

TESTIMONY OF A. SPRIGHTLEY RYAN  
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BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES  
COMMITTEE ON APPROPRIATIONS  
SUBCOMMITTEE ON INTERIOR, ENVIRONMENT AND RELATED AGENCIES  
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Thank you for the opportunity to testify today. I will focus on governance, particularly on the importance of management control.

A lot has changed at the Smithsonian over the past two and a half years, since the resignation of former Secretary Small and the governance reforms prompted by that and other events. These important improvements have enhanced accountability and transparency at the Smithsonian.

As GAO has already noted, the Regents and the Smithsonian have implemented most of the reforms recommended by its Governance Committee in June 2007, resulting in notably stronger governance. To cite one example, management has improved policies on expenses and travel. As a result, in our audit of the Institution's oversight of executive travel as well as our review of the non-travel expenses of Regents, Board members and Institution executives, we found few problems. The Institution embraced our recommendations, further tightening its travel policies and strengthening oversight. Financial management overall is also improving. Management has implemented a number of our recommendations in that area and, notably, the number of comments and significant deficiencies in the annual financial statement audits has declined over the last three years.

Nonetheless, there remain significant challenges to strong governance. In particular, management control needs to be further strengthened – a recurring theme that emerges from our office's work. Management control begins with the Institution's control environment, its tone at the top, as well as its mechanisms for ensuring that programs achieve their intended results; that resources are used as effectively and efficiently as possible in a manner consistent with the organization's mission; that protect programs against fraud, waste, abuse, and unlawful conduct; and that provide reliable and timely information for management to use in making decisions. Good management controls advance an organization's goals and reduce the risk of financial mismanagement and reputational harm.

I share in your Committee's belief, as expressed in the statement of managers for the fiscal year 2009 Omnibus appropriations bill, that the reforms to date "are only the initial steps and that a

continuing commitment to reform, especially to the principles of fiscal stewardship of public resources, and to accountability and openness, are essential.” In addition to the continuing commitment, there remains a lot of truly difficult but important work. This work does not involve dramatic, headline-grabbing changes, nor can it be done overnight, but it is critical to the Smithsonian, particularly to its success in fulfilling its new strategic plan.

Smithsonian management does recognize the need to improve management control. In its response to Recommendation 23 of the Regent’s Governance Committee,<sup>1</sup> management, with the help of an outside consultant, developed a detailed report on what steps are necessary to attain excellence in these areas, so there is little I can say that the Smithsonian doesn’t already know. But I think it is critical to emphasize these important tasks and to note that implementation of those steps is far from complete. As GAO rightfully continues to stress, and as Institution management has recognized, implementation requires proper training and accountability, areas that continue to be a challenge for the Institution. Implementation also requires discipline, leadership, and strong policies and procedures.

This work is especially important to the success of the Institution’s ambitions as expressed in the new strategic plan – ambitions whose achievement require additional resources. Today I will focus on the management controls related to the stewardship of public resources: financial discipline, better central oversight, and stronger controls over care of the collections.

## **FINANCIAL DISCIPLINE**

The Smithsonian cannot sustain the quality of its programs or fully realize its strategic plan without improving its financial discipline. Only by designing management controls to manage costs and increase efficiencies can the Institution respond to budgetary demands. That will be especially true in high-risk areas such as the management of capital projects; financial reporting; implementation of the financial management system, known as the Enterprise Resource Planning or ERP system; use of funds policies; and personal property accountability.

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<sup>1</sup> Recommendation 23 asked for a review of “the Smithsonian’s financial reporting systems and internal controls to ensure that appropriate systems and controls are in place to enable the [Audit and Review Committee of the Board of Regents] and the Board to provide meaningful oversight of the accuracy and integrity of Smithsonian financial statements and reports.” Report of the Governance Committee to the Board of Regents, June 14, 2007.

### ***Capital Projects***

Capital projects, such as the construction or revitalization of buildings, represent the largest expenditures by the Institution other than salaries and related expenses. In prior audits of high-dollar value construction projects such as the Udvar-Hazy Center and the Patent Office Building renovation (now the Reynolds Center), all of which involved both appropriated and donated (trust) funds, we noted shortcomings in oversight. For example, we found that management lacked the financial reports necessary to gauge the health of the projects, measure performance, track planned versus actual costs, or review schedule updates, and that management did not effectively monitor project contingency funds.

