceeded \$500,000, not the \$330,000 disclosed to the media. This salary was 46% above the salary given his predecessor in his last year as Secretary.

In the realm of expenses, we found that Mr. Small was given a blank check to not only fly first class, but also to enjoy other expensive perquisites (such as hotel suites, limousines and on one occasion a charter flight) that went far beyond those allowed other executives of the Smithsonian or previous secretaries. They were not reviewed for reasonableness.

Mr. Small and his deputy, Sheila Burke, were allowed to serve on for-profit boards of directors with virtually no oversight from the Board of Regents, and both were allowed to take as much time as they liked for either vacation or their outside board activities. In the case of Mr. Small, he appears to have taken nearly 70 weeks of vacation over his seven years of tenure and spent 64 business days serving on for-profit boards, for which he earned over \$600,000 in cash compensation, \$3.3 million in stock compensation, and \$1.8 million in stock option compensation. Ms. Burke appears to have been away from the office for more than 400 business days during her tenure because of her service on boards and other non-Smithsonian activities, for which she earned about \$1.2 million in cash compensation, \$3.5 million in stock compensation, and \$5.6 million in stock option compensation. This compensation was more than three times the amount she received from the Smithsonian over the same period.

During its investigation, the Committee often heard that Mr. Small's excesses should be excused because of his success in raising funds for the Smithsonian. We heard that he had raised over a billion dollars for the Institution. In fact, the Smithsonian's own data shows that private funds raised annually from donors actually declined over the course of Mr. Small's tenure. Funds contributed by private

donors peaked in 2000 and those donations were largely the work of Mr. Small's predecessor, Michael Heyman, and others.

The Committee has recommended a number of reforms which it believes are essential to proper operation of the Smithsonian and it believes these can and should be addressed by the Regents before the end of the year. Our recommendations can be summarized as follows:

- The expenses of Mr. Small and his wife should be subject to an audit for reasonableness.
- The compensation of the Secretary should be reasonably competitive and transparent and take into account the Smithsonian's unique nature.
- The Smithsonian should follow federal regulations that foster openness, transparency and effective governance.
- Its salary structure should be generally consistent with government pay schedules.
- The Smithsonian must have an active governing board with a chairman who can provide the time for proper oversight. In this regard, the roles of the Chief Justice and the Vice President should be clarified, and Congressional Regents should accept fiduciary responsibilities.
- The Board should be expanded or reorganized to allow for the addition of Regents with needed expertise.
- Internal financial controls, audit functions, and the roles of the General Counsel and Inspector General should be strengthened.
- Smithsonian employees should be allowed to participate only in nonprofit board activities subject to prior approval.
- The selection of the next Secretary must reflect governance challenges facing the Institution.
- Achieving effective oversight and governance at nonprofit organizations may ultimately require legislative action.

That completes my testimony. I ask that the executive summary of the IRC report be included in the hearing record at this point.

## EXECUTIVE SUMMARY

### A. Overview

The Independent Review Committee came to its task with a deep affection for the Smithsonian Institution.<sup>1</sup> It is the Committee's hope that its work will help restore the people's trust in the Smithsonian and bring to an end the adverse media and public attention of the past several months. Although the Smithsonian is in the midst of a governance crisis, the IRC believes the Institution itself appears sound and that its problems can be solved expeditiously if the Regents recognize the urgency of the situation and commit sufficient time and resources to correcting the matters. The Committee recognizes that the Board of Regents, through its Committee on Governance, has begun this process by developing an initial set of reform initiatives.

In reviewing the operations of the Smithsonian during the tenure of Lawrence M. Small as Secretary, with a particular focus on his compensation, benefits and expenses, the IRC has determined that the problem was not one merely of misunderstood guidelines, nor was it one only of poor decisions in spending Smithsonian funds on expensive or lavish travel, entertainment and personal needs. The problems go much deeper than this. Mr. Small's management style – limiting his interaction to a small number of Smithsonian senior executives and discouraging those who disagreed with him – was a significant factor in creating the problems faced by the Smithsonian today. In addition, Mr. Small limited the flow of information so as to prevent the Board from hearing criticism of his stewardship.

The Committee, however, believes that the resignation of Mr. Small has not, by itself, remedied the problems at the Smithsonian. The Smithsonian must correct the underlying deficiencies in its organizational structure, decision-making and financial controls that allowed inappropriate management conduct to go undetected. As noted by the Office of the Vice President in its letter to the Committee, the

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<sup>1</sup> The Committee is referred to in this Report as the "IRC" or "Committee" and the Smithsonian as the "Smithsonian" or "Institution." References to the "Board" are to the Board of Regents of the Smithsonian.

current situation presents the Smithsonian with an opportunity to bring its management in line with best practices and to revamp the composition, selection and duties of the Board of Regents.

