Smithsonian Institution
Office of the Inspector General

In Brief

Administration of Relocation and Recruitment Payments
Report Number A-07-04, September 28, 2007

Why We Did This Audit

During our audit of executive compensation at the Smithsonian, we observed that the Smithsonian had no consistent, Institution-wide method for processing or documenting relocation or recruitment payments, and that central oversight of such payments was lacking. In this audit, we sought to assess if the Institution has adequate policies and procedures to govern the granting and recording of relocation and recruitment payments; whether the Institution made payments in accordance with these policies and procedures; and whether the Institution addressed all associated tax liabilities.

What We Recommended

We made five recommendations to strengthen oversight of relocation and recruitment payments. We recommended that management amend policies and procedures, improve user training, report corrected information to the IRS, and maintain a central file of all approved service agreements in the Office of Human Resources.

Management concurred with the report's findings and recommendations and proposed corrective actions that will resolve all the recommendations.

What We Found

The Smithsonian in many instances did not ensure proper reporting to the IRS of employee taxable income arising from relocation and recruitment payments. In the 5-year period covered by our audit, the Smithsonian generally reported lump-sum payments to employees correctly on IRS W-2 forms. However, when the Smithsonian reimbursed employees for moving expenses, or when it paid third parties directly for temporary housing or other non-deductible expenses, the Smithsonian generally did not did not report taxable income or other required information accurately to the IRS.

For the period 2002 through 2006, the Smithsonian reported employee income associated with these payments of approximately $1.2 million when, according to the transactions we reviewed, it should have reported employee income of about $1.4 million. We identified a number of factors that contributed to the inaccurate processing of these transactions, including the Institution's decentralized organizational structure, weak guidance on proper processing procedures, and the lack of adequate training for data entry and reporting.

We also found that the Smithsonian did not maintain required employee service agreements for relocation and recruitment payments. Service agreements spell out employees' responsibility to repay relocation or recruitment amounts if they leave the Smithsonian prior to serving a minimum period, such as one year. While we found instances where units followed up to recover payments from employees when they left the Smithsonian before fulfilling the terms of their service agreements, we also identified cases where management failed to recover payments from breached agreements. Examples of cases we reviewed include:

- A Smithsonian Business Ventures (SBV) executive was authorized moving and temporary living expenses of nearly $100,000 without signing a service agreement. SBV reimbursed the employee for temporary living expenses of over $40,000. The executive left SBV within a year of his start date and SBV never required the employee to reimburse the Institution for any portion of the payments.
- Two Office of Protection Services employees received recruitment payments of $5,000 each. Neither employee fulfilled the required six-month terms of employment set out in their service agreements and neither reimbursed the Institution.

For additional information or a copy of the full report, contact the Office of the Inspector General at (202) 633-7050 or visit http://www.si.edu/oig

AUDIT REPORT

Administration of Relocation and Recruitment Payments

Number A-07-04

September 28, 2007

Smithsonian Institution

Office of Inspector General

Smithsonian Institution Memo

Office of the Inspector General

Date September 28, 2007

To Sheila P. Burke, Deputy Secretary and Chief Operating Officer
John E. Huerta, General Counsel
James D. Douglas, Director, Office of Human Resources
Alice C. Maroni, Chief Financial Officer
Andrew J. Zino, Comptroller

cc Thomas Ott, Acting Chief Executive Officer, Smithsonian Business Ventures
Charles R. Alcock, Director, Smithsonian Astrophysical Observatory
Eldredge Bermingham, Acting Director, Smithsonian Tropical Research Institute

From A. Sprightley Ryan, Inspector General

Subject Audit Report on the Administration of Relocation and Recruitment Payments, Number A-07-04

During our audit of executive compensation at the Smithsonian,[1] we observed that the Institution had weak policies and procedures regarding relocation and recruitment payments, which can have federal tax implications for the Smithsonian and its employees. The Smithsonian had no consistent, Institution-wide method or standards for processing or documenting these payments, and the Institution's individual units were recording such payments with little central oversight.

We initiated this audit to address these issues in more detail. Our objectives were to assess if the Institution has adequate policies and procedures to govern the granting and recording of relocation and recruitment payments; whether the Institution made these payments in accordance with these policies and procedures; and whether the Institution addressed all associated tax liabilities. We reviewed records of relocation and recruitment payments for 246 employees from calendar years 2002 to 2006, covering payments totaling about $1.9 million. However, Smithsonian management was unable to assure us that there were not additional payments because these types of payments were not consistently processed or properly coded in the Smithsonian's multiple payment systems. We include a detailed description of our scope and methodology in Appendix A.

