



In Brief

Friends of the National Zoo Revenue Operations Report Number A-06-01, August 28, 2007

Why We Did This Audit

Friends of the National Zoo (FONZ) is a nonprofit organization governed by a member-elected Board of Directors. FONZ has an agreement with the Smithsonian to operate the concessions at the National Zoological Park (Zoo), the net proceeds from which are to be used exclusively for the benefit of the Zoo.

The Zoo's Deputy Director requested that we evaluate FONZ's revenue operations. Our objectives were to determine whether FONZ is managing the Zoo's revenue operations in the most efficient and profitable manner.

What We Recommended

We made 16 recommendations to strengthen FONZ's revenue operations by improving financial performance, operational effectiveness, and the visitor experience.

Except for investment policy oversight by the FONZ Board of Directors, management generally concurred with the report findings and recommendations. Based on improvements already implemented by FONZ's new Executive Director, we are closing 7 of the 16 recommendations

What We Found

FONZ has made significant contributions to the Zoo. It promotes quality educational programs for the public, generates profits from its concessions and parking operations, and marshals hundreds of volunteers who help support many important functions for the Zoo. Nonetheless, we identified numerous areas where FONZ can improve its revenue-generating operations by:

- Strengthening its retail inventory management practices through ensuring optimum stock levels and reducing the cost of goods sold.
- Increasing the use of carts, tents, tables, and other temporary structures to supplement the lack of permanent square footage available for retail and to complement food and beverage offerings.
- Streamlining its overall retail staffing structure.
- Establishing aggressive financial targets for revenue and net contribution growth and exploring all options for achieving these targets.
- Enhancing the quality of the visitor experience through improving its customer service training and continuing efforts to better assess customer satisfaction.
- Reexamining the free parking policies for Zoo and FONZ employees as well as FONZ members.
- Developing, documenting, and monitoring policies and procedures in accordance with the current needs of the organization.
- Ensuring the master plan that is under development reflects the needed expansion of retail, food and beverage, and parking facilities, as well as the addition of other entertainment amenities.

During the course of our audit, FONZ management, working with its Board, adopted a new strategic plan that will focus on improving the visitor experience, enhancing partnerships with stakeholders, and achieving organizational excellence.

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>.



Office of the Inspector General

Date August 28, 2007

To Cristián Samper K., Acting Secretary
Robert J. Lamb, Executive Director, Friends of the National Zoo
M. John Berry, Director, National Zoological Park
Robyn S. Kravit, President, Board of Directors, Friends of the National Zoo
William W. Brubaker, Director, Office of Facilities Engineering and Operations

cc Sheila P. Burke, Deputy Secretary and Chief Operating Officer
Thomas Ott, Acting Chief Executive Officer, Smithsonian Business Ventures
Ira Rubinoff, Acting Under Secretary for Science
Mary R. Tanner, Deputy Director, National Zoological Park

From A. Sprightley Ryan, Inspector General

Subject Audit of Friends of the National Zoo Revenue Operations, Number A-06-01

Attached please find a copy of our final report on our Audit of Friends of the National Zoo (FONZ) Revenue Operations.

We made 16 recommendations to strengthen FONZ's revenue operations. Over the past year, the new Executive Director has implemented many improvements, and therefore we are closing seven of these recommendations.

Our report includes additional observations on the agreement between FONZ and the Smithsonian. We suggest the agreement be amended to clarify the provisions regarding concessions fees.

Please call me on 202.633.7050 or email me at sprightley@oig.si.edu if you have any questions.

AUDIT REPORT

**Friends of the National Zoo
Revenue Operations**

Number A-06-01

August 28, 2007



Smithsonian Institution

Office of Inspector General



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From A. Sprightley Ryan, Inspector General

Subject Audit of Friends of the National Zoo Revenue Operations, Number A-06-01

At the request of the Deputy Director, National Zoological Park (Zoo), we conducted an audit of the Friends of the National Zoo (FONZ) to determine whether FONZ is managing revenue operations in the most efficient and profitable manner.

FONZ is a nonprofit organization governed by a member-elected Board of Directors. Its sole purpose is to provide support to the Zoo. FONZ has an agreement with the Smithsonian to operate the concessions at the Zoo, the net proceeds from which are to be used exclusively for research and educational work for the benefit of the Zoo. In the most recent FONZ-Smithsonian agreement, Smithsonian Business Ventures (SBV) was given primary responsibility for overseeing the FONZ-managed concession activities.

The National Zoo is one of only three large zoos in the country that does not charge admission. While the Zoo relies primarily on the federal government for its funding, it also depends heavily on net proceeds from FONZ-managed revenue operations. FONZ obtains its resources by direct fund-raising efforts, volunteer programs, membership programs, and by operating the merchandise, food, and parking concessions at the Zoo. Money provided by FONZ supports conservation and biological education programs. FONZ also funds grants to Zoo scientists; assists the Zoo in developing new exhibits; and offers information and other services to Zoo visitors.

Through its various operations, FONZ generated operating revenue in FYs 2005 and 2006 of approximately \$13.9 million and \$17.3 million, respectively. The largest revenue-producing activities are merchandise, food service, membership, and parking, as shown in the following table:

Major Revenue Operations

Program*	FY 2005	FY 2006
Merchandise	\$4,159,426	\$5,687,401
Food Service	\$3,814,496	\$4,530,318
Membership	\$2,165,117	\$2,360,390
Parking	\$2,151,796	\$2,533,979

*According to FONZ, in FY 2006, fundraising events generated \$1,215,965 and picnics and parties generated \$668,207.

To evaluate the operating efficiency and profitability of FONZ's revenue operations, we met with Zoo and FONZ officials; toured Zoo concession areas; and reviewed FONZ's internal controls, financial data, and information on the Zoo's ten-year master plan. We also visited seven large zoos in the East and Midwest areas of the country to observe their revenue operations. Through a survey we developed, we obtained data on revenue operations from a number of other zoos as well as Smithsonian Business Ventures and compared key financial metrics to FONZ's operating results.¹ We focused our analysis on 2003 through 2005 as this was the most current data available at the time we conducted our fieldwork. Since the completion of our fieldwork, 2006 data for FONZ has become available and FONZ has indicated that, in comparison to the other years in our analysis, it was a very successful year. A more detailed discussion of our scope and methodology is included in Appendix A.

Appendix B contains additional charts and information comparing FONZ to other zoos and SBV. Please note that comparisons throughout this report relating to cost of sales, direct labor, and net contributions are shown as a percent of revenue, unless otherwise stated.

¹We did not verify the accuracy of the survey data provided by respondents for our analysis. We made certain adjustments to respondent data to improve comparability.

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RESULTS IN BRIEF

FONZ has provided significant contributions to the Zoo over the years. It promotes quality educational programs for the public, generates profits from its concessions and parking operations, and marshals hundreds of volunteers who help support many important functions for the Zoo. Nonetheless, we identified numerous areas where FONZ can improve its operations.

FONZ could increase sales and reduce expenses in its merchandise operations by strengthening its inventory management practices, increasing retail square footage, and streamlining its management and staffing structures. Further, the FONZ Board of Directors and the Zoo should explore all options, including the feasibility of outsourcing merchandise operations, to enhance profitability. We also noted that store presentation needed to be improved, and by the end of our audit, we observed that FONZ had made significant improvements in this area.

While FONZ's food and beverage revenues have generally been lower than those of the peer survey average,² FONZ has generated moderately higher net contributions³ owing to the lower cost of its food sales. FONZ can grow net contributions from its food services and improve the quality of the visitor experience by expanding the use of its small permanent food and beverage locations as well as its portable carts.

In addition, FONZ should explore using carts to expand the variety of food items offered. Chart 1 shows FONZ's net contribution performance compared to the peer survey average for both its merchandise and food and beverage operations.

We believe FONZ could also increase its net contribution to the Zoo by improving customer service in its merchandise and food service operations. FONZ and the Zoo need more comprehensive data about visitor experiences. Customer service feedback on FONZ's operations should be centralized and FONZ and the Zoo should establish a coordinated process for documenting and evaluating comments and the results of follow-up efforts related to customer complaints. FONZ needs to place more emphasis on providing outstanding customer service in the training it provides to management and permanent staff as well as to seasonal employees.