The root cause of the Smithsonian's current problems can be found in failures of governance and management. The governance structure of the Institution is antiquated and in need of reform. The relationship between the Board of Regents and Mr. Small, as Secretary, was contrary to effective oversight. At a time when organizations are expected to operate with increasing transparency, the operation of the Smithsonian, and especially the actions of Mr. Small and those who reported directly to him, had become increasingly secretive. Mr. Small created an imperialistic and insular culture in the Office of the Secretary in which the Secretary, rather than the Board, dominated the setting of policy and strategic direction for the Smithsonian. The Board of Regents allowed this culture to prevail by failing to provide badly needed oversight of Mr. Small and the operations of the Smithsonian. The Board did not look behind the tightly controlled data provided by Mr. Small. Nor did it engage in the active inquiry of Mr. Small and Smithsonian management that would have alerted the Board to problems.

As a result of the corporate scandals of the early part of this decade and the adoption of the Sarbanes-Oxley Act of 2002, boards of directors have become increasingly active in the oversight of management and in the development of strategy and long-term plans for organizations they control. Many nonprofit institutions have also updated their governance practices following the adoption of Sarbanes-Oxley. Historically, the Smithsonian Board of Regents appears not to have taken a strong oversight role. Mr. Small's predecessor tried to increase the involvement of the Regents in the affairs of the Smithsonian, but found a limited interest on the part of the Regents in taking a more active role. During Mr. Small's tenure, some changes were made to the Smithsonian's governance that brought it more in line with best practices. Over the last several years, for example, the Board, to its credit, has held planning and strategy sessions and has established committees on audit, compensation and governance. These efforts, however, did not go far enough. The governance structure of the Institution

needs more comprehensive reform. The Committee hopes that the findings and recommendations of this Report will aid the Smithsonian in its efforts at such reform.

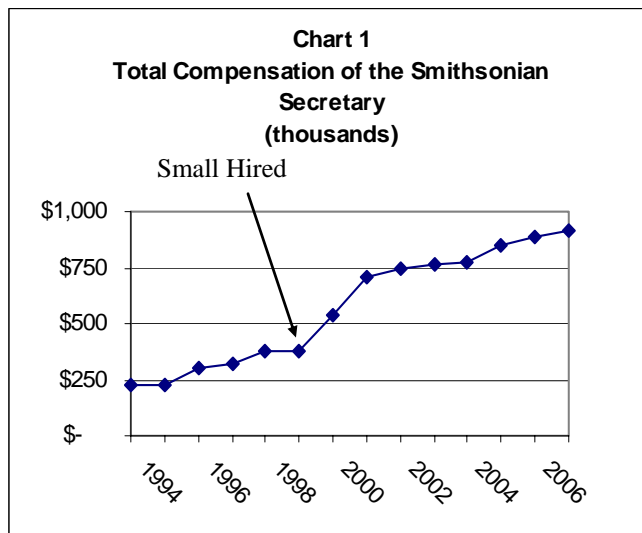
**B. Summary of Committee Findings**

1. Mr. Small's Compensation Far Exceeded the Compensation of Prior Secretaries

Historically, the Secretary of the Smithsonian received total compensation near the mid-point of comparable positions, with modest annual increases. In contrast, Mr. Small's total starting compensation – \$536,100 – was forty-two percent higher than the compensation of his predecessor, and by the time he left office this year, Mr. Small's total compensation – \$915,658 – was almost 2½ times the compensation of his predecessor. What made Mr. Small's initial package so much larger than that of his predecessor was a \$150,000 annual payment styled as a housing allowance.

Mr. Small's initial compensation package would have been reasonable had the \$150,000 housing allowance been a true housing allowance and not simply additional salary. The language of Mr. Small's contract read as if this housing allowance was to reimburse Mr. Small for his out-of-pocket housing costs in making his home available for Smithsonian business and social functions. An individual who played a key role in the initial financial negotiations with Mr. Small conceded that the language of the contract was misleading and that the housing allowance was, in fact, a “packaging device” for delivering Mr. Small additional compensation in a manner that would conceal the true size of his pay.

Another troubling aspect of Mr. Small's compensation was the forty-five percent increase in base salary – from \$330,000 to \$480,000 – he received in 2001. The then-Executive Committee increased Mr. Small's base salary, at his request, to put him in the 75<sup>th</sup>



percentile of what Smithsonian management had chosen as comparable institutions. The selection of the 75<sup>th</sup> percentile applied only to Mr. Small's compensation. Compensation for the rest of the Smithsonian senior staff remained close to the 50<sup>th</sup> percentile.