RESULTS IN BRIEF

The Smithsonian in many instances did not ensure proper reporting to the IRS of employee taxable income arising from relocation and recruitment payments. In the period covered by our audit, the Smithsonian generally reported lump-sum payments to employees correctly on IRS W-2 forms. However, when the

[1] *Audit of Executive Compensation at the Smithsonian,* No. A-06-06, January 19, 2007.

Smithsonian reimbursed employees for moving expenses, or when it paid third parties directly for temporary housing or other non-deductible expenses, the Smithsonian generally did not report taxable income or other required information arising from these payments accurately on W-2 forms. These problems were caused by a decentralized organizational structure, weak procedures, and the lack of training for data entry and reporting. We found that the Smithsonian made relocation and recruitment payments using many different methods, including two different payroll processing systems, purchase orders, and travel vouchers, and that management could not accurately identify the total amount of the payments. As a result, during the audit period the Smithsonian reported income of approximately $1.2 million of such payments on employees' W-2 forms when, according to the transactions we reviewed, it should have reported approximately $1.4 million.

To standardize approvals of recruitment and relocation payments and to improve the recording and reporting of these payments to the IRS, we recommended that the Smithsonian strengthen policies, procedures, and user training, and that the Institution cease offering moving expense reimbursements for new employees except in limited circumstances.

BACKGROUND

As an initial matter, we would like to comment on terminology in this area, which can be confusing. The Office of Personnel Management (OPM) defines payments to new employees as recruitment incentives and payments to existing employees as relocation incentives; the Federal Travel Regulation defines payments to both new and transferred employees as relocation allowances. The Smithsonian calls the payments relocation allowances or incentives if they are paid to federal employees, and relocation reimbursements or bonuses if they are for trust employees.[2] For purposes of this audit, we will use the terms relocation payments to describe reimbursements for existing employees and recruitment payments for incentives or reimbursements for expenses for new employees.

The Smithsonian offers relocation and recruitment payments to attract employees to specialized positions the Smithsonian is having trouble filling. We found that the Smithsonian made payments ranging from $250 to over $105,000 to pay for move-related expenses and to motivate candidates to join the Smithsonian. These payments included temporary living expenses, moving expenses, closing costs for the purchase of a new home, a cash advance, and a tuition deposit. In the paragraphs that follow, we explain the Smithsonian's methods for making these payments, federal and trust regulations, IRS reporting requirements, and Smithsonian policies and procedures.

The Smithsonian makes three different types of relocation and recruitment

[2] Chief Financial Officer Bulletin No.10-007, June 22, 2007.

payments:

- Lump-sum payments to employees;
- Reimbursements to employees for actual moving expenses; and
- Payments directly to vendors on behalf of employees for airline travel, moving household goods, temporary housing, and the like.

Smithsonian Payment Methods

The Smithsonian makes the three different types of relocation and recruitment payments mentioned above using several different methods. The Smithsonian makes lump-sum payments through the National Finance Center, which is the Smithsonian's primary payroll provider. The Smithsonian also has a separate business operation called Smithsonian Business Ventures (SBV), which makes lump-sum payments as well as expense reimbursements to its employees through a different system, Automatic Data Processing (ADP). In addition, the Smithsonian pays employee reimbursements for actual moving expenses using travel vouchers and purchase orders. Further, the Smithsonian pays airlines, moving companies, and temporary housing providers directly on behalf of employees using a central travel card, purchase orders or through contracts with these vendors.

There are two different groups of rules and regulations that govern these transactions for federal employees. The relevant statute authorizing these payments is 5 U.S.C. § 5753. OPM has issued regulations[3] governing payments for employee recruitment and relocation. In addition, the General Services Administration's Federal Travel Regulation (FTR)[4] also provides guidance for travel-related payments. Both OPM and FTR regulations require new employees who receive relocation or recruitment payments to enter into a service agreement. Service agreements require new employees to serve a minimum period and require repayment by the employees if they fail to complete the agreed-upon period of service. Smithsonian directives require employees who do not meet the terms of the agreement to repay the Smithsonian, generally on a prorated basis. There are no provisions for the Chief Executive Officer of SBV to waive this requirement.

OPM Regulations

OPM permits the use of incentive payments as a means for the government to attract and retain well qualified applicants and employees. The incentives are recruitment payments to attract new employees and relocation payments to encourage current employees to relocate to another geographic location. These incentive payments are taxable income, and employees may use these payments for any purpose including paying their moving expenses.

[3] The statute uses the terms recruitment and relocation bonuses. The regulation is 5 C.F.R. §575.
[4] 41 C.F.R. §302 subpart (a) applies to recruitment and subpart (b) applies to relocation payments.