We are currently completing a follow-up audit of capital project management and are very pleased to report that the Institution has significantly improved its oversight by implementing stronger policies and reporting standards.

However, accounting for project costs remains a cumbersome, manual process, and requires substantial year-end effort to ensure construction-related items are properly recorded for presentation in the Institution's financial statements. In the fiscal year 2008 financial statement audit, the Institution's external auditors labeled project cost accounting a significant deficiency, because they discovered several errors during their review of construction-in-progress accounts and associated year-end accruals. Coding errors and a lack of rigorous training on how costs should be managed contributed to these problems. Moreover, the lack of a project costing module in the ERP financial system limits efficient monitoring and overall project management.

The Institution recognizes capital project management as one of its internal control reform priorities. We hope that the Institution's implementation of a project costing module in the ERP system will eliminate most of these problems, assuming adequate training. More importantly, it should reduce costs by eliminating labor-intensive manual accounting procedures.

### ***Financial Reporting***

The Institution is improving its overall financial management, as shown by the decrease in the number of significant deficiencies found by the Institution's external auditors in their annual financial statement audits. But the external auditors necessarily focus only on year-end results and do not address smaller but still significant ongoing financial management issues. For example, the Institution is still unable to produce quarterly financial statements, and the auditors

cannot conduct extensive interim testing to detect accounting problems, both of which are fundamental to sound financial management. Preparation of quarterly statements will add further discipline to financial management: it will provide improved analytical data for planning and monitoring purposes, accelerate detection of transaction problems, and improve the reliability of financial information. Interim testing will help identify any breakdowns in controls.

### ***The Financial System (ERP)***

One problem underlying the examples I've described above, and one that hampers better financial management overall, is the delay in implementing the many modules of the ERP system. Initially, the Institution had unrealistic expectations for ERP implementation, projecting that all the modules the Institution had ordered would be fully functional by 2006. Now, it seems that the earliest that the final module will be installed is by the close of 2011. Still to be implemented include a project costing module, as I mentioned earlier; a cash management module to further automate the Institution's banking; a grants and contracts module; and a budget formulation module. These modules will enhance efficiency by easing the consolidation and analysis of data and reducing the errors that come from relying on manual processes. They will also enable easier monitoring and auditing, thereby increasing accountability.

At the same time, we have to note that while those financial management modules in the ERP that have been implemented represent significant progress, they do not yet function as effectively as possible. Partly, that is a result of inadequate training: employees in the units receive training on the ERP, but they do not always learn how to use the ERP to better manage risks, costs, and their programs to achieve their goals. A common complaint we hear is that the training needs to be more functional. An employee will be taught how to use the system, for example, but not necessarily how to properly classify particular transactions within the system.

### ***Use of Funds***

Another high-risk area the Smithsonian has identified concerns use of funds restrictions. These restrictions are the statutory constraints (such as the Anti-Deficiency Act) as well as policy and regulatory constraints on how federal monies may be spent. At the Smithsonian, they also include policy considerations and donor restrictions that govern how trust (non-appropriated) monies may be spent.

We have touched on use of funds in many of our audits and reviews, and the Institution has addressed many of our concerns. For example, in our January 2007 report on the then-Secretary's expenses, we noted the lack of a well-publicized, consistently enforced policy on how certain funds could be spent, and that such a policy should be in the form of an official Smithsonian-wide Directive. The Institution has since issued such a policy. And in our review of the travel and other expenses of the former director of the National Museum of the American Indian, we remarked on the lack of oversight of the use of funds that resulted in management not questioning the use of over \$48,000 of the museum's funds to pay for an oil portrait of the former director.

More recently, in our audit of facilities maintenance funds, we reported that the Smithsonian took funds appropriated for facilities maintenance work and used them to pay for unplanned capital projects. We found that in fiscal year 2008, the Institution improperly applied maintenance dollars to fund approximately \$550,000 out of approximately \$1 million obligated for two capital projects. As a result, the Smithsonian had incorrect accounting entries that recorded these costs as current expenses rather than capital expenses, likely understating depreciation expenses. In addition to these accounting and reporting errors, we are concerned that the misapplication of funds increases the risk of greater overall facilities costs because these monies were not spent on needed maintenance.

Unfortunately, we could not determine to what extent the Institution paid for capital projects with maintenance dollars because the Smithsonian did not document how it makes such funding decisions. And we found there was a lack of appropriate training and supervision.