Chart 1

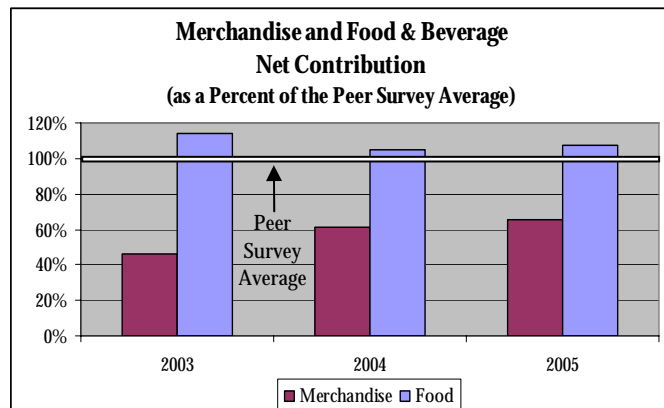


Chart 1 depicts merchandise and food service in relation to their peer survey averages and are not meant to be compared to one another.

² Peer survey averages were computed based on our survey of 32 large zoos, with 18 respondents. The peer survey averages only include those zoos that operate their own concessions, which amounted to approximately ten for merchandise and eight for food service.

³ Net contribution is sales revenue less cost of goods sold, direct labor expenses and other direct expenses. Other direct expenses were not fully comparable to other entities because of differences in expense structures and allocation methods.

Parking spaces at the Zoo are inadequate during peak months. FONZ and the Zoo, in consultation with the Secretary, should examine two options for increasing parking revenues: they should reevaluate the policy of allowing free parking for FONZ and Zoo employees and others, and reexamine the unlimited free parking currently enjoyed by FONZ members.

We observed two areas where governance over FONZ’s operations can be improved. The first concerns the way policies and procedures are developed, approved, and documented. The second concerns how FONZ’s Board monitors policy implementation.

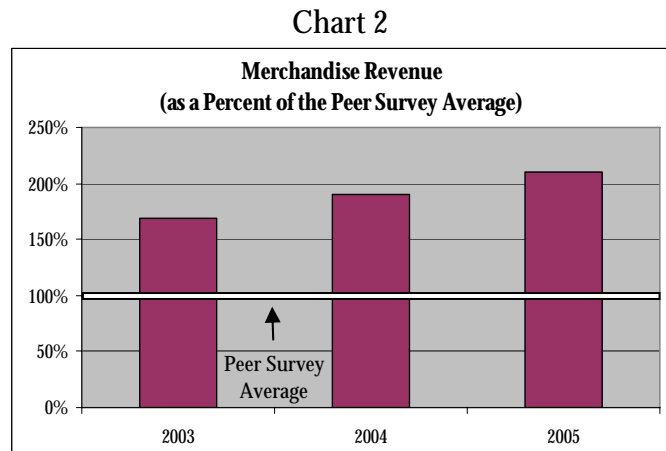
Finally, looking to the future, we considered the Zoo’s ten-year master plan, which it has been developing since early 2005. The master plan is essentially a blueprint for updating the Zoo’s infrastructure and revitalizing its exhibits. Preliminary cost estimates range from \$500 million to \$600 million. We identified four areas that could dramatically increase future revenues and enhance the quality of the visitor experience: the expansion of retail facilities, the expansion of food and beverage operations, the expansion of parking facilities, and the addition of other entertainment amenities that have been proven revenue-producers at other zoos. It is critical that the Smithsonian fully explore these opportunities to maximize revenue for the Zoo. These facilities need to be included in the master planning process from the outset. Building large, sustainable revenue-generation into the design now will help maintain the Zoo at a world-class level well beyond the initial ten-year planning horizon.

We are making 16 recommendations to strengthen FONZ’s operations and the oversight of its activities.

RESULTS OF AUDIT

Merchandise Operations

Because the Zoo enjoys one of the highest visitor attendance levels of any U.S. zoo, estimated at about 2 million annually, FONZ has been able to generate merchandise sales that far surpass the peer survey average (see Chart 2). Nonetheless, its high cost of goods sold (COGS) and direct labor expenses make for net contributions that were far below the peer survey



average. FONZ could increase sales and reduce expenses by improving how it manages its merchandise operations. Specifically, FONZ should strengthen its inventory management practices, increase retail square footage, reexamine its management and staff structure, and improve store presentation.

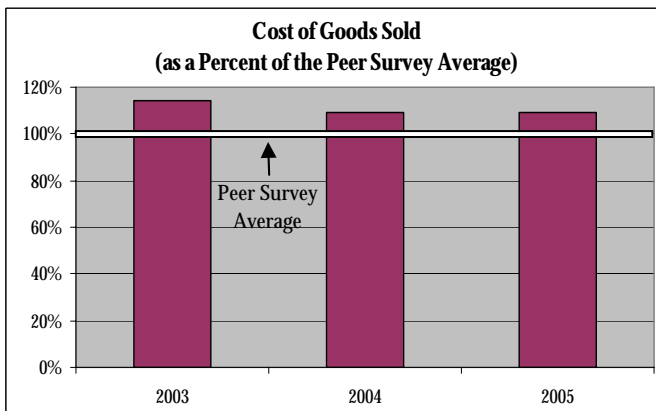
We also compared FONZ's merchandise operations to SBV's and found that FONZ generated higher net contributions relative to revenues, but by other measurements, FONZ performed both better and worse between 2001 and 2005. See Appendix B for additional details.

Strengthen Inventory Management Practices

FONZ needs to strengthen its inventory management practices. We found that FONZ had not developed meaningful inventory aging reports and lacked formal written policies to improve sales of slow-moving merchandise. FONZ is performing some analyses of its merchandise mix, but we noted that improvements could be made. For example, a consultant retained by FONZ observed in 2007 that the overbuy of some merchandise classifications needed to be kept under control and that other merchandise mix allocations should be reevaluated. According to FONZ's software provider, a customized aging report could be designed for a fee of about \$2,000. We believe that use of a comprehensive aging report would enable FONZ to manage its inventory more effectively.

We also noted weaknesses related to the inventory turnover rate and COGS. FONZ's inventory turnover in 2004 and 2005 was 18 to 19 percent less than the peer survey average, a factor in FONZ having profitability below the average. However, we did note that FONZ significantly improved its inventory turnover rate in 2006.

Chart 3



FONZ's COGS exceeded the peer survey average for all 3 years in our survey (see Chart 3). For example, in 2005, FONZ exceeded this average by 9 percent. If FONZ's COGS had been at the peer survey average, its net contribution would have increased by approximately \$160,000.⁴

A 2007 assessment by an independent retail merchandising consultant also identified deficiencies in FONZ's management of its merchandise operations. The consultant concluded that FONZ's inventory planning and controls were weak and its merchandise assortment was too broad, and recommended reducing non-productive merchandise styles, thereby decreasing related inventory costs. For example, the consultant observed that 47 percent of the inventory generated the bottom one-third of sales dollars, while only 14 percent of the inventory was invested in styles (types of merchandise) generating the top one-third of sales dollars. The consultant's analysis also identified missed sales, reporting that nearly half of FONZ's top 50 items were out of stock or had less than three

⁴ We note that a high COGS as a percent of revenue could indicate either a higher price paid for merchandise or an insufficient retail mark-up.

weeks' supply on hand. Additionally, 5 of the top 10 items were out of stock or had under two weeks' supply. Further, staff in the merchandise operation was viewed by the consultant as not motivated and the retail executive team appeared to lack merchandising skills.

During our fieldwork, we also noted that FONZ should examine whether it could improve its margins with more efficient sourcing. For example, because FONZ and SBV sell similar items, such as panda bear plush items, we suggested that FONZ and SBV pursue joint purchasing efforts to take advantage of volume discounts as well as other related benefits. The then-president of SBV's museum retail operations agreed to explore a joint purchase program. Partnering with SBV would also further help FONZ's stated strategic goal of collaboration with the Zoo and the Smithsonian to "maximize the combined strengths of all."

Increase Square Footage of Retail Space

As has been pointed out by various consultants, current limitations on retail space hamper FONZ's ability to increase revenues from merchandise operations. FONZ should develop a short-term plan to address this issue. In the longer term, FONZ, in coordination with Smithsonian management, must fully integrate the locations and designs of its retail merchandise and food operations into the Zoo's ten-year master plan to maximize net contributions for the Zoo.⁵

Currently, FONZ has approximately 3,700 square feet of permanent retail space, while the peer survey average is approximately 6,500 square feet. A 2002 consultant's study concluded that FONZ's retail space was insufficient for the Zoo's existing visitation levels and that it needed 6,300 square feet. We noted that FONZ's 2005 sales per square foot were three times the peer survey average. While this may be a positive indicator, according to the *Museum Retail Industry Report 2004* it could also indicate a need for more space.