According to OPM regulations, an agency that offers incentive payments must have an incentive plan that includes the designation of officials with authority to review and approve the payment of incentives; the categories of employees who are not eligible to receive incentive payments; the required documentation for determining that the position is difficult to fill; requirements for determining the amount of the incentive; the payment methods (lump sum, installment) that may be authorized; requirements governing service agreements; and documentation and recordkeeping requirements. Regulations limit agencies' incentive payments to up to 25 percent of the employee's base pay (including locality adjustments) unless agencies receive OPM approval.[5]

Federal Travel Regulation

The FTR provides much more detailed guidance than the OPM regulations for reimbursements to employees for actual moving expenses and more clearly defines the types of acceptable travel expenses. If the agency is paying for moving expenses, the agency must, at a minimum, pay the employee for transportation of the employee and immediate family members, per diem for the employee only, and transportation and temporary storage of household goods. The FTR requires employees to provide receipts for claimed expenses. At its discretion, the agency may pay other moving expenses. However, for new employees, the FTR forbids the agency from paying expenses such as per diem for family members, cost of househunting trips, and miscellaneous expense allowances.

In our opinion, implementation of the FTR requires specialized knowledge and additional administrative support. Unit personnel entering the payment data according to the FTR must accurately code these transactions in the accounting system to ensure accurate reporting to the IRS. Additional administrative support such as specialized training for unit and accounting personnel is needed to ensure these employees identify and report these transactions, without error, to the IRS.

IRS Reporting Requirements

Employers must report to the IRS certain relocation and recruitment payments made to employees or on their behalf. Specifically, the IRS regulations require that lump-sum payments and payments of non-deductible expenses to employees or third-parties be reported as additional income in Boxes 1, 3, and 5 of the employee's Form W-2. Employers also must report, for informational purposes, reimbursements such as for the costs of moving household goods and traveling from the old to the new home, in Box 12 of Form W-2.[6] The IRS does not require employers to report payments paid directly to third-party vendors, such as moving companies, because

[5] An agency may raise the cap to amounts higher than 25 percent of annual base pay if there is a critical agency need and the agency receives OPM approval.

[6] We believe this reporting requirement was designed to prevent employees from claiming a deduction for expenses that the employer reimbursed.

the employees never received the monies and these expenses would have been deductible if paid by the employee. Diagram 1 in Appendix B illustrates the different types of relocation and recruitment expenses and tax reporting requirements, and Diagram 2 in Appendix B displays the IRS Form W-2, Wage and Tax Statement.

Smithsonian Policies and Procedures

The Smithsonian established several policies and procedures that were intended to mirror the federal rules for recruitment and relocation payments. These are contained in Smithsonian Directives, a Travel Handbook, and other policies to address federal and trust employee relocation and recruitment payments. For federal employees, the Smithsonian issued Smithsonian Directive (SD) 212, a Federal Personnel Handbook. The Smithsonian also issued a Travel Handbook, which is similar to the FTR, and SD 312, which covers Smithsonian travel policy for both federal and trust employees. The Smithsonian has implemented an incentive plan for federal employees that follows the guidance of the OPM regulations and specifies that the Unit Directors are the approving officials.

The Smithsonian issued SD 213, Trust Employees Personnel Handbook, which provides a definition of recruitment and relocation for trust employees. However, neither SD 213, the Travel Handbook, nor SD 312 were intended to explain how to make recruitment and relocation payments to trust employees. There were no procedures which explained how these payments should be made. Nor does this guidance clearly indicate the extent to which trust employees were expected to follow federal rules. We also noted that the Smithsonian had not implemented incentive plans for trust employees.

In June 2007, the Smithsonian amended its guidance for reimbursing employee relocation costs. The Smithsonian will use GSA-approved relocation management vendors to assist with relocation reimbursements to ensure that employee payments receive the proper tax treatment and that relocation expenses and reimbursements are properly documented and recorded. The guidance describes eligibility for federal and trust employees, requires certain authorizations and approvals, and requires signed service agreements for all job candidates to be considered eligible for relocation reimbursements. The interim guidance does not prescribe proper transaction coding to ensure complete and accurate IRS reporting.

RESULTS OF AUDIT

The Smithsonian Did Not Accurately Report Taxable Income for Employee Relocation and Recruitment Payments to the IRS

The Smithsonian expended at least $1.9 million[7] in employee relocation and recruitment payments from calendar years 2002 to 2006, $971,346 to 166 federal employees and $936,375 to 80 trust employees. Of the $1.9 million we identified, approximately $1.4 million should have been reported to the IRS as income to employees. We found that generally lump-sum payments and SBV reimbursements were properly reported to the IRS. However, the Smithsonian only reported about $1.2 million, or 86 percent, of the $1.4 million to the IRS. Based on our review, we concluded that the Smithsonian did not properly report $184,275 as income on employees' W-2 forms.