These problems arise from a relaxed view of management control that prefers ambiguity, because ambiguity allows for discretion. But this view does not appreciate that ambiguity also creates confusion that causes errors. Dispersed responsibility for funds control and the lack of a common understanding of the purpose and rules governing funds control will continue to cause such problems. Dispersed responsibility also means there is no accountability for errors.

Although the Institution disagreed that they misused funds, management nonetheless agreed to our recommendations, including revising its policy manuals regarding funds control, establishing quality controls to review significant maintenance and capital transactions, and providing training on these changes.

And here I do have to mention the other topic of today's hearing, facilities maintenance. In a companion audit to the one I just discussed, we did find, for the limited areas we tested, that the Institution does have processes in place for adequately maintaining the heating, ventilation and air conditioning systems and vertical transportation equipment. In other words, for those limited systems we looked at, when the Smithsonian spent its facilities maintenance funds on maintenance, it did so appropriately and effectively.

### ***Personal Property Accountability***

Another high-risk area that the Institution has identified as a priority in its governance reforms is the management of personal property (as opposed to real property) assets. Such assets include everything from desks to laptops to trucks to microscopes and telescopes. As of May 2009, the Institution had more than 10,000 personal property items, valued at approximately \$175 million.

Inventories the Smithsonian conducted in fiscal years 2006 and 2007 showed a substantial number of missing and unrecorded assets: for the two years combined, there were about 960 missing assets with a cost of \$8.7 million, which we estimate to be around 7 percent in dollar value of recorded assets; and 1,591 unrecorded assets with a cost of \$19.4 million. Missing assets are those recorded in the Asset Management (AM) module in the Institution's financial system, but not found during the inventory. They may be been lost or stolen, and since they are unaccounted for they will mostly be written off. Unrecorded assets are those not recorded in the AM module, but found during the inventory. The risk with unrecorded assets is that there is no accountability for them.

We just issued an audit report on personal property accountability and were pleased to find that recent changes in policies and procedures have substantially improved the management of recorded personal property. The Smithsonian has hired a dedicated personal property management official; instituted Smithsonian-wide inventories; implemented a new centralized asset management system to record property; and in July 2008 substantially revised its policies and procedures for the first time since 1985. The most recent inventory, for fiscal year 2009, showed a substantial improvement, with only about 1 percent (dollar value) of assets missing. These improvements vividly illustrate the substantial efficiencies that result from stronger management controls.

Yet, as in all these areas, significant challenges remain. The Smithsonian did not hold individuals accountable for personal property losses, believing they could not do so without a signed form acknowledging responsibility for the property in their possession. Yet the Institution did not ensure that all responsible individuals completed these accountability forms. The Institution has held only one person accountable for \$40 worth of the \$12.3 million in missing property in the last five years. Because of resistance from management at the units, current policy does not hold unit managers directly accountable for enforcing personal property accountability or require them to pursue or reduce the incidence of missing property.

We were also concerned that policies do not require control of – or that inventories even list – all property whose loss may pose a significant risk to the Institution, particularly items such as BlackBerries and laptops that could contain sensitive information. Finally, we also found a dearth of training; none of the property custodians we interviewed had received training on personal property management.

In sum, despite the improvements, we found that senior management could more forcefully convey the importance of personal property accountability, and management at the unit level should more fully accept responsibility. Management did agree to our recommendations to address our concerns, and we will be following up on their implementation.

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To put its ambitious strategic plan in motion and then to reach its goals, the Smithsonian will require greater financial discipline. As our work demonstrates, many opportunities to optimize resources can be found simply from strengthening management control: implementing the remaining modules of ERP can eliminate costly, labor-intensive manual accounting procedures; fortifying the personal accountability of Smithsonian officials entrusted with property will ensure that staff have the tools necessary to perform their duties and that the Institution will not incur the costs of locating and replacing lost equipment; supporting employees with clear policy guidance, reinforced by regular training, will improve job performance and reduce labor costs associated with errors and remediation.

I applaud the commitment of Institution leaders to address these areas and would encourage the Committee to understand these reforms as long-term investments that will not yield complete

results within a single budget cycle. We will continue to monitor the Institution's progress and will report on our findings.