In the short run, FONZ should increase efforts to expand the use of carts, tents, tables, and other temporary structures to supplement the lack of permanent square footage available for retail. An independent retail merchandising consultant similarly noted recently that FONZ should add overall square footage via new shops and/or carts and kiosks. Particular attention should be given to strategically locating facilities around the new animal habitats in Asia Trail I and the elephant habitat as part of Asia Trail II. We expect that there will be a spike in visitors when Asia Trail II opens to the public, creating significant sales opportunities.

In their plans for long-term retail growth, FONZ's Board of Directors and the Zoo should also fully explore the benefits of outsourcing FONZ's retail merchandise operations. Other zoos we visited or surveyed that used third-party entities to run their merchandise operations generally had positive experiences. For example, one zoo stated that "merchandise sales through our vendor have grown significantly." Another zoo

⁵ We discuss the longer-term issues in more detail in the report section on the master plan.

responded that once retail operations were transferred to an outside vendor they received “positive revenue payback and (the) vendor has made significant improvements to (our) retail stores.” Moreover, according to a contract proposal provided to FONZ by a specialty retailer in 2005, the retailer would have provided FONZ one-time payments totaling up to \$899,000 and annual net contribution increases of 11 to 19 percent over what FONZ was generating from its own merchandise operations. After analysis, FONZ viewed the proposal as highly speculative and rejected it.

Regarding financial accountability and transparency for FONZ’s concessions, we observed that the Board minutes often compared performance against annual budgets. However, we saw little evidence in the minutes that the Board held FONZ management accountable for meeting long-range financial or performance goals. FONZ’s former Executive Director noted that he had not developed any strategic plans, but that FONZ was incorporated in the Zoo’s strategic plan. FONZ recently established new Goals and Strategic Priorities indicating that a 2007-2010 operational plan will be presented to the Board. Furthermore, FONZ intends to define the means to measure, monitor, and improve performance for each goal and component area. In our view, aggressive financial targets need to be established for achieving and sustaining long-term growth and should be used as benchmarks to evaluate FONZ’s performance and the benefits of outsourcing.

Streamline Overall Staffing Structure

FONZ should reexamine its overall staffing structure, which seemed top-heavy. Generally, FONZ’s direct labor expense as a percentage of revenue has been higher than the peer survey averages. For example, in 2005, the number of FONZ managers supporting merchandise operations was 55 percent above the peer survey average. At the same time, FONZ’s managers were overseeing 44 percent fewer staff than managers at other zoos.

As another example, one zoo we visited, with similar revenues, had an executive-level manager, three store managers, and a part-time clerical employee. In contrast, FONZ had two executive-level managers, four store managers (including an assistant manager), a buyer, a full-time clerical employee, and retained the services of an outside merchandise consultant to supplement its management.

In our view, FONZ has an opportunity to increase net contribution by reevaluating its staffing structure. For instance, FONZ could compare its management and staff resources to other zoos with similar revenues. FONZ agreed that this area requires further analysis and indicated that it would review its staffing structure.

Improve Store Presentation

At the time of our audit fieldwork, FONZ needed to substantially improve the presentation of merchandise in its stores. During a walkthrough of FONZ's stores with the then-president of SBV's retail operations, we observed long lines due to few cash registers, customers having difficulty walking through crowded aisles, and some shelves that were overloaded with merchandise while others were empty. On another visit, we noted boxes of merchandise stacked on the store floor while some shelves were empty and employees were conversing outside the front of the store. A 2007 assessment of FONZ's retail operations by an independent retail merchandising consultant also concluded that FONZ's merchandise presentation could be improved and that its stores were poorly maintained.



2006 FONZ display - empty fixtures, unattractive merchandise display, damaged wall



2007 FONZ display - stocked fixtures, attractive merchandise display, fresh paint

continue to reevaluate its floor designs and layouts, fixtures, and overall visual presentation.

At the exit conference we toured the two largest retail facilities at the Zoo with FONZ management and noted that significant improvements had been made to the presentation of these stores. FONZ also added a cash register to its largest store. According to FONZ's Executive Director, one of the refurbished stores has realized a 12 percent increase in sales as compared to the same period last year, and FONZ will

Recommendations

To strengthen management of FONZ's merchandise operations, we recommend that the Executive Director, FONZ:

1. Develop detailed inventory aging reports and perform appropriate analyses to ensure optimum stock levels and improve overall inventory management.
2. Determine why FONZ's COGS appears to be higher than the peer survey average and make appropriate changes as necessary, including possible joint purchasing opportunities with SBV.

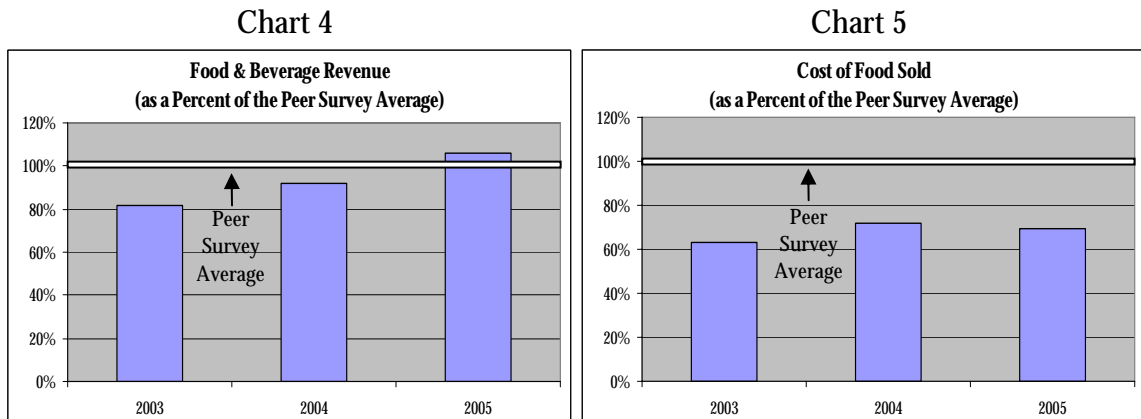
3. Increase efforts to expand the use of carts, tents, tables, and other temporary structures to grow merchandise net contributions.
4. Reexamine FONZ's overall staffing structure and make adjustments as warranted.

To maximize net contributions from merchandise operations, we recommend that the FONZ Board of Directors and the Zoo:

5. Establish aggressive, but achievable, financial targets for revenue and net contribution growth and explore all options, including the feasibility of outsourcing merchandise operations, for achieving these targets.

Food Service Operations

While FONZ's food and beverage revenues have generally been lower than the peer survey average (see Chart 4), FONZ has generated higher than average net contributions from food service because of its lower cost of food sales (see Chart 5). Based on the limited third-party concessionaire data provided by SBV (data that accounted for about one third of SBV's total food revenues), we noted that FONZ produced net contributions that were double SBV's.⁶



Nonetheless, we believe that FONZ can increase net contributions from its food services by expanding the use of its small permanent locations as well as portable carts. To do so, FONZ should employ a more effective strategy for staffing the facilities, especially during peak months, and consider offering a wider variety of food. According to discussions with FONZ officials, a key approach to staffing its food services has been to recruit students from the inner city. FONZ also employs other methods of recruiting, such as job fairs and newspaper and online job postings. However, FONZ still had not succeeded in obtaining adequate resources to open many of its food service locations. For example, according to FONZ's Director of Food Service, in 2006 FONZ needed 108 food service employees to staff all food service locations fully but was only able to fill 70 positions. Excerpts from visitor letters we reviewed also reinforce the need to focus attention on expanding food

⁶ SBV's "net contribution" refers to the percentage of gross food sales (less discounts) received by SBV from its third-party concessionaires.

and beverage services. One April 2006 visitor wrote that “the lack of water available for purchase is pathetic.” Another frustrated customer during a peak month vented to us that she had to wait in line a long time for water because the vending machines were not stocked. FONZ’s inability to staff its food services adequately translates into lost opportunities to grow profits as well as negative visitor experiences.



Un-staffed FONZ food stands during 2006 peak season

FONZ also should explore using smaller locations and carts to expand its variety of food items. A 2002 consultant study similarly recommended that FONZ expand its cart program. Currently, the majority of FONZ’s food sales are from the standard hot dogs, hamburgers, chicken nuggets, pizza, and popcorn fare. Other zoos we visited offered a much wider variety of foods such as made-to-order wraps, culturally diverse dishes, branded ice cream products, fresh-cut potato chips, homemade fudge, and fresh-squeezed lemonade.



Columbus Zoo’s offerings include spring rolls, teriyaki chicken, and General Tso’s rice bowls

We found that many zoos contract out at least some of their food services, particularly portable carts, and have reaped significant financial benefits.