Examples of payments that the Smithsonian failed to report as taxable income to employees included:

- In 2002, the Smithsonian reimbursed an executive over $19,000 in temporary living expenses and it reimbursed another executive over $14,000 in expenses for temporary housing, pre-move, and other expenses.
- In 2003, the Smithsonian reimbursed an executive over $10,000 for pre-and post- move trips and temporary living expenses and reimbursed a different executive over $10,000 for expenses related to closing costs on a new home.
- In 2004, the Smithsonian paid an executive over $11,000 for temporary living expenses.
- In 2005, the Smithsonian reimbursed an executive $1,000 for his child's tuition deposit.
- In 2006, the Smithsonian gave an executive a $5,000 cash advance for move-related expenses.

Table 1 compares the taxable income that should have been reported on employees' W-2 forms to the amounts that were reported by calendar year for the audit period.

Table 1: Reporting of Taxable Income For Relocation and Recruitment Payments in Boxes 1, 3, and 5 of IRS Form W-2s ($'s)[8]

	2002	2003	2004	2005	2006	Total
Expected	141,325	72,176	67,322	176,599	89,940	547,362
Reported	85,571	4,000	22,470	173,975	77,071	363,087
Difference	(55,754)	(68,176)	(44,852)	(2,624)	(12,869)	(184,275)

[7] We were unable to verify the accuracy of this total because of inconsistent transaction coding in the Smithsonian's accounting systems, among other issues we describe in the report.
[8] This table excludes lump-sum payments.

Of the total amount that was not reported as taxable income to employees ($184,275), the Smithsonian paid $59,303 directly to third-party vendors for temporary housing expenses. This amount was made up of payments for two individuals: $58,194 for temporary housing of one executive in 2003 and 2004, and $1,109 for temporary housing of another executive in 2003.

In addition to the failure to report all the taxable income from relocation and recruitment payments, we also found that the Smithsonian did not report other types of reimbursements not considered income to the employee. These included reimbursements for moving expenses, lodging while traveling, and shipping of household goods. Under IRS rules, such amounts must be reported for informational purposes in Box 12 of the Form W-2. These reimbursements totaled $104,745 for our audit period, and the Smithsonian reported only $14,354.[9] These types of expenses, if paid by the employee, would have been deductible expenses for IRS tax purposes. In our opinion, employer reporting of these payments is important to prevent employees from claiming a deduction for expenses that the employer already reimbursed.

Overall, based on the records available, the Smithsonian had not reported relocation or recruitment payments correctly for 54 employees: 21 employees had incomplete data reported in both Box 1 and Box 12 on the IRS Form W-2s, 11 employees had incomplete data only in Box 1, and 22 employees had incomplete data only in Box 12.

There are a number of causes for the weaknesses in the Institution's processing of these transactions, including a decentralized organizational structure, weak procedures, and the lack of adequate training for data entry and reporting.

- The Secretary delegated the authority for approval of relocation and recruitment payments to the units. Smithsonian units are dispersed geographically and organizationally, located primarily in Washington, D.C., Massachusetts, and Panama. The units are also organizationally divided between scientific museums and research facilities, art museums, history museums, and administrative functions. Consequently, responsibility for approving these payments was fragmented.

  This fragmentation enabled the units to enter recruitment and relocation payment data by a variety of methods without close oversight by the Office of the Comptroller (OC) or the Office of Human Resources (OHR). In some cases, unit directors (who may be the beneficiaries of these payments) authorized administrative and accounting personnel to make payments through travel vouchers and purchase orders without ensuring that the

[9] SBV could not provide evidence of how these transactions were reported to the IRS in 2002.

payments were properly coded. The units also entered payment data into the contracting system, and there was no process for reviewing this data to identify payments which would need to be reported to the IRS.

- The Smithsonian established guidelines for recording relocation and recruitment expenses in 1996 (SD 212 and 213), but did not provide specific guidance on procedures that should be used to process the types of payments which are required to be reported to IRS on employees' W-2 forms. Management had not updated these directives to reflect payments made through new systems such as the travel manager system that was installed in 2001, or the Enterprise Resource Planning (ERP) system that was installed in 2003.

  The Smithsonian's policies also did not establish which system(s) the units were supposed to use when they recorded relocation and recruitment payments. As a result, Smithsonian personnel used various systems to record relocation and recruitment payments. In addition to making payments through NFC and the Travel Manager module of the ERP, the units also paid relocation expenses through the ERP purchase order and contracting systems.