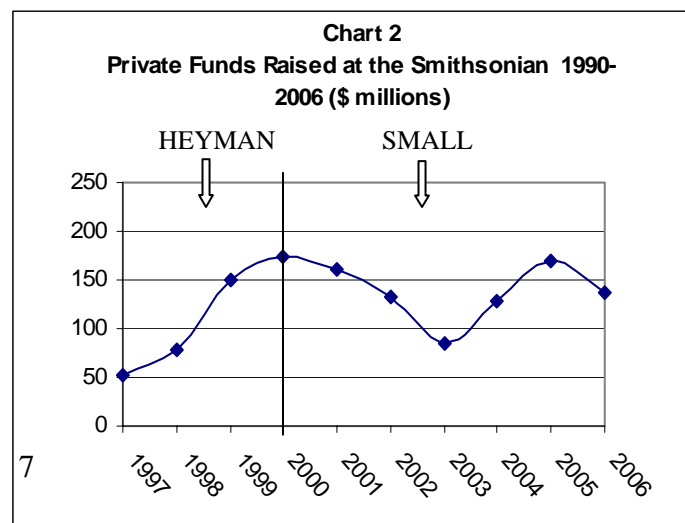
2. The Terms of Mr. Small's Compensation Were Not Fully Disclosed to the Board

Mr. Small's initial compensation package was negotiated between Mr. Small and a small number of Regents, none of whom is currently on the Board. The Committee found no evidence that the Board of Regents as a whole ever learned the terms of Mr. Small's initial compensation package. In fact, contrary to the requirements of the Smithsonian's governing documents, the full Board did not formally approve the terms of Mr. Small's annual total compensation until 2004, and some Regents did not learn all the details of Mr. Small's compensation until they read about it in the recent press accounts.

3. Private Grants and Contributions and Business Revenues Have Declined During Mr. Small's Tenure, Making the Smithsonian More Reliant on Federal Appropriations and Grants

One of the reasons for hiring Mr. Small was the belief that his business background and connections would allow him to increase the Smithsonian's private fundraising and business income and thereby reduce the Smithsonian's reliance on federal monies. There is a perception among many of the individuals interviewed by the IRC and the public that Mr. Small succeeded in those efforts. Certain Regents have defended Mr. Small's actions by pointing to this success, going so far as to suggest that his excesses might be excused in light of the fact that he raised over a billion dollars for the Smithsonian. This justification is wrong for two reasons. First, the IRC rejects the idea that success is in any way a license for inappropriate behavior.

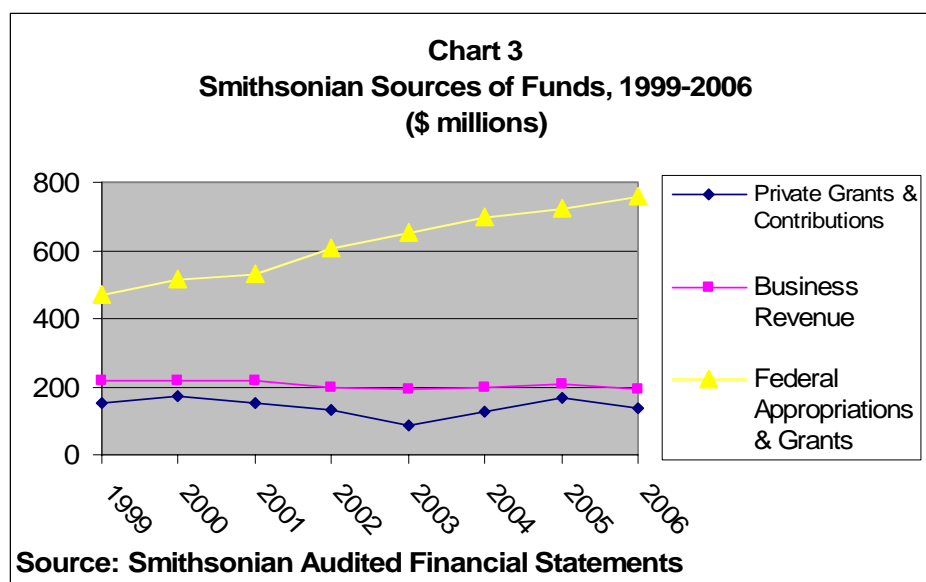
Second, as shown by Chart 2, private funds raised annually from donors have actually declined over the course of Mr. Small's tenure. Funds contributed by private sources peaked in



2000, and thereafter the amount of private funds committed to the Smithsonian began to decline, reaching a low of \$88 million in 2003. Although Mr. Small was involved in finalizing a gift of \$80 million from The Behring Foundation in 2000 and gifts of \$30 million and \$45 million from the Donald Reynolds Foundations in 2001 and 2005, respectively, those donations originated from the work of others. Private funds raised in 2006 improved to \$132 million, but that figure is about ten percent lower than the amount raised in 1999, the year before Mr. Small took over. The evidence collected by the Committee regarding comparable nonprofits does not show a similar decline in fundraising over the same period.

As Chart 3 shows, business revenue has dropped by a similar percentage during Mr. Small's tenure. This drop in business revenue has been further exacerbated by increased operating expenses (most notably senior executive salaries) at Smithsonian Business Ventures. In contrast, funds from federal appropriations and governmental grants have increased more than sixty percent over the same period. The Smithsonian informed the IRC that the increase in federal appropriations reflects, in significant part, the opening of two new museums and increased spending for anti-terrorism measures

following 9/11, and that the Smithsonian's federal staff has decreased by about percent since 2000. Nevertheless, the net effect is that the Smithsonian became



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dependent on taxpayer funds during Mr. Small's tenure.