Third-party concessionaires can provide quality specialty food offerings and generate increased cash flow. For instance, one zoo in our survey stated that outsourcing carts resulted in a doubling of cart

FIESTA MEXICANA			
Nachos Grande	4.95	Taco Platter	6.50
Cheese Nachos	3.95	Choice of beef or chicken tacos on corn or flour tortillas with Spanish rice and beans, salsa, and sour cream	
Chicken Torta	5.95	Tamales Platter	6.50
Steak Torta	6.95	Choice of tamales with Spanish rice and beans.	
Burrito	5.50	Burrito Platter	6.50
Tacos	4.95	Choice of beef or chicken with Spanish rice and beans, salsa, and sour cream	
Taco Salad	6.25		
Choice of beef or chicken with cheese, pico de gallo and hot peppers			
Chicken Quesadilla	5.95		
Cheese Quesadilla	4.50		

Lincoln Park Zoo offers Mexican dishes



Saint Louis Zoo's fresh potato chip stand illustrates use of third-party concessionaire

revenues. FONZ told us that in the past they had attempted to use third-party concessionaires on a temporary basis to provide supplemental food service, but because of other events occurring around the District, they had difficulty acquiring services. We believe that pursuing seasonal or longer-term contracts with third-party concessionaires for supplemental food service could help solve FONZ's recruiting problems, create an opportunity to provide visitors with a better variety of food offerings, and yield more profits for use in expanding the Zoo's educational and conservation programs.

At the time of our exit conference, we took a tour of some areas of the Zoo with FONZ management and noted that there was an increased cart presence from third-party concessionaires, including specialty items such as gelato and fresh-squeezed lemonade. FONZ acknowledged the difficult challenges in recruiting concessions staff and indicated that it is evaluating its recruiting program and taking steps to recruit and retain quality employees in sufficient numbers.



FONZ recently added new third-party concessionaire carts for fresh-squeezed lemonade and snacks

Recommendations

To increase food and beverage revenues and improve visitor services, we recommend that the Executive Director, FONZ:

6. Expand the use of its small permanent locations and portable carts by developing a more effective strategy for staffing the facilities and serving a wider variety of food items at these locations.
7. Increase efforts to award seasonal or longer-term contracts to third-party concessionaires for supplemental food services.

Customer Service

We believe FONZ could increase net contributions from merchandise and food operations by enhancing the quality of the visitor experience. FONZ and the Zoo obtain customer satisfaction data through a variety of sources including visitor surveys conducted by an outside consultant and “secret shopper” reports. Visitors also communicate their experiences through comment cards, emails, and letters. Based on these sources of feedback and our own observations, customer service could be improved. Further, we found that FONZ lacked a disciplined process for handling and learning from customer feedback.

For merchandise operations, a visitor survey performed by an outside consultant in the fall of 2004 (the latest year available) found that employee courtesy had improved since that summer. Nonetheless, FONZ fell far below the averages of other zoos in this survey for scores related to merchandise quality, price, and percentage of visitors making purchases. Moreover, we note that for the Zoo to “be the world’s finest,” FONZ will need to achieve higher levels than the averages.

Secret shopper reports for 2005 and 2006 showed that employee courtesy towards visitors needed improvement. For instance, in 2005, FONZ store employees did not greet one in four secret shoppers in a friendly manner. In 2006, FONZ cashier and floor employees failed to greet secret shoppers in a friendly manner 31 percent and 44 percent of the time, respectively. More than one in four secret shoppers were not encouraged to visit again or given a friendly goodbye by FONZ cashiers.

Regarding food service, a visitor survey from 2004 (the latest year available) documented that food lines were too long, many food facilities were closed, and beverage vending machines were not operating. FONZ scores for food price and quality were below the averages of other zoos. For example, on food prices, only 3 percent of Zoo visitors gave FONZ the highest rating, versus the 28 percent average of other zoos in the survey. Twenty-one percent of Zoo visitors gave food quality an excellent rating compared to the benchmark of 52 percent. It appears to be making progress. We noted that the 2006 secret shopper reports showed that 46 percent of secret shoppers gave food taste an “outstanding” rating and 49 percent gave it a “good” rating. Again, FONZ should strive to surpass the average ratings for other zoos to accomplish its strategic goals.

Secret shopper reports for 2006 generally indicated that FONZ food employees were attentive, knowledgeable, and tendered transactions properly. However, one in five secret shoppers was not greeted in a friendly manner or thanked after the transaction. Further, between 2005 and 2006, secret shopper scores reflected a general decline in cleanliness of the food facilities. We experienced much the same during our visits to the Zoo, observing long lines and unkempt areas at the Mane Restaurant. A summer 2006 visitor complained that “your employees working at the gift shop and snack stands were rude and were more interested in talking with each other than waiting on the customers.”

We also found that there was no effective process for documenting and evaluating visitor feedback on FONZ's operations or for the follow up and resolution of associated customer complaints because the information was dispersed to many offices without any centralized tracking. FONZ was unable to provide any visitor comment cards to us because it disposed of the cards after review. FONZ also could not provide any evidence of required log-in or aggregated data used to analyze problems communicated through comment cards, emails, or letters. In our discussions with FONZ's former Executive Director, he indicated that the complaints were usually about issues FONZ already knew about. Yet the Zoo and FONZ could provide only limited information on follow-up actions to correct the deficiencies and to communicate to the visitors. Further, while secret shopper results were routinely discussed during management and staff reviews, according to FONZ officials, performance goals for customer satisfaction were not established in employee performance plans. Consequently, we found a lack of accountability for timely resolution and lasting correction of customer service shortfalls.

According to best practice, creating a customer feedback system provides an opportunity to discover potential problems early and begin to correct them. To be effective, however, gathering and measuring customer feedback must be consistent, and the results must be reviewed frequently. For example, over time, comment cards can help management gauge the quality of both the service and food from the customer's perspective.

Both the Zoo and FONZ have made it a strategic goal to ensure that every visitor is provided with outstanding customer service and amenities. To reach this goal, FONZ needs to ensure that the formal and refresher training provided to management, permanent staff, and seasonal employees places more emphasis on providing outstanding customer service. We noted that FONZ offered one basic training class a year, and, according to the former Executive Director, this training was conducted differently each year. One manager noted that increased employee incentive programs such as perfect attendance or employee-of-the-month awards could help to improve performance. Increased training and incentive programs could also help FONZ achieve its stated goal of "maintaining competitive business practices, setting objectives and rewarding success, and providing developmental and leadership opportunities." In addition, having well-defined standards for the visitor experience enables organizations to better hold managers and staff accountable for performance.

The current Executive Director stated that FONZ will develop a new training program based on recently adopted customer service standards. Further, he indicated that FONZ is developing a concessions staff enrichment program to provide behind-the-scenes animal tours and other opportunities to connect staff more closely with the Zoo. FONZ also is working with the Smithsonian's Office of Policy and Analysis to design, administer, and analyze visitor surveys on a regular basis.

Recommendations

To improve visitor services, we recommend that the Executive Director, FONZ and the Zoo Director:

8. Continue to improve customer service training opportunities and incentive programs for permanent and seasonal retail and food operations staff, and have the training stress courtesy to visitors and keeping facilities clean and organized.
9. Establish a process for documenting and evaluating visitor feedback on FONZ's operations and the results of follow-up efforts to resolve customer service issues.

Opportunities Exist to Increase Parking Revenues by Curbing Free Parking

FONZ's parking revenues topped \$2.5 million in FY 2006, an increase of nearly \$400,000 from FY 2005. The increase mainly reflects growth in the number of Zoo visitors as well as the full-year effect of a 2005 rate hike to a maximum of \$16 for parking of three hours or more. We identified two areas FONZ and the Zoo should examine that, in our opinion, could yield even greater revenues from parking. The first involves a reevaluation of the policy allowing free parking for FONZ and Zoo employees and others. The second area requires an examination of the unlimited free parking benefits enjoyed by FONZ members.

In reviewing the peer survey responses, we noted that other zoos averaged nearly 2,000 visitor parking spaces. In contrast, the National Zoo has fewer than 900 spaces, the second lowest in our survey, even though the Zoo's visitation levels are among the highest of its peers. Because of the limited parking spaces available, FONZ's website advises visitors that during peak months the parking lots fill up early in the morning. Consequently, we believe that FONZ needs to fully explore opportunities for opening up additional parking spaces for paying visitors.