- The Smithsonian did not ensure that unit managers and administrative personnel were adequately trained in how to process relocation and recruitment payments. Generally, written materials were not specific enough for processing these types of transactions. Consequently, in many cases unit personnel treated these transactions as if they were regular business travel expenses. We found the units were entering either international travel or domestic travel class codes in the ERP instead of relocation expense class codes. For example, we reviewed travel vouchers and purchase orders that had relocation expenses, and the units had entered the correct class code for payments related to only three employees. Because the units were entering improper class codes, the Office of the Comptroller could not ensure accurate reporting to the IRS.[10]

The underreporting of income in Boxes 1, 3, and 5 of the W-2 forms is troubling because it means that the Smithsonian did not report employees' correct wages to the IRS and may not have withheld the proper federal tax amounts from employee pay. Failure to properly account for these transactions reduces management's ability to continuously monitor the Smithsonian's compliance with laws and regulations.

[10] For example, the units were paying two types of costs through the travel manager system: relocation reimbursements paid to employees and relocation expenses paid directly to vendors. For transactions paid through the travel manager system, unit personnel entered the following codes: "travel in the USA" (code 2111), blank (no code entered), "relocation costs" (code 1250), "travel outside the USA" (code 2112), "transportation" (code 2212), "other professional services" (code 2526), or "relocation allowance" (code 1284).

Because management could not identify all the relocation and recruitment payments made during the period, there are likely additional transactions that were not classified correctly or properly reported to the IRS on the employees' W-2 forms.

The Smithsonian Did Not Maintain Required Service Agreements for Relocation and Recruitment Payments

Both federal regulations and Smithsonian policies require that employees who receive relocation and recruitment payments obtain approval using instruments that are commonly referred to as service agreements. Service agreements spell out employees' responsibility to repay relocation or recruitment amounts if they leave the Smithsonian prior to a minimum period, such as one year.

We reviewed a sample of 154 employees, including all Smithsonian relocation reimbursements to employees and direct payments to third-parties during our audit period, as well as 65 employees who received lump-sum payments in 2004, 2005 and 2006 in amounts that totaled $3,000 or more. Of the 154 employees we sampled who should have had a service agreement on file, we found the units did not have service agreements for 34 (or 22 percent). Out of the 34 employees without service agreements, 20 had neither a service agreement nor an employment letter; 12 had employment letters (one was unsigned); and 2 had other forms of approval (an e-mail and a delegated authority request). We note that employment letters are not authorized as a substitute for service agreements in any approved policies or procedures made available for our review.

We also observed that the majority of the 34 employees without service agreements worked at units that maintain their own offices of human resources, namely the Smithsonian Astrophysical Observatory (SAO) in Cambridge, Massachusetts; SBV; and the Smithsonian Tropical Research Institute (STRI) in Panama. For example, we found 8 instances of employees without records of service agreements at STRI. STRI did not require its employees to have service agreements. Instead, STRI issued employment letters to its employees. However, these letters did not contain the same protections that service agreements require, such as establishing a minimum service term or requiring the employee to repay the relocation or recruitment amounts if the employee leaves prior to fulfilling the service term. We found many instances where the documentation, particularly in the earlier years, was incomplete or missing.

Smithsonian procedures require service agreements to be centrally reviewed and filed in the employees' official personnel file only if they related to lump-sum payments made through the NFC system. Therefore, neither OHR nor OC had reviewed or approved any of the non-lump sum service agreements or employment letters. While we found instances where units followed up to recover payments from employees when they left the Smithsonian before fulfilling the terms of their service agreements, we also identified cases where management failed to recover payments from breached agreements.

For example, SBV hired an executive in 2005 who did not sign a service agreement. SBV also could not provide a copy of an approved employment letter. Instead, SBV provided a draft service agreement that would have authorized moving and temporary living expenses of $99,879 (including grossed-up taxes). The executive traveled from Boston to Washington for several months, but never relocated. SBV reimbursed him for temporary living expenses of over $40,000. The executive left SBV within a year of his start date and was never required to reimburse SBV for any portion of this amount. SBV did, however, report the $40,000 as income on the employee's W-2 Form.

In another example, SBV reimbursed a different executive approximately $105,800 for moving and temporary living expenses, $5,800 more than the $100,000 limit established in the service agreement. For reasons undocumented, the SBV CEO waived repayment of the excess $5,800. We noted that the executive was only required to work at the Smithsonian the prescribed minimum 12 months for this type of payment, and he left one day after his one year requirement ended. Moreover, we found no provision authorizing the CEO to waive the excess amount.

We also found other examples where two Office of Protection Services employees received recruitment payments of $5,000 each. Neither employee fulfilled the required six-month terms of employment set out in their service agreements, and neither employee reimbursed the Institution.

RECOMMENDATIONS

To ensure that the Institution reports all required information accurately on its employees' IRS W-2 forms, to reduce administrative costs, and to ensure that the Institution recovers payments when service agreements are not fulfilled:

We recommend that the Chief Financial Officer:

1. Amend existing policies and procedures to clarify the acceptable payment methods for relocation and recruitment transactions, specify payment limitations, and reemphasize transaction coding instructions. The policies and procedures should also address waiver exceptions and prohibit the use of employment letters as a substitute for service agreements.