4. Mr. Small's Expenses Were Not Reviewed for Reasonableness

Nonprofit organizations like the Smithsonian must properly document expenses incurred in the conduct of the organization's activities to evidence reasonableness and relation to the organization's mission. With respect to Mr. Small's expenses, the Smithsonian failed to do so. Until the recent review completed by Cotton & Co., there had been no review of Mr. Small's expenses by either the Chief Financial Officer or internal or external auditors of the Smithsonian. Instead, Mr. Small and his staff exercised sole discretion in determining which expenses would be charged to the Smithsonian. At the beginning of 2000 and 2001, Mr. Small was given by his chief of staff signed blank expense authorizations. Thereafter, while the Smithsonian had detailed guidelines and policies for business expenses, Mr. Small exempted himself from these policies.

5. Mr. Small and the Deputy Secretary Have Been Absent from the Smithsonian for Substantial Periods Due to Vacation and Compensated Service on Corporate Boards

The records provided by the Smithsonian show that from 2000 through 2006 Mr. Small and Sheila P. Burke, the current Deputy Secretary, were absent from the Smithsonian for about 400 and 550 work days, respectively, as a result of vacation time and time spent serving on corporate and other boards and performing other non-Smithsonian-related duties. This level of absenteeism was not prohibited by the Smithsonian leave policy because Mr. Small and Ms. Burke were allowed unlimited leave. Mr. Small appears to have taken nearly 70 weeks of vacation over his seven years (or nearly 10 weeks per year). In addition, he spent 64 business days serving on for-profit corporate boards for which he earned approximately \$642,925 in cash compensation, \$3.3 million in stock compensation and \$1.8 million in stock option compensation.

Ms. Burke appears to have been out of the office for about 400 business days (or about one-quarter of the work days) during her tenure because of her service on boards and her other non-Smithsonian activities. For her corporate board service, Ms. Burke earned approximately \$1.2 million in cash compensation, \$3.5 million in stock compensation and \$5.6 million in stock option

compensation. Her total compensation for outside board service was more than three times the compensation she received from the Smithsonian over the same period. The Committee is cognizant of her reputation for hard work, long hours, willingness to return phone calls promptly, and ready response to email, even when she is away from the office. Still, the IRC believes that any person who holds the job of Deputy Secretary and Chief Operating Officer should expect to spend full time at the Smithsonian without the distraction of extensive outside activities.

6. Mr. Small's Disposition Was Ill-Suited for the Position of Secretary

In selecting Mr. Small as Secretary, the Regents hoped that his experience in the business world would bring talents that complemented the Smithsonian's existing expertise in science and the arts. As one now looks back over his tenure, it is clear, however, that his attitude and disposition were ill-suited to public service and to an institution that relies so heavily, as the Smithsonian does, on federal government support. The mismatch between Mr. Small and the Institution appeared as early as the initial negotiations with Mr. Small when he made it clear that if he and his wife were not allowed to travel in first class, it would be a "deal breaker." Over the years, Mr. Small placed too much emphasis on his compensation and expenses. Rather than seeing this as an indication of the need for careful oversight, the Regents involved in Mr. Small's compensation, to the contrary, became complicit in Mr. Small's desire to maximize his personal income and have the Smithsonian pay his expenses.

7. The Board Exercised Inadequate Oversight Over Mr. Small

The Board frequently deferred to the Secretary, allowing him to run and dominate the meetings, set the agendas, and determine who would contact the Regents and what information would be provided them. With limited and controlled information provided by the Secretary, the Regents were unable to engage in real and effective debate. During Mr. Small's tenure, it appears that the Board reported to him rather than the Secretary reporting to the Board. The Committee was told by a Regent that Mr. Small "did not listen to the opinions of the Regents" and "did not seek input from the Regents in decision making." Another Regent commented that Mr. Small did not seek advice, only approval.

In the place of full Board oversight, the Executive Committee, on numerous occasions, agreed to compensation requests from Mr. Small without engaging in its own analysis of the reasonableness of those requests. In 2001, for example, as discussed above, the then-Executive Committee acquiesced to a request by Mr. Small for a forty-five percent increase to his salary without questioning the need for the increase and without consulting with the full Board. More recently, when asked, the Board retroactively approved actions of the Secretary that were contrary to Smithsonian guidelines and to contractual arrangements, in almost all situations without adequate investigation or analysis. The Board often minimized Mr. Small's mistakes, glossed over or ignored criticism of him, and offered post-hoc justifications for his improper acts even in the face of new revelations and Congressional scrutiny.