On the first issue, during a fiscal year 2005 audit of parking,⁷ we noted six categories of visitors that received free parking: Zoo employees, FONZ employees, FONZ members, FONZ volunteers, vendors, and guests attending special events. ***When totaled, up to 30 percent of the vehicles parked in the Zoo lots did not pay parking fees.*** To our knowledge, other District-based Smithsonian units do not routinely provide free parking to their employees. In our view, during peak periods, free employee parking at the Zoo should be restricted. During off-peak periods, when parking spaces typically go unused, free employee parking could be allowed as an employee benefit without detriment to parking revenues.

The second area that needs examination is the unlimited free parking benefits for FONZ members. We recognize that the relationship between annual membership dues, admission fees, and parking fees is complex. However, the National Zoo is one of only

⁷ ***Parking Operations at the National Zoological Park***, No. A-04-09 (December 27, 2004).

three large zoos that do not charge admission. Moreover, despite a March 2006 rate increase, FONZ charges the lowest dues for household memberships, \$55, versus a range of \$65 to \$99 for household/family memberships at the other seven zoos we visited. The primary membership benefit at most of the other zoos was free admission, while FONZ members cite free parking as one of their most important benefits. We also noted that the two other large zoos that did not charge admission placed limitations on free parking for their members. A couple of zoos we visited also were considering eliminating free parking as a membership benefit; one of these was discussing only offering free parking to members during the off-season. In comparison to its peers, about 40,000 FONZ members enjoy the lowest annual household membership dues, do not pay admission, and receive unlimited free parking.

FONZ officials told us during our audit that FONZ had no current plans to limit free parking for its members but will continue to evaluate member parking benefits in the future. We think the parking issue warrants additional scrutiny. Offering unlimited free parking during the off-peak months and limiting free parking to perhaps one or two visits during peak months (with reduced rate parking for additional visits) would be a good way to provide a valued member benefit while also increasing parking revenues.

Recommendations

In view of the parking constraints at the Zoo, we recommend that the Executive Director, FONZ and the Zoo Director, in consultation with the Secretary:

10. Reevaluate the policy of allowing free parking for FONZ and Zoo employees and others.
11. Reexamine the unlimited free parking benefits enjoyed by FONZ members and consider limiting free member parking during the peak months.

Governance Over FONZ's Operations Needs Strengthening

FONZ's external auditors issued an unqualified opinion on FONZ's financial statements for each year in our review period. And, to its credit, FONZ has generally corrected internal control weaknesses identified by its auditors. However, we identified two areas where governance over FONZ's operations can be improved. The first concerns the way policies and procedures are developed and documented. The second addresses how FONZ monitors policy implementation.

Policies and Procedures

In our opinion, FONZ needs to establish a more disciplined system for developing, approving, and documenting formal policies and procedures for its operations. FONZ did not maintain a central file of current, approved policies and procedures. Instead, individual departments were expected to develop their own procedures on an as-needed basis. Further, while FONZ has written policies addressing many activities, most policies

we reviewed were not formally approved by FONZ's Board of Directors⁸ nor did they evidence executive approval. Formal policies are the tools that management uses to efficiently and effectively control its operations, and it is important for the Board to formally approve key, overarching policies to steer the organization in the desired direction and set the tone from the top. In our view, it is also important for departmental policies and procedures to document executive-level review and approval.

When we asked department managers for copies of their policies and procedures, in some cases we were told that the documents were either being revised or had not been developed. For example, when we requested operating policies on merchandise buying and retail pricing guidelines, FONZ prepared a summary of procedures in use rather than providing us with formally approved written policies and procedures. Additionally, while the food and beverage operation uses a competitive bidding process, there was no written policy requiring and outlining that process. Also, at the time of our request for written procedures, FONZ did not provide us with bank reconciliation procedures and was not consistently performing bank reconciliations in a timely manner. They have since implemented detailed monthly reconciliation procedures.

FONZ also could not provide written policies on access control restrictions for its financial systems. At the time of our review, FONZ allowed full access to its financial system by most business office staff. FONZ's recently hired controller stated that he did not believe the financial system allowed for journal access to be restricted once a user was in the system. However, FONZ indicated that there were mitigating controls in place such as the monitoring and approval of journal entries and reconciliations. While we agree that some mitigating controls exist, we believe that segregation of duties could still be strengthened.

The lack of proper segregation of duties and system access restrictions creates an undue risk that an individual with custody of assets could make accounting entries to hide theft of funds or to cover up shoddy or incomplete books of account. For example, we noted in FONZ's payroll policy one person was assigned payroll duties, but had full access to the accounting system. A payroll technician who prepares the payroll and authorizes disbursement of funds should be restricted from access to the accounting records. At a minimum, this policy should require that another employee enter payroll transactions into the financial system and a supervisor should review and authorize the transaction. Best practices require system access levels to be restricted to the minimum necessary to perform required job duties.⁹ While we recognize that it is difficult for a small office to maintain complete segregation of duties, we believe FONZ has room to strengthen controls by reducing system access privileges for some business office staff.

⁸ FONZ's Board of Directors comprises 24 volunteers from various distinguished backgrounds. The Board, through its six committees, supports FONZ's mission to enhance and promote conservation, education and science at the National Zoo.

⁹ For example, Appendix III to OMB Circular A-130, *Security of Federal Automated Information Resources* addresses restrictions on system access levels.

Oversight of Policy Implementation

FONZ's Board could better document the results of its meetings, and the Finance and Audit Committee should strengthen its oversight of FONZ's internal controls. FONZ could not provide the minutes of its Board meetings for four months of our review period. Further, many Board minutes they did provide were labeled draft and did not have signature approval, and therefore we could not determine if these minutes were final. We noted that most draft minutes included a statement of approval of the prior month's minutes. In addition, FONZ could not provide any minutes for its Finance and Audit Committee meetings.

The Finance and Audit Committee is responsible for budget review, financial statement oversight, internal controls oversight, and investment activity. We identified two areas where committee oversight could be improved. First, during our review of FONZ's external auditor's work papers, we noted that the committee asked FONZ's former Executive Director to perform a risk assessment and submit a written report on the mitigating controls that were in place. While FONZ's former Executive Director told us that FONZ completed an assessment, he could not provide any written documentation of the assessment findings or any related actions taken in response, nor did we find any mention of the assessment results in the Board minutes we reviewed.

Second, while FONZ did develop investment policies, it was not consistently following them. As an example, the investment policy requires the committee to meet quarterly, which they did not. Moreover, FONZ's operating personnel, rather than a committee member, received investment reports and had apparent authority to direct investments. In 2004, after carefully considering proposals from investment firms, the Board approved U.S. Trust as FONZ's investment broker. U.S. Trust established client objectives based on discussions with FONZ. These objectives identified an investment time horizon of "at least 3 to 5 years." This objective conflicts with FONZ's policy requiring capital reserves to be classified in the following manner: up to 1 year, 1 to 5 years, and over 5 years. Because the "at least 3 to 5 years" designation does not fit within FONZ's policy classifications, it is difficult to assess policy compliance.

Today's increased public scrutiny of nonprofit organizations requires greater oversight of operations by their Boards as well as by top management. FONZ's Board and executive management need to ensure that they adopt appropriate policies and procedures and implement them in accordance with the needs of the organization.

Recommendations:

We recommend that the Executive Director, FONZ:

12. Establish a more disciplined system for developing, approving, and documenting formal, written operational policies and procedures and provide oversight to ensure that policies and procedures are implemented as designed.

13. Ensure a proper segregation of duties in financial operations and restrict financial system access to the greatest extent possible.

We recommend that the FONZ Board of Directors:

14. Direct the Executive Director to document a thorough risk assessment and report to the Board on FONZ's system of mitigating controls.
15. Implement oversight procedures in accordance with FONZ's investment policies.

Zoo Master Plan - Vision for the Future

The Zoo has been developing a ten-year master plan since early 2005. The master plan is essentially a blueprint for updating the Zoo's infrastructure and revitalizing its exhibits to provide every Zoo visitor with a world-class educational, exciting, and enriching experience. Preliminary cost estimates range from \$500 million to \$600 million. The Zoo expects funding to be shared between federal and private sources. Since the Zoo resides within the National Capital Region, various agency reviews are required, such as by the National Capital Planning Commission (NCPC). The NCPC is the central planning agency for the federal government and seeks to protect and enhance the extraordinary historical, cultural, and natural resources of the nation's capital. According to the Smithsonian's Office of Facilities Engineering and Operations (OFEO), the NCPC must approve the master plan before it can be implemented.