2. Strengthen user training for recording, processing, and reporting of relocation and recruitment payments.

3. Cease offering moving expense reimbursements to new employees, except in limited circumstances where justified, and instead only offer lump-sum recruitment payments.

We recommend that the Comptroller:

4. Report corrected information to the IRS on the appropriate forms for those employees that we identified.

We recommend that the Director of OHR or his senior-level designee:

5. Approve relocation and recruitment service agreements for all Smithsonian federal and trust employees in writing and maintain a central file of all such agreements.

SUMMARY OF MANAGEMENT RESPONSE

Management's September 21, 2007, response to our draft report concurred with all five recommendations. By October 1, 2007, management will cease offering moving expense reimbursements to new employees and only offer new employees lump-sum payments, with limited exceptions. In addition, the Office of Human Resources will approve all relocation and recruitment service agreements in writing and maintain a central file of all such agreements. By December 31, 2007, management will issue revised policies and procedures, develop and disseminate training materials, and after consultation with the General Counsel, report appropriate corrected information to the IRS.

The full text of management's response is included as Appendix C.

OFFICE OF THE INSPECTOR GENERAL COMMENTS

Management's planned actions respond to the recommendations, and we consider the recommendations resolved. We believe managers should make correcting the deficiencies we identified in this report a priority and ensure that the proposed milestones are met or exceeded.

We appreciate the courtesy and cooperation of Smithsonian representatives during this audit.

APPENDIX A. SCOPE AND METHODOLOGY

To determine whether the Institution has adequate policies and procedures to govern the granting of relocation and recruitment payments, we interviewed management and staff from the Office of the Comptroller; Office of Human Resources; Office of the General Counsel; Office of the Chief Information Officer (OCIO); Smithsonian Business Ventures (SBV); Smithsonian Tropical Research Institute; Smithsonian Astrophysical Observatory; National Museum of Natural History Shipping Office; and several Institution museums and organizations. We reviewed the Smithsonian's policies and procedures for granting, recording, and making relocation and recruitment payments for federal and trust employees for calendar years 2002 to 2006.

Because the Smithsonian did not have written procedures covering all payment methods used, particularly for trust employees, we looked to federal regulations to the extent practicable. We used guidance established by the Federal Travel Regulation and the Office of Personnel Management as well as federal tax reporting rules from the IRS, such as Publication 521, "Moving Expenses."

To determine the total universe of relocation and recruitment payments made to Smithsonian employees, we reviewed payroll data from the Office of Human Resources for calendar years 2002 to 2006. We also interviewed the units and queried the travel management system. We identified 246 employees who received relocation and recruitment payments. However, given the poor controls at the unit level and lack of central oversight, we have no assurance that we identified all of the employees who received these payments. We found many instances where the records, particularly for the earlier years, were not available.

Of the 246 employees we identified, we examined a sample of 154 employees. We selected all employees who had been paid by SBV and those that were paid through travel vouchers and purchase orders. The sample also included 65 employees paid in lump-sum amounts $3,000 or greater through the NFC system in calendar years 2004, 2005, and 2006. The Smithsonian was unable to readily obtain payroll data from NFC prior to 2004. We verified whether a signed service agreement was on file at OHR or the units and followed up to determine if former employees repaid the Smithsonian when they failed to meet their respective service agreement terms.

When we attempted to determine the amount of payments made using methods other than lump-sum, we found the Office of the Comptroller did not have a complete universe. To obtain a more comprehensive listing, OCIO staff produced a listing of travel vouchers and purchase order transactions based upon information in the comments fields. We also interviewed unit staff to determine if we had missed transactions and to obtain supporting documentation.

To determine whether relocation payments were made in accordance with policies and procedures, we contacted the individual units and requested that they provide copies of signed vouchers and purchase orders and supporting documentation for all employees in their organization who had received relocation and recruitment payments during the audit period. For each payment, we determined whether the payment was properly authorized; whether the employee had signed a service agreement; whether the correct class code had been used; the nature of the expense; and whether the payment had been made to a third-party vendor or as a reimbursement to the employee.

To determine whether all associated tax liabilities had been addressed, we verified whether payments were reported to the Internal Revenue Service by reviewing payroll information and employee form W-2 and 1099 tax documents from NFC. (NFC provides automated payroll services to the Smithsonian for both federal and trust employees.) We also reviewed payments made by SBV through its ADP system as well as the associated tax reporting documents. We reviewed payments made to existing employees and found only one 1099 payment to review. We also talked to an IRS customer service representative for help in understanding tax rules.