As early as 2001, there was public criticism of actions taken by Mr. Small that should have raised questions about his ability to manage the Smithsonian effectively. For example, several newspaper articles questioned Mr. Small's use of a privately chartered plane for Smithsonian business. Yet the minutes and transcripts of the Board meetings give no indication that the Regents at the time ever discussed, let alone investigated, this or any other adverse comments. Had the Board done so, it would have learned that Mr. Small did not pay for the plane as he claimed, but rather the Smithsonian paid for it and management directed accounting staff to alter its accounting records after the fact.

The Board also had no involvement, either before or after the fact, in setting the terms of the employment for Ms. Burke, the Deputy Secretary and the Institution's number two official. (Ms. Burke became the Deputy Secretary in 2004. Prior to that, her title was Under Secretary for American Museums and National Programs.) The basic terms and policies of her service were set solely by Mr. Small and, in most instances, were known only to her and Mr. Small. Despite the fact that Ms. Burke disclosed her outside board service on her conflict of interest forms submitted to the Office of the Secretary, Mr. Small failed to provide these forms or the information regarding Ms. Burke's outside board service to the Board.

8. The “Gatekeepers” of the Smithsonian Were Marginalized

The General Counsel and the Inspector General of the Smithsonian should serve “gatekeeper” roles by monitoring compliance of senior management with laws and policies. The General Counsel and the Inspector General did not play these monitoring roles because Mr. Small isolated them from not only the Board of Regents but also from having any meaningful oversight of the Secretary’s office. Additionally, over time Mr. Small significantly reduced the budget and staff of, among others, both the Office of General Counsel and the Office of Inspector General. Neither the General Counsel nor the Inspector General made adequate efforts to overcome the isolation from the Board or the diminution of their respective roles. The Chief Financial Officer was also ineffective in monitoring financial matters of the Office of the Secretary.

9. The Smithsonian’s Internal Financial Controls and Audit Function Are Inadequate

Internal financial controls are systems of policies and procedures that create reliable financial reporting, promote compliance with laws and regulations and achieve effective and efficient operations. The Smithsonian’s internal financial controls have been inadequate to achieve these goals for a number of reasons. First, the Smithsonian has not committed sufficient resources to the accounting and audit functions. Second, the Smithsonian lacks comprehensive and formal accounting procedures and policies. Third, the Smithsonian has not complied with its own policies and procedures with respect to accounting for expenses. Finally, the Smithsonian’s outside auditor had not been vigorous in monitoring the Smithsonian’s implementation of recommendations contained in its management letters until early 2007, when it finally noted that insufficient accounting resources and staff capacity at the Institution constituted a “reportable condition.”

10. Smithsonian Business Ventures Has Operated with Insufficient Oversight from the Board or Senior Smithsonian Management

In the course of its review, the Committee has become aware of significant failures of internal controls and inappropriate conduct at Smithsonian Business Ventures (“**SBV**”), the Smithsonian

division responsible for managing the commercial activities of the Smithsonian. Senator Grassley has indicated his desire for the Committee to conduct a review of the senior management of SBV and the appropriateness of compensation and benefits paid to senior management of SBV. While the Committee agrees that such a review is necessary and warranted, it is beyond the scope of the Committee's review. There appear to have been severe failures in oversight of SBV by Smithsonian senior management and the Board. It also appears that neither the Board nor the Smithsonian executives who sat on the SBV board, including the Chief Financial Officer and the Deputy Secretary, provided oversight of SBV, even though all acknowledged the widespread allegations of inappropriate activity and failures of internal controls at SBV.

11. The Smithsonian Appears to Remain a Strongly Ethical Institution Despite the Problems with the Office of the Secretary and SBV

The ethics of an organization usually reflect the attitude and behavior of those in senior management. There was a clear indication that Mr. Small deemed himself outside the Smithsonian's otherwise recognized ethics standards. Accordingly, given the "tone at the top" set by the Office of the Secretary, one might expect to find the absence of internal controls and ethical lapses to be pervasive at the Smithsonian. While it did not undertake a comprehensive review, the Committee did not find evidence that indicated that there are major internal control issues at the Smithsonian as a whole, other than in the Office of the Secretary and at Smithsonian Business Ventures. Nor did the Committee find evidence to indicate that the strong ethical principles that have characterized the Smithsonian over the years have been compromised.

C. Summary Of Recommendations

The Committee recommends that, wherever possible, the Board of Regents should implement the following recommendations by reorganizing its internal governance structures and procedures. The Committee, however, offers no legal opinion as to whether these recommendations can be implemented solely by the Board of Regents. If the implementation of any recommendation requires

legislative action, the Committee urges the Board of Regents to seek Congressional assistance promptly and for Congress to act with all deliberate speed to enact necessary legislation.

1. The Regents Must Act Quickly to Address the Governance Crisis

The current crisis of governance at the Smithsonian and the resulting loss of public confidence necessitate urgent action by the Regents. To restore public and Congressional confidence, the Regents must devote substantial time and resources over the next several months to considering and then implementing a comprehensive program to improve governance. With diligence, the IRC believes the necessary governance changes can be implemented by the end of the year.