Because this audit focused on revenue-generating activities at the Zoo, we held discussions with Zoo, FONZ, and OFEO representatives to determine the extent to which revenue-generating operations were being reflected in the master plan. According to these officials, the master planning process was still in its initial stages, and they had concentrated their efforts on infrastructure renewal and facilities. While consultants did perform some studies on visitor amenities and FONZ is a member of the master planning team, the team was not focused on revenue operations. According to OFEO, the master plan process is more of a broad-brush approach and is not intended to be the end of the planning process. The needs identified in the approved master plan will feed the development of more detailed capital project plans. In our opinion, the team should fully integrate revenue operations into the master planning process from the outset to maximize future revenue contributions for the Zoo's conservation and education programs and to develop outstanding visitor services.

We recognize that FONZ and the Zoo need to make difficult decisions in balancing expansion of animal exhibit space with the need to maximize revenues from concessions and other visitor amenities that support Zoo operations. Prior Zoo Directors chose to focus heavily on animal exhibits, which restricted FONZ's ability to generate revenues for the Zoo's programs. For example, according to FONZ, proposed retail space was eliminated in the Zoo's planning and design of the Kids' Farm and Asia Trail I to enhance

the footprint for animals and exhibits. Now, according to Zoo and FONZ officials, paths along Asia Trail I are not wide enough for peak visitation, severely restricting the space available for visitor amenities.

FONZ's Executive Director is currently trying to add certain amenities to the new Asia Trail II project, because they were not fully incorporated in the capital project plan from the outset. Consequently, the completion of these amenities will lag beyond the rest of the project and will potentially result in a less integrated visitor experience. Additionally, late scope changes usually cause delays, increase costs, and create uncertainty and challenges with acquiring necessary approvals from NCPC and other government entities. OFEO agrees that it is crucial to fully integrate revenue operations early in the master planning because all positive and negative impacts from these facilities must be taken into account.

We identified four areas that the Zoo, FONZ, and OFEO should examine more fully in the early stages of planning because they could substantially increase future revenues and enhance the quality of the visitor experience: the expansion of retail facilities, the expansion of food and beverage operations, the expansion of parking facilities, and the addition of entertainment amenities that have proven successful at other zoos.

Expand Retail Facilities. Based on information in a 2002 study performed by a FONZ consultant and using projected visitation figures of three million,¹⁰ we project that by 2016 about 11,000 to 12,000 square feet of retail space – three times the existing facilities – will be needed. A 2005 consultant's study also found FONZ's existing retail configuration deficient. Further, a more recent 2006 National Zoological Park Entry and Transportation Capacity Assessment noted that about 15,000 square feet of retail space would be required to accommodate the same visitation levels, assuming various Metro shuttle alternatives. Accordingly, we believe that the master planning team should fully consider the Zoo's retail space needs in all phases of its redesign of the Zoo. The design, size, and locations of the retail space are crucial to efficient visitor traffic flows, high capture rates, and an enjoyable visitor experience and, consequently, the ability to maximize retail revenue. The design and location of the retail space needs to be strategically selected to complement and further the Zoo's educational and conservation themes and, according to experts we talked to, should be situated as close to exhibits as possible.



Toledo Zoo's retail space located near an animal exhibit features exhibit-related items and other merchandise

¹⁰ Projected visitation of three million is based on the Traffic, Parking and Visitation Study presented in April 2006 to the Master Plan team.

Expand Food and Beverage Operations. The Zoo’s master planning process should include greater consideration of the need to expand food and beverage operations, with an emphasis on special events facilities that include catering amenities. Many of the zoos we surveyed indicated that the largest opportunities for revenue growth were from catering for special events, particularly those of a personal nature such as weddings, birthdays, retirements, and reunions. Other zoos have structures that range from large multi-purpose permanent dining facilities to outdoor covered pavilions that can be configured for picnics or formal occasions. In some cases, corporate donors provided much of the capital to build the facilities.



Saint Louis Zoo’s dining facility with indoor and outdoor seating can also be converted to host special events

These zoos reported 2005 food and beverage revenues from catering in the hundreds of thousands of dollars. One zoo with in-house catering earned revenues of over \$1 million, and some zoos reported a very robust and growing demand for these facilities. In contrast, FONZ reported 2005 revenues from catering of only \$44,000. FONZ is unable to provide much in-house catering for events due to its limited facilities. However, FONZ does host many corporate picnics and parties which are held in rented tents, outdoor areas, and

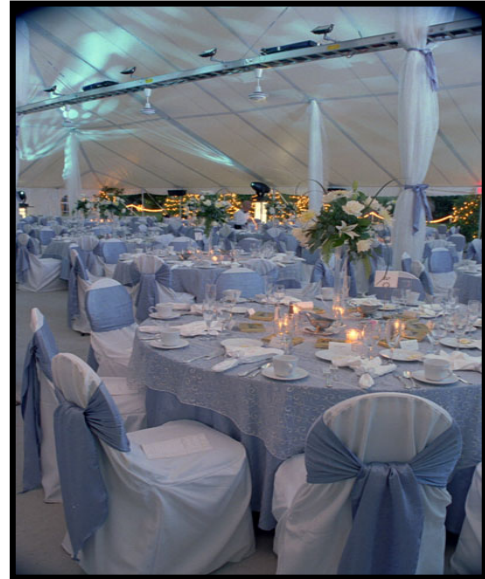


Saint Louis Zoo’s visitor center may be converted to host special events (the building also contains kitchen facilities)

animal or educational buildings, primarily using outside caterers. In 2005, FONZ generated \$564,000 in revenue from hosting picnics and parties. FONZ’s Executive Director noted that FONZ hosts over 110 of these events each year. This further supports our supposition that there is a high demand for special event facilities with the potential for generating additional profits by providing the catering as well.

In our opinion, having world-class special event facilities will not only benefit FONZ and the Zoo by generating sizeable profits for education and conservation efforts, but will also enhance fundraising efforts by building a broader public appeal. Increasing such uses also aligns closely with FONZ’s recently published goals and strategic priorities to “develop and host events that attract expanded audiences, strengthening the affiliation of the public with the Zoo” and “strengthen and expand partnerships with corporate, governmental, non-profit, and educational entities.”

We recognize that to expand catering and special events, FONZ and the Zoo will either need to obtain a waiver from the Smithsonian Secretary or succeed in modifying Smithsonian policy that restricts the use of Smithsonian facilities for social events.¹¹ We note that the Institution has granted waivers to the Cooper-Hewitt National Design Museum to host weddings. In our discussions about removing the policy restrictions on hosting social events for the Zoo, management expressed many concerns, including, in part, additional labor costs to run the events; facilities security and maintenance expenses; payment of unrelated business income tax; maintaining political neutrality; over-commercialization; and animal welfare. While these are all valid and significant concerns, we believe that the proper design and location of the facilities – integrated early in the master planning process – combined with appropriate policy restrictions (on political functions for example) can mitigate these concerns. Certainly, a credible business plan will need to be developed that makes a compelling case for the expansion. The Zoo should carefully reexamine this issue and its full potential for the long term.



Saint Louis Zoo's semi-permanent tent facility used to host special events during the period April – October

Expand Parking Facilities. The Zoo must provide for substantially increased parking facilities or other convenient transportation alternatives in its master plan if it expects to attract visitors at the levels projected and deliver a world-class visitor experience. Nevertheless, according to discussions with the Zoo's Deputy Director and other members of the planning team, the master plan will not provide much additional visitor parking, and employee parking will be problematic as well. We noted that a master plan study on parking concluded that at least 2,000 spaces are needed to accommodate the projected attendance levels. And, even with 2,000 spaces, there will still be some days when parking will be insufficient. Yet, the master plan alternatives being considered ranged from no net increase to an increase up to 1,200 total spaces. The overarching assumption is that future attendance will need to be increasingly dependent on public transit. We noted that parking facilities are inadequate during peak times for existing attendance levels of about 2 million. At projected levels of 3 million, demand would exceed existing parking facilities for more than 4 months of the year.

Public transportation has been readily available for many years and surveys have shown that about one-fifth to over half of Zoo visitors already use it. Some studies have also demonstrated that nearly two-thirds of visitors used their cars to visit the Zoo. Families with young children, seniors, and people with physical limitations may have difficulty using public transportation to visit the Zoo. During our visit to the Philadelphia zoo, officials lamented that “their biggest limitation to increasing visitation is parking,” a

¹¹ Smithsonian Directive 401 restricts the use of Smithsonian facilities when the primary purpose is social in nature, such as weddings, birthdays, or retirement parties.

common theme at many of the zoos we visited. In keeping the world-class goal in mind, the Institution needs to reexamine the parking issue and fully evaluate the detrimental effects of not providing sufficient parking or viable alternatives for all of its patrons.