### **CENTRAL OVERSIGHT**

In addition to financial discipline, another aspect of management controls that requires sustained attention is appropriate central oversight. An inherent risk to an organization like the Smithsonian is that the independent nature of each of its components, or units, will give rise to inconsistent approaches to implementing common functions, inviting mistakes and confusion and increasing financial and operational error. It may also mean the Institution is not taking advantage of possible cost efficiencies. While the mission of each unit may differ, they have many operations in common, especially those functions that support routine operations like project management, information technology, and financial management. In reviewing the results of our audit work, we've seen the inconsistencies that come from decentralization. The Smithsonian should go further in setting forth uniform expectations in how various administrative practices should be conducted.

#### ***Relocation Expenses***

In an audit we completed two years ago on the payment of relocation expenses to employees, we found that staff members were processing payments in three different ways and were not coding these transactions accurately. Payments were processed through payroll, through travel vouchers, and through purchase orders. Indeed, because staff processed payments through so many systems, and coded the transactions inconsistently, we could not be sure that we had even identified all relocation payments, a distressing finding given that these payments had federal tax implications for both the employees and the Institution. These payments were handled so haphazardly because of the absence of Institution-wide standards for processing and documenting them, and the lack of training on how to report this type of data properly.

#### ***Personally Identifiable Information***

Last spring we completed an audit on how the Institution handles privacy information, often referred to as personally identifiable information (PII), and found the Institution's approach to be limited in scope and ultimately ineffective. The Smithsonian lacks a comprehensive privacy program and has not yet defined clear roles and responsibilities for a Senior Agency Official for Privacy (SAOP). It does not provide full privacy training for all employees and contractors; does not systematically identify or track sensitive PII or physically secure all PII; nor does it always

ensure that Smithsonian websites comply with privacy requirements. These weaknesses stem, in part, from the absence of an active SAOP with Institution-wide responsibility and authority, and the decentralized management of the Smithsonian's websites; for example, almost every museum and office has its own webmaster with the responsibility to update that unit's individual web page. Such a decentralized environment leads to inconsistent implementation of policies which, in turn, heightens the risk that security and privacy will be compromised.

These audits and others, including the one on personal property accountability, underscore the need for a shift in the interaction between the Smithsonian's central functions and the units. The autonomy of the units is entrenched in the culture and history of the place, and drives its vitality, creativity and innovation. But it also prevents the most effective use of the Institution's limited resources and poses other risks. Inconsistent payment practices, inaccurate accounting, inadequate oversight of projects, and the potential misuse of PII are just some of the consequences of this decentralization. Functions such as procurement, information technology, information security, project oversight and accounting should not be subject to varying policy interpretations and operating practices. The Smithsonian should be more unified in its operations. It is headed in the right direction with its responses to the Governance recommendations, but it has to go farther, particularly as it seeks to implement more pan-Institutional, cross-unit initiatives in fulfilling its strategic plan.

## **MANAGEMENT CONTROLS OVER CARE OF THE COLLECTIONS**

A continuing challenge for the Institution, and one that we are keeping a close watch on, is the stewardship of its unparalleled collections. We were heartened to see the increase in the fiscal year 2010 appropriations for the Institution's collections care initiative. Studies over the years, by our office and by the internal Office of Policy and Analysis, show that the Institution's collections are increasingly at risk of theft or loss or deterioration.

Our 2006 audit of physical security and inventory controls over the collections at the Smithsonian's largest museum, the National Museum of Natural History (NMNH), found missing or inoperative security devices, weak supervision of non-staff in collection areas, and inadequate guard coverage. Moreover, NMNH did not develop or did not follow inventory plans; did not conduct cyclical inventories; and did not have accurate or complete inventory records. Shrinking budgets and staff resources were partly to blame. And while NMNH has addressed our recommendations from that audit, these issues remain a concern.

We recently completed a similar audit of collections safeguards and inventory controls at the National Air and Space Museum (NASM); we are awaiting management's formal comments before issuing our final report. We found similar problems there, most notably weaknesses in security devices and procedures.

We also just began another such audit, this time of the National Museum of American History. While we will again focus on security and inventory controls, we are expanding our scope to examine the condition of the collections, with a focus on storage, which has historically had issues with environmental contaminants, moisture, crowding, and other serious risks to the proper preservation of the collections.