2. The Expenses of Mr. and Mrs. Small Should be Subject to an Audit for Reasonableness and the Expenses of Senior Management Should Be Subject to Annual Audits

The Committee did not conduct a complete audit of Mr. Small's expenses. Rather, the Committee reviewed the work of Cotton & Co. and the supporting materials. The Cotton & Co. review was a limited review based on information and policy interpretations provided by the Smithsonian. Thus, there has been no independent audit of the expenses of Mr. Small. If for no other reason than potential tax liabilities, the Committee recommends that the Smithsonian have an independent auditor perform an audit of Mr. Small's expenses and those of his wife. The Committee believes this audit could be done expeditiously because a significant amount of information has already been collected by Cotton & Co. The Committee also recommends that the Audit and Review Committee of the Smithsonian undertake to have the expenses of senior management audited on an annual basis for compliance with Smithsonian policies and reasonableness.

3. The Compensation of the Secretary Should be Reasonably Competitive and Transparent and Take Into Account the Smithsonian's Unique Nature

The Committee recommends that compensation for the Secretary be competitive with similar CEO roles at comparable nonprofits focusing on a comparison group that includes a significant number of institutions (such as major state universities) that principally rely, as the Smithsonian does, on

public funds. Historically, the Smithsonian appears to have had little difficulty in attracting qualified Secretaries at such compensation levels. It is the Regents' responsibility to determine this amount, and the Committee considers it beyond its mandate to provide specific guidance as to the appropriate compensation level. In determining this level, the Committee urges the Regents to consider developing a compensation philosophy that is transparent, reasonably competitive and reflective of the special nature of the Smithsonian. Working at the Smithsonian is a privilege. Serving as its Secretary is an honor. Compensation levels should reflect this. The Committee sees no reason why the Secretary should be given special travel privileges, perquisites or other benefits that are not available to other executives of the Smithsonian, except where the Board makes a determination in advance that such perquisites and benefits are reasonable and appropriate.

4. The Smithsonian's Policies Should Be Consistent With Federal Regulations and its Salary Schedule Should be Consistent With Government Salary Schedules

The Committee is concerned about the tendency of the Institution to embrace those federal regulations it finds convenient while ignoring others. For example, at times, the Smithsonian denies requests filed under the Freedom of Information Act ("**FOIA**") on the ground that it is not a federal entity, while, at other times, it grants FOIA requests. The IRC recommends that the Smithsonian affirmatively adopt policies to promote openness, transparency and effective governance consistent with federal regulations, such as FOIA, the Privacy Act of 1974, Chief Financial Officer Act of 1990, the Sunshine Act, personal financial disclosure requirements, the Ethics in Government Act and conflict of interest rules. If the Smithsonian does not so act, Congress should consider appropriate legislation.

The IRC finds that there has been a marked disparity in the salary structure of the Smithsonian due, in part, to the fact that most employees are bound by government pay scales while others are employed by the Smithsonian trust and are paid on a separate scale. Additionally, the Committee learned that, for the purpose of raising the salaries of certain individuals who worked closely with the Secretary, positions were transferred from government pay scales to the trust.

To bring better balance to the Smithsonian's salary structure, the Committee recommends that the Smithsonian develop one comprehensive salary structure for all Smithsonian employees, rather than having a separate structure for trust employees. To the degree possible, this structure should align with the salary structure that incorporates standards of the federal senior executive service ("**SES**") or its equivalent. To be competitive in attracting talented museum curators or scientists, the Smithsonian should also be allowed, on a very limited basis, to exceed federal salary limitations in order to ensure that they can hire highly qualified individuals for key positions. Those paid above federal SES levels should be limited in number, perhaps 40 or 50. The needs of the Smithsonian when it comes to compensation should be well thought out, open to Congressional and public scrutiny and not arbitrary.

In determining the salaries of the Secretary and those who are paid above government salary limitations, careful attention should be paid to developing appropriate peer group analysis and maintaining reasonable ratios between these salaries and those governed by federal pay structures. The IRC recognizes that there is significant competition for museum curators, directors and scientists, but it recommends that the Smithsonian strive to pay at the 50<sup>th</sup> percentile, recognizing that a job with the Smithsonian carries great prestige to the outside world and offers the opportunity to make substantial contributions to the arts and sciences. It is also recognized that there may be instances that call for travel and expense guidelines to be exceeded. These should be carefully controlled and should be subject to prior approval. The Board should maintain oversight of these instances and make sure that they are in fact the exception and not the rule. So that the Secretary and Deputy Secretary set an appropriate example, the expenses of the Office of the Secretary should be audited annually and reviewed by the Audit and Review Committee of the Board.