We conducted this audit in Arlington, Virginia and Washington, D.C. from February to September 2007 in accordance with ***Government Auditing Standards*** as prescribed by the Comptroller General of the United States and included tests of internal controls as we considered necessary.

A summary of the relocation and recruitment payments we identified follows, listed in descending order according to the total amounts paid by Smithsonian unit during the period covered by our audit.

Smithsonian Institution Relocation and Recruitment Payments
Calendar Years 2002 – 2006

Unit	Number of Employees	Total Payments
Smithsonian Astrophysical Observatory	49	$397,780.14
Office of Facilities Engineering and Operations	96	366,898.69
Smithsonian Business Ventures	20	353,926.65
National Museum of Natural History	17	134,606.20
National Museum of African American History and Culture	2	100,000.00
Office of External Affairs	3	75,759.34
Smithsonian Tropical Research Institute	8	68,377.45
National Museum of the American Indian	10	63,119.91
Museum Conservation Institute	4	57,440.96
National Zoological Park	9	53,670.03
Office of Investments	1	35,000.00
Arthur M. Sackler Gallery/Freer Gallery of Art	2	32,794.86
National Museum of African Art	1	30,000.50
Smithsonian Institution Press	3	27,441.63
Hirshhorn Museum and Sculpture Garden	7	26,213.64
Office of the Chief Information Officer	2	19,999.02
National Postal Museum	1	17,661.00
Under Secretary for Art	2	15,568.20
Smithsonian Institution Archives	1	9,493.00
Archives of American Art	1	7,242.94
National Museum of American History	2	6,819.06
Smithsonian Institution Libraries	2	6,000.00
Cooper-Hewitt National Design Museum	3	1,908.00
Total	**246**	**$ 1,907,721.22**

APPENDIX B. FEDERAL TAX REPORTING

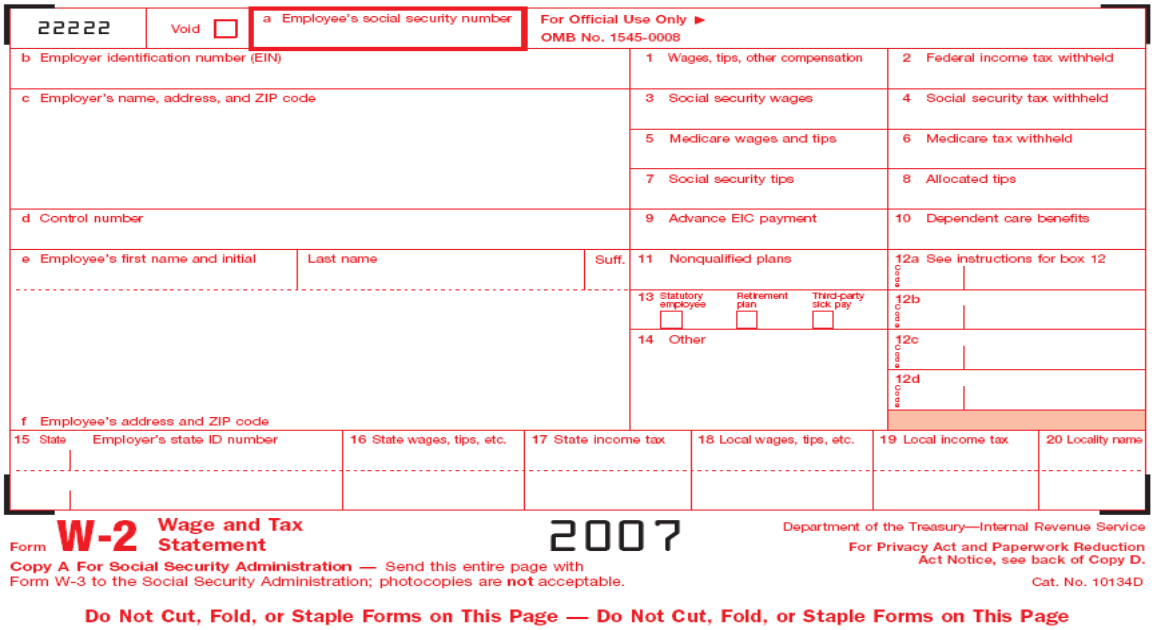
The following diagrams describe the federal tax reporting implications for the different types of payments noted in our report.