We understand the resource constraints that prevent more comprehensive collections stewardship, from accurate and complete inventories to sound preservation, but we believe that the Institution could do more pan-Institutional planning and prioritizing to use whatever resources are available. For example, in our forthcoming report on the NASM collections audit, we are recommending more thorough and systematic security assessments, which can then be the basis for prioritized budget requests.

The importance of continually improving management control over collections cannot be overstated. The new strategic plan does focus on strengthening collections and expresses a commitment to digitize and make the collections accessible online. To do so effectively will also require a greater commitment to controls, as well as to addressing a myriad of other concerns I haven't even touched on, such as storage capacity for the collections, which are always increasing in number.

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Institution management is keenly aware of these and other management controls weaknesses and is addressing them in response to Governance Committee Recommendation 23. Keeping them a priority and fostering a disciplined management culture requires a continuing commitment from the top of the organization, reinforced by emphatic and clear communications. The Institution's new strategic plan should help, because it stresses the value of integrity, which requires all Smithsonian employees to carry out their work with the greatest responsibility and

accountability. The strategic plan also names as a priority organizational excellence, which must be grounded in strong management controls.

In addition to communication, there must also be clear consequences for failure to adhere to excellence, for noncompliance with policies. Holding individuals accountable for missing personal property, for example, would further safeguard the Institution's assets and affirm the expectation that employees will abide by the Smithsonian's *Statement of Values and Code of Ethics*.

Achieving these improvements in governance also rests equally on the shoulders of the staff in their day-to-day duties. To reform the control environment will require a careful and sustained effort to train and supervise staff. We are hardly alone in this observation. GAO has emphasized the importance of effective training. The Institution's external auditors recommended this year that the Smithsonian "place renewed focus on training and staff supervision to maximize the effectiveness of its accounting resources." The same thought applies to all functions related to management controls.

As Inspector General, I meet frequently with senior officials at the Smithsonian to understand their perspective and to understand how our audit work is received in the units most affected by our results. I also listen to more general concerns. Although these are not necessarily matters captured in audits or investigations, I'd like to share my thoughts, based on these conversations, on broader issues that will bear on the success of efforts to improve management controls.

One is the need for better marketing. It remains a challenge, in some instances, to persuade the programmatic side of the Institution of the importance of these controls. Many of the units – the museums and research centers and libraries and archives – view any new procedures or policies as a form of paperwork punishment for the misdeeds of errant executives who are now gone. In this view, because the few bad actors have left, and the remaining Smithsonian employees are devoted and trustworthy, the controls serve only to expand the power of the central administration. Another view questions putting any additional resources towards these back-office functions when there isn't enough money for core, programmatic missions. Unfortunately, at times the central administration, referred to as the Castle, seems to agree that these are unnecessary burdens to the units.

These views are mistaken. The Castle needs to do a better job of explaining that the purpose of management control is not to create paperwork, it is to reduce risk and improve operations and thereby protect Smithsonian resources. Nor is its purpose to centralize power. Management control is essential to managing an organization; their purpose is to improve the effectiveness of the Institution in fulfilling its important mission. Effective management control produces the information managers need to make the best decisions, such as how much a program is costing and whether it works, and how it compares to other programs when difficult resource decisions arise. Strong management control will make the Institution's resources go farther, and will reduce the incidence of problems that cost the Institution money (for example, by ensuring that laptops don't disappear), or that cause the Institution public embarrassment (for example, by creating oversight that prevents lavish spending at the public's expense, or by ensuring that if a laptop does disappear, no sensitive information is lost).

Finally, by fostering greater transparency and accountability, strong management controls instill confidence in the Institution by its congressional and public stakeholders. They assure generous donors and appropriators that the Institution is being the proper steward of what are ever more scarce public resources.

There may be reasons to complain about the number of new policies in the last two years and the seemingly excessive work they require. They may not be perfect, but that does not lessen the need for them. To think so ignores the Institution's obligation to be accountable and to acknowledge that every dollar the Smithsonian spends is either appropriated by Congress or comes from donations and from the trust it holds on behalf of the public.

Addressing these many challenges may not be easy, but the Institution is filled with creative people who are passionate about its mission to increase and diffuse knowledge. And the Secretary can continue to show leadership in these areas. Our office will strive to hold the Institution to the promise of its strategic plan. We believe the brilliance and dedication of the entire Smithsonian community should be harnessed to strengthen a management control environment that will make the Institution the most effective and efficient steward it can be.