5. The Smithsonian Should Have an Active Governing Board with a Chairman Who Can Provide the Time and Proper Oversight

The Committee proposes the governing structure of the Smithsonian be reorganized by establishing a Governing Board as a major component of the Board of Regents that would take on primary fiduciary responsibility for overseeing the Smithsonian. Being a fiduciary carries with it a major commitment of time and effort, a reputational risk and, potentially, financial liability.

The IRC recognizes the historical value of having the three branches of government represented on the Board. Fiduciary constraints, however, require that the Smithsonian be run by a governing board whose members act as true fiduciaries and who have both the time and the experience to assume the responsibilities of setting strategy and providing oversight. Time is a major factor. For an organization as complex as the Smithsonian and with a budget surpassing \$1 billion a year, the Regents should expect to meet at least six times each year. As discussed further below, the Committee recognizes and agrees that the governmental Regents play an important substantive, as well as symbolic, role at the Smithsonian.

The establishment of a Governing Board would in many ways formalize the Smithsonian's informal governance structure in which a "Committee of the Whole" meets in advance of the Board of Regents meeting to have a vigorous and probing discussion of issues requiring Board consideration. Under this present system, the Board of Regents meetings that follow have been formal proceedings to approve what had been discussed by the Committee of the Whole. The proposal of the IRC would formalize this process by establishing within the Smithsonian's governance documents a recognition that the Governing Board members would be the Regents responsible for the oversight of the Smithsonian and its management.

The Governing Board should have its own Chairman who would handle issues requiring the attention of the Board where items would be discussed and debated and where reports would be received from officers such as the Inspector General, Chief Financial Officer, General Counsel, Ethics

Officer and museum and scientific project leaders. The IRC believes strongly that an organization with a budget as large and with operations as complex as the Smithsonian requires the services of a chairman who can devote far more time to the operations of the Board than can the Chief Justice.

While meetings of the Governing Board should be open to those whose knowledge or reports are important to deliberations of the Governing Board, the Board should reserve, at every meeting, time for an executive session where issues involving management, including the Secretary's performance, can be freely and openly discussed without the presence of employees. The Committee also recommends that the Executive Committee be enlarged to five members and its activity limited in practice to handling routine affairs of the Board between meetings and when special meetings, either in person or telephonically, cannot be arranged. All actions of the Executive Committee should be presented to the full Governing Board for review.

6. The Role of the Chief Justice and Vice President Should Be Clarified

Historically, the Chief Justice has been elected to serve as the Chancellor. In that role, the Chief Justice would preside over the second part of the Board meeting where discussion and formal votes would be taken on those issues requiring action of the Board of Regents. Under the IRC proposal, however, the Chief Justice would not be considered a fiduciary Regent. Only fiduciary Regents would vote. The IRC recommends such a unique structure because it believes the historic role played by the Chief Justice in governance of the Smithsonian should not lightly be discarded and because the Chief Justice has made it clear he wishes to remain associated with the Institution. The Committee believes, however, that if governance of the Smithsonian is to be updated, it will require a commitment of time on the part of every Regent that far surpasses that which has been expected in the past. The Committee also questions if it is appropriate for the Chief Justice to have fiduciary obligations to a separate entity, even if that entity is closely linked to the government, and to assume the legal and reputational risks associated with being a fiduciary. The Committee believes that it is not feasible to expect the Chief Justice to devote the hours necessary to serve as a fiduciary Regent.

The same situation applies to the Vice President. Under the IRC's proposal, the Vice President would continue to serve as a Regent in a non-fiduciary capacity, and would chair meetings of the Board in the absence of the Chief Justice. If neither the Chief Justice nor the Vice President were present at a meeting of the Board, the Chairman would preside.

7. Congressional Regents Should Accept Fiduciary Responsibilities

A clear understanding needs to be reached regarding the role of the Congressional Regents. Service as a Regent must require that all members of the Board, including members of Congress, be willing and able to assume a role with clear fiduciary responsibilities and to devote the time necessary to carry out those duties personally. So that there will be neither an actual nor an appearance of conflict of interest, the IRC believes that any Congressional Regent who serves on one of the Congressional authorizing or appropriations committees with authority over the Smithsonian should recuse himself or herself from Congressional votes involving Smithsonian financial matters.

8. The Board Should be Expanded or Reorganized to Allow for the Addition of Regents with Needed Expertise

The Board must expand the level of expertise among the Regents on key issues, especially financial management and facilities and museum management, and ensure that the Regents who are appointed have sufficient time and attention to dedicate to the Smithsonian. To achieve this expansion of current expertise and ensure that Regents are active and engaged, the Committee recommends the Regents consider the following: (1) if current Regents have sufficient time and interest in continuing to serve; (2) adding to Board Committees – such as Audit and Review, Governance and Compensation and Human Resources – non-Regent members with special expertise; (3) employing outside experts to advise the Board and its Committees in specific subject areas; and (4) increasing the total number of citizen Regents from 9 to 11 by either adding two additional citizen Regents or reducing the number of Congressional Regents from six to four - two from the House and two from the Senate.