Add Amusement and Entertainment Amenities. While the Zoo is considering adding a carousel, specifics for entertainment amenities continue to evolve as part of the master planning process. We would urge the Zoo to commit to adding a carousel to its planned



Carousel at the Columbus Zoo - Carousels could include sponsored animals and rocking chairs, attached birthday party room, and year-round enclosure



Toledo Zoo's seated amphitheater hosts concerts and other special events

amenities. We note that other zoos are making substantial profits on carousels as well as simulators, concert pavilions and amphitheaters, train rides, seated animal rides, paddle boats, and movie theaters. These amenities not only bring in needed financial contributions, they substantially enhance the enjoyment and educational experience for zoo visitors.

Current draft master plan alternatives include options for a carousel as well as an aerial tram or a surface tram/bus to transport visitors around the Zoo. We note that nearly every zoo we visited had a carousel and some type of train ride. These particular amenities combined earned hundreds of thousands of dollars in free cash flow each year. Additionally, in many cases, donors contributed all the capital costs. Financing also may be structured to periodically bring in renewed capital contributions. Moreover, given the size and hilly terrain of the National Zoo, most visitors would benefit from some type of transportation option to navigate the Zoo's widely dispersed exhibits. Well-chosen stops



Zoo Atlanta's train ride to see exhibits



Lincoln Park Zoo's trackless children's train requires little space

could be matched to key exhibits and be co-located with merchandise and food facilities to further enhance visitor convenience. Some other zoos also had either train rides that circled exhibits and provided an educational tour or small trackless train rides for children.

Recommendations

To increase future revenues and enhance the quality of the visitor experience, we recommend that the Directors of the Zoo and OFEO, and the Executive Director, FONZ, in consultation with the Secretary:

16. Fully examine the following options during the master planning process:
 - a. Expand existing retail facilities to accommodate expected visitation levels and locate new facilities to maximize revenue and convenience for zoo visitors.
 - b. Expand food and beverage operations, especially catering and special event facilities, and obtain needed waivers or modify policy restrictions on hosting social events at the Zoo.
 - c. Fully document ways that future attendance levels will be accommodated either through increased parking or other transportation alternatives.
 - d. Add amusements and entertainment amenities, particularly a carousel and some type of train ride or tram throughout the Zoo to enhance future revenue streams and the enjoyment and educational experience for Zoo patrons.

Observations on the FONZ-Smithsonian Agreement

FONZ and the Smithsonian signed an agreement in 2003 that established responsibilities and expectations for FONZ as well as various Smithsonian stakeholders. Two issues came to our attention during our review that we believe merit management attention. First, the agreement assigns SBV the primary responsibility for Smithsonian management oversight of all FONZ-managed concessions, requires SBV to review and approve any changes in menu, portions presentation, or prices proposed by FONZ. In addition, it requires SBV to approve in advance any contract for third-party vendors to provide retail sales services. Finally, it requires SBV to perform an annual review of FONZ's preventive maintenance program for equipment used by FONZ in its concession activities.

We found that SBV provided little oversight during the period covered by our audit. In an interview, SBV's former Chief Operating Officer indicated that SBV put forth little effort for FONZ. While SBV did provide reviews of parking rates, a food concession proposal, and other areas, SBV's former Chief Financial Officer acknowledged that SBV had minimal involvement with FONZ and had not provided the level of oversight expected in the agreement. Neither SBV nor FONZ were able to provide documentation of any ongoing oversight activities.

The second issue concerns a provision in the agreement that requires FONZ to pay an annual concession fee of four percent of gross merchandise and food sales to the Smithsonian. The agreement, as written, is unclear regarding the intent of this concession fee or where within the Smithsonian FONZ should pay it. In practice, FONZ has been making the payments to SBV, and SBV has included the payments as revenue for purposes of calculating its net gain. We noted that between 2003 and 2006, the cumulative fees amounted to \$1.2 million. In 2006, for example, the fee was \$383,000, and it reduced FONZ's total merchandise and food net contribution to the Zoo by 12 percent.

After reading the agreement, we assumed that the concession fees were in exchange for SBV's required oversight services. However, when we questioned Zoo and FONZ officials on the rationale for the payments, they indicated that the fees were designed primarily to offset services provided by the Smithsonian, such as security, IT equipment and support, utilities, and executive overhead. In our view, if the fees were for SBV oversight, it certainly appears that FONZ has not received commensurate value for its money. If they were for Smithsonian support services, then the fees should have been paid directly to the central trust fund, not funneled through SBV. We suggest the agreement be amended to clarify what the concession fees are for and specify both where the payments are to be made and the basis for the payments, as appropriate.

Summary of Management Response

FONZ's June 18, 2007 and the Zoo's June 15, 2007 responses to our draft report generally agreed with the report's findings and 15 of our 16 recommendations. Management noted that many of the recommendations have been actively addressed or were in the process of being addressed over the past year by new FONZ management. FONZ has improved its operations by reducing nonproductive inventory, enhancing its store presentation, expanding cart and tent food offerings, strengthening customer service training, and employing a more effective strategy for staffing facilities. FONZ indicated that it will continue to use all information and report recommendations to improve FONZ revenue operations and support for the Zoo.

The FONZ Board did not concur with our recommendation regarding the lack of Board oversight on investment policies. FONZ's Executive Director also expressed two chief concerns regarding our observations on FONZ's financial measures. First, FONZ questioned the methodology we employed in comparing FONZ with other zoos because we could not address factors such as differences in size of usable zoo property for parking, amenities, and exhibit space, as well as differences in zoo philosophies regarding zoo amenities or differences in labor and other costs. Second, FONZ noted that the focus of our financial analysis was the period 2003 through 2005 and that because the audit period was dated, the report may give readers the impression that it reflects current conditions and practices.

Since we received the responses in June, we held several follow-up meetings with Zoo and FONZ officials to clarify areas of concern and reach resolution on as many issues as possible, including more details on actions to be taken and target dates for implementation. Management also provided us with substantial, additional documentation to supplement their formal responses, and our summary comments incorporate this additional information. Management's planned actions are as follows:

Recommendation 1. FONZ partially concurs. While FONZ agrees that performing effective analyses is important to ensure optimum stock levels, it does not believe that a specific inventory management tool -- a detailed inventory aging report -- is necessarily the best way to improve inventory management. FONZ has committed to improving its inventory management and provided information on significant actions it implemented during the latter part of our audit. FONZ improved its inventory turnover rate from 2.7 in 2005 to 3.5 in 2006. Moreover, it performed an inventory analysis at the end of 2006 and has taken steps to streamline its inventory. According to FONZ, it reduced inventory levels from a high of \$1.3 million in 2003 to less than \$700,000 as of June 2007. In addition, FONZ reviews monthly inventory reports to ensure its best sellers are properly stocked and slow selling items are marked down. FONZ also retains an outside consultant to analyze inventory activity and provide advice on a quarterly basis.

Recommendation 2. FONZ concurs. In March 2007, FONZ increased the retail markups on a number of items and indicated that its COGS was consistent with the zoo peer survey average. FONZ will continue to review its purchase costs as well as its markup practices. To reduce purchase costs, FONZ has initiated contact with SBV and set a target date of December 31, 2007, to explore joint purchasing opportunities.

Recommendation 3. FONZ concurs. FONZ's Executive Director agrees that retail carts, tents, and other temporary structures are important to supplement FONZ's limited store space. FONZ's gift shops have expanded the use of mobile carts around the Zoo, and sales from temporary outlets were almost 12 percent of total in-park revenues in 2006. FONZ will continue to use these sales outlets to the extent practicable given limitations on electricity and network connectivity as well as pedestrian traffic flows and park aesthetics. Further, FONZ and the Zoo are planning for an expanded retail presence on Asia Trail II.

Recommendation 4. FONZ concurs. FONZ held discussions with its retail consultant and discussed staffing levels with two other zoos. FONZ concluded that staffing structures vary considerably among zoos and that a strict comparison of staffing numbers is difficult. Based on FONZ's unique operations, i.e., the distance between shops, warehouses, and offices at the Zoo, the fact that merchandise management and staff routinely assist other zoo departments and support special events, and FONZ's significant on-line and seasonal mall store presence, FONZ believes that its permanent staff structure is balanced and appropriate.

Recommendation 5. FONZ and the Zoo concur. According to the Executive Director, FONZ's Board of Directors sets aggressive financial targets in the annual budget process for revenue and net contributions. For 2007, FONZ's budget assumed only a 6 percent drop in concessions revenue from 2006 despite its forecast of an 11 percent drop in visitation, reflecting recently implemented operating improvements. Regarding the feasibility of outsourcing, FONZ's Board recently re-examined its merchandise operations and recommended against outsourcing.