Diagram 1

Payment Type	Paid By	Paid To	Type of Expense	Payment Would be Deductible if Made by Employee	IRS Reporting
1	Employer	Employee	Lump-sum payment for recruitment or relocation	N/A	Form W-2, Wages, Tips, and other Compensation, Boxes 1, 3, and 5. The employee must report this amount on the Form 1040 as an addition to wages
2	Employer	Employee	Reimbursement for Reasonable Moving Expenses	Yes	Form W-2, Box 12 code "P". Informational only
3	Employer	Employee	Cost of meals while traveling from the old home to the new home; pre-move house-hunting expenses; temporary living expenses after starting work in the new location; and qualified real estate expenses	No	Form W-2, Wages, Tips, and other Compensation, Boxes 1, 3, and 5. The employee must report this amount on the Form 1040 as an addition to wages
4	Employer	Third-Party	Reasonable Moving Expenses	Yes	None
5	Employer	Third-Party	Pre-move house hunting expenses; temporary living expenses after starting work in the new location; and qualified real estate expenses.	No	Form W-2, Wages, Tips, and other Compensation, Boxes 1, 3, and 5. The employee must report this on the Form 1040 as an addition to wages

Payments made to individuals prior to their official start date may be reported on an IRS Form 1099.

Diagram 2



From the IRS Instructions for the Form W-2:

Moving Expenses – Report moving expenses as follows:

- Qualified moving expenses that an employer paid to a third-party on behalf of the employee (for example to a moving company) and services that an employer furnished in kind to an employee are not reported on Form W-2.
- Qualified moving expense reimbursements paid directly to an employee by an employer are reported only in Box 12 of Form W-2 with Code P.
- Nonqualified moving expense reimbursements are reported in Boxes 1, 3, and 5 of Form W-2. These amounts are subject to federal income tax withholding and Social Security and Medicare taxes.

Code P – Excludable moving expense reimbursements paid directly to employee. Show the total moving expense reimbursements that you paid directly to your employee for qualified (deductible) moving expenses.

APPENDIX C. MANAGEMENT RESPONSE

Smithsonian Institution

Date September 21, 2007

To A. Sprightley Ryan, Inspector General

cc Sheila P. Burke, Deputy Secretary and Chief Operating Officer
John E. Huerta, General Counsel
Thomas Ott, Acting Chief Executive Officer, Smithsonian Business Ventures
Charles R. Alcock, Director, Smithsonian Astrophysical Observatory
Eldredge Bermingham, Acting Director, Smithsonian Tropical Research Institute

From Alice C. Maroni, Chief Financial Officer
Andrew J. Zino, Comptroller
James D. Douglas, Director/Officer of Human Resources

Subject Response to Draft Audit report on the Administration of Relocation and Recruitment Payments, Number A-07-04

Thank you for the opportunity to respond to this audit report on the Administration of Relocation and Recruitment Payments. The Office of the Comptroller identified this problem nearly two years ago and began a process to reform Smithsonian policy and practice. A number of policy options were considered and interim policy guidance was issued by the Chief Financial Officer in June 2007.

The following comments address the specific recommendations made in the report by the Office of Inspector General.

Recommendations:

We recommend that the Chief Financial Officer:

1. Amend existing policies and procedures to clarify the acceptable payment methods for relocation and recruitment transactions, specify payment limitations, and reemphasize transaction coding instructions. The policies and procedures should also address waiver exceptions and prohibit the use of employment letters as a substitute for service agreements.

   Response: Concur. The Office of the Comptroller (OC) Financial Policies and Procedures Division (FPPD) will revise existing policies and clarify the acceptable payment methods, payment limitations, and coding for relocation and

recruitment transactions. The policy will also be amended to address the issue of waivers to policy, and will require the use of service agreements in all applicable instances.

Target completion date: December 31, 2007

2. Strengthen user training for recording, processing, and reporting of relocation and recruitment payments.

   Response: Concur. FPPD will develop training materials and disseminate the necessary information for recording, processing and reporting of relocation and recruitment payments to unit personnel.

   Target completion date: December 31, 2007

3. Cease offering moving expense reimbursements to new employees, except in limited circumstances where justified, and instead only offer lump-sum recruitment payments.

   Response: Concur. The Institution will cease offering moving expense reimbursements to new employees, limiting payments to new employees to lump-sum payments, except in limited circumstances where justified.

   Target completion date: October 1, 2007

We recommend that the Comptroller:

4. Report corrected information to the IRS on the appropriate forms for those employees that we identified.

   Response: Concur. The Comptroller will confer with the General Counsel and based on his guidance will report the appropriate corrected information to the IRS.

   Target completion date: December 31, 2007

We recommend that the Director of the OHR or his senior-level designee:

5. Approve all relocation and recruitment service agreements for Smithsonian's federal and trust employees in writing and maintain a central file of all such agreements.

   Response: Concur. The OHR will approve all relocation and recruitment service agreements in writing, and maintain a central file of all such agreements.

   Target completion date: October 1, 2007

APPENDIX D. CONTRIBUTORS TO THE REPORT

The following individuals from the Smithsonian Office of the Inspector General contributed to this report:

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