To make sure that the Smithsonian Board is made up of individuals capable of providing the necessary expertise, the Regents should adopt a nominating process that allows for a broader field of candidates. In looking at candidates, those charged with picking future Regents should note the necessity for expertise in financial management, investment strategies, audit functions, governance, compensation, and facilities management, as well as an interest in and a devotion to the arts and sciences. Contributions to the Smithsonian should not be the determining factor for service on the Board, but only one of many factors considered in the selection of Regents. Care should be taken to avoid appointing Regents who have clear personal and professional ties to the Secretary that may compromise the Board's independence.

In addition, if the Smithsonian desires to have positions for individuals that honor them for their contributions to the arts and sciences, including their financial generosity, it should establish non-fiduciary advisory boards for the Institution in general as well as for its various museums and divisions. The National Board, now primarily a development group, could have its scope expanded. The formerly active but now moribund Smithsonian Council could be revived to bring together distinguished scientists, academics, and museum directors to advise the Smithsonian and its constituent parts on programs, policy, and long range planning. Having both a vibrant Board and Council should help curb the extensive criticism the Smithsonian received during recent years regarding the conditions on certain donations and the scope and content of certain shows and displays.

9. Internal Financial Controls, Audit Functions and the Role of the General Counsel and Inspector General Must be Strengthened

The Smithsonian's system of internal controls and audit needs to be strengthened through additional resources, adoption of best practices and retention of personnel with substantial experience in the financial and audit area. In February 2007, KPMG identified the inadequacy of the Smithsonian's accounting staffing and resources as a "reportable condition." The Committee understands that the Smithsonian is in the process of selecting an outside auditor, and the Committee

recommends that the Smithsonian expeditiously implement the recommendations of this auditor, as well as those recommendations contained in prior management letters. In addition, the Committee recommends that (1) the Smithsonian provide the General Counsel's office and Office of the Inspector General with the necessary tools and resources to perform their gatekeeper and guardian functions, (2) the General Counsel serve as the Smithsonian's corporate secretary and (3) the Smithsonian ensure vigorous compliance with the Inspector General Act.

10. Smithsonian Executives Should Be Permitted to Participate in Only Nonprofit Board Activities Subject to Prior Approval

As a general rule, the Smithsonian has been careful in monitoring the outside work of its employees. The exceptions have been Mr. Small and the Deputy Secretary, both of whom have been allowed to collect significant compensation for service on the boards of for-profit corporations. As discussed above, these outside commitments have taken these individuals away from the Smithsonian during working hours for significant periods of time. The Board must develop a uniform policy on outside work. The IRC recognizes that arguments can be made in favor of allowing an organization's senior executives to serve on the boards of for-profit corporations. The benefits of doing so, however, accrue primarily to the individuals and only secondarily to the Institution. Accordingly, the IRC recommends that the Board prohibit its executives from serving on the boards of for-profit corporations.

With respect to nonprofit boards, the Regents should control and require prior approval of any outside activities, including service on any other professional service boards and teaching and lecturing obligations, weighing carefully the time commitments needed and the benefits to the Smithsonian. Any compensation received by any Smithsonian employee for service on any outside board or organization should not be kept by the individual, but should be turned over to the Smithsonian for the benefit of the Institution.

11. The Selection of the Next Secretary Must Reflect the Governance Challenges Facing the Smithsonian

Being Secretary is a difficult and time consuming job. The Secretary oversees a complex amalgam of museums, research centers, a zoo, retail shops, restaurants and buildings. The Secretary is the caretaker for one of the great names in the science and arts. It is also a job with great challenges, prestige, and opportunities to have a lasting mark on our national heritage. Business skills are valuable to the Smithsonian and efforts to introduce business planning and measurement tools should be encouraged. But what must be avoided in picking the next Secretary is the manner in which Mr. Small operated. The Secretary must work for the Board. The Secretary must set the ethical tone, not sidestep it. The operations of the Smithsonian, especially the Secretary's office, should be open and transparent.

12. Achieving Effective Oversight and Governance at Nonprofit Organizations May Ultimately Require Legislative Action

Unfortunately, the problems at the Smithsonian are not unique. As the media and Congressional oversight committees have made clear, there have been similar problems at several large tax-exempt organizations, including major museums and universities, not to mention the income and expense excesses and governance issues at for-profit companies. This raises the issue of effective management of nonprofits and how governance at these entities should be structured, the responsibilities of their boards of directors and trustees, and how oversight of these organizations should be provided. The IRC believes that boards of nonprofits – especially large nonprofits – should move to reform their governance structures to bring them into line with best practices that have been well documented. These include the financial management and audit requirements in the Sarbanes-Oxley legislation, as well the recent Securities and Exchange Commission requirements for disclosure of the total compensation of senior executives. Some nonprofits have made progress in these areas, while others have not. Failure to take voluntary action will likely lead, ultimately, to action by Congress, state legislatures, and the courts to impose reforms from without, just as was done in the case of the corporate world.