Recommendation 6. FONZ concurs. FONZ recognizes the particularly difficult challenge in its recruitment of concessions staff. In 2007, FONZ expanded recruitment efforts by enhancing job fairs and developing an affinity program to connect the seasonal workforce more closely to the Zoo itself. FONZ also offered incentives to existing workers to recruit friends and colleagues, attended university job fairs, and partnered with community organizations. FONZ will continue to seek ways to provide its guests with a wider variety of food items at the smaller locations, including the use of third-party concessionaires.

Recommendation 7. FONZ concurs. FONZ has expanded its use of third-party concessionaires for supplemental food services. In 2007, FONZ negotiated two seasonal contracts covering five different locations around the Zoo and awarded four short-term contracts with local restaurants during the peak spring period to help with service and variety. Through third-party concessionaires, FONZ provided Zoo guests with more food outlets and a greater variety of food and beverage services, such as gelato, fresh-squeezed lemonade, cotton candy, and gourmet coffee. FONZ will continue to evaluate the effectiveness of short-term versus long-term durations of these contracts.

Recommendation 8. FONZ and the Zoo concur. FONZ contracted with an outside firm that specializes in customer service to assist FONZ in changing its culture to one that stresses exemplary customer service. In April 2007, FONZ directors and key employees participated in an interactive workshop to intensify their focus on customer service training and performance. FONZ developed a customer service theme, standards, and behaviors that will be used to establish a customer service training program for all employees. FONZ expects to complete the development of the training program by September 30, 2007, and a newly formed strategic committee of FONZ's Board will provide oversight of improvements in customer service.

Recommendation 9. FONZ partially concurs and the Zoo concurs. FONZ asserted that it follows up and resolves all customer complaints it receives and indicated that it would be a significant administrative burden to establish a formal process for tracking all visitor correspondence including emails, comments cards, and letters. FONZ has agreed to monitor customer feedback primarily through two vehicles: secret shopper reports and a new visitor survey. FONZ indicated that scientific surveys of visitor satisfaction with sound statistical analysis of the data are a far superior way of obtaining customer feedback and identifying both problems and areas of excellence. FONZ has been working closely with the Smithsonian Office of Policy and Analysis to design and implement a series of standardized visitor surveys to establish baseline levels of visitor satisfaction with customer service and monitor them over time, conducting surveys two to three times a year.

Recommendation 10. FONZ and the Zoo concur. Both are committed to developing a strategy for implementing employee parking fees in the future as part of the ongoing feasibility study (economic analysis by the parking task force) for a parking garage at the Zoo. The Zoo Deputy Director noted three large events that are scheduled for 2008 – preparations for Association of Zoos and Aquariums (AZA) accreditation, implementation of the new Zoological Information Management System, and FONZ's 50th Anniversary – that will substantially increase employee workloads. The Zoo and FONZ are concerned that announcing plans now to implement paid parking for employees would reduce productivity at a critical time. In addition, because implementing paid parking would be considered a change in working conditions, the American Federation of Government Employees union will need to be involved, and these matters usually take considerable time to resolve. The Zoo and FONZ have committed to work with the Smithsonian's Secretary to reevaluate the parking policy for FONZ and Zoo employees and develop a strategy for implementing employee parking fees by December 31, 2009.

Recommendation 11. FONZ concurs. Zoo officials defer to the FONZ Board. The FONZ Board examined membership rates and benefits, including free parking, in early 2006. The Board increased dues for selected membership levels in 2006 and is not inclined to pursue such a re-examination now because the new membership rates are just completing the first cycle. As with recommendation 10, FONZ's Board will reconsider member parking benefits by December 31, 2009, as part of the parking garage feasibility study.

Recommendation 12. FONZ concurs. While FONZ agrees that a more systematic approach to developing and recording operating policies may be in order, its limited resources mean that other, higher priorities need be addressed first. Nevertheless, by December 31, 2008, the FONZ Board will work with the Executive Director to prioritize the areas for which written policies and procedures should be developed. FONZ will develop and approve policies and procedures for these areas by December 31, 2010, and the Board will provide oversight to ensure implementation.

Recommendation 13. FONZ concurs. FONZ believes that it has implemented a proper segregation of duties and appropriate access controls considering the small size of its organization. FONZ hired a new Controller, who established a process for supervisory review and approval of all journal entries and bank reconciliations. FONZ also noted that its outside auditors did not find any weaknesses in FONZ's control environment in fiscal year 2006.

Recommendation 14. FONZ concurs. By December 31, 2008, the Board, working with the Executive Director, will determine the areas for which risk assessments should be developed. FONZ will complete the risk assessments and report to the Board on its system of mitigating controls by December 31, 2010. The Board will provide oversight to ensure that mitigating controls are implemented.

Recommendation 15. FONZ does not concur. The Board believes that it has exercised appropriate oversight of FONZ's investment policies.

Recommendation 16. The Zoo Director and FONZ concur. The Zoo stated that revenue-generating opportunities and transportation alternatives have been an integral part of the master planning process and indicated that the design team used external consultants to focus on these areas in the development of the master plan document. OFEO also agreed that the master planning team should fully integrate revenue operations into the master plan design from the outset. The draft master plan, recently issued for public comment, includes options that best fit animal care, staff, and visitor amenities. The final master plan will also reflect input from top Smithsonian officials as well as the Board of Regents. Officials acknowledged that implementation of the master plan will be a multi-year process and that specific details for revenue-generating opportunities will require a business plan to determine the capital costs and how they can be recovered, as is currently being done for the proposed multilevel parking garage.

We include the full text of management's response as Appendix C.

Office of the Inspector General Comments

During our audit, the FONZ Board named a new Executive Director to oversee FONZ's operations. In addition, FONZ management, working closely with the FONZ Board, adopted a new strategic plan to improve the visitor experience, enhance partnerships with stakeholders, and achieve organizational excellence. We briefed FONZ and Zoo officials on our findings during the audit and observed that the new Executive Director has made many improvements in FONZ's revenue operations over the past year. For example, we have seen a marked improvement in overall store presentation and tidiness, staff friendliness towards visitors, and an increase in the availability of food services.

Comments on Responses to Specific Recommendations

Management's actions taken and planned respond to the intent of our recommendations and we consider them resolved. For recommendations 1, 3, 4, 6, 7, and 13, management has substantially completed the actions to improve FONZ's revenue operations, and we consider these recommendations closed. Regarding recommendation 15, FONZ's Finance and Audit Committee recently briefed the FONZ Board regarding the status of its investments and is reevaluating FONZ's investment strategy. Based on information provided to us on the Board's oversight of investments, we consider this recommendation closed as well. However, on the issue of keeping minutes for committee meetings, we note that the June 2007 *Report of the Governance Committee to the Board of Regents* directed the Institution to enhance the transparency of the Board of Regents' operations and deliberations by directing it and its committees to keep minutes for all meetings, including executive sessions. We urge FONZ's Board to adopt this best practice and keep minutes of all Board and committee meetings.

To fully address recommendations 10 and 11 regarding the free parking policy for Zoo and FONZ employees as well as FONZ members will require vetting by the Secretary and Board of Regents. Also, while FONZ concurred with recommendation 12, in subsequent discussions FONZ indicated that formal written purchasing policies and procedures were not necessary for the food and merchandise departments because these were very thinly staffed offices. In our view, it is especially important to document policies and procedures for these departments because merchandise and food services are FONZ's two largest revenue-producing operations and because such documentation promotes transparency and assists succession planning.

Management stated they have taken actions that satisfy recommendations 5, 9, and 16, and that these recommendations should be closed. We do not agree.

In recommendation 5, we suggested that FONZ establish aggressive financial targets for revenue and net contribution growth and explore all options, including the feasibility of outsourcing merchandise operations, for achieving these targets. According to FONZ, its Board does set aggressive financial targets and cites the approved 2007 budget as an example. However, FONZ provided little detail on how it set this goal or why. Moreover, if they are expecting an 11 percent decline in visitation, we fail to understand how a goal of a 14.5 percent decline in net contribution is an aggressive target.

As for the outsourcing part of our recommendation, we understand that the FONZ Board recently re-examined this issue and recommended against it. In response to our requests for the details of the Board's analysis, FONZ provided us letters from the Zoo Director and the FONZ Executive Director to the Acting Secretary, which conclude that because FONZ is generating significant operating profits and its retail operations personnel are embedded in other operational activities, the Zoo would have to hire replacement employees for some Zoo services such as education programs, visitor services and the Zoo's website. FONZ did not provide any trend analyses of detailed metrics such as sales per visitor, visitor capture rates, and expense per dollar of sales. Since the Finance and Audit Committee did not retain minutes of its meetings and the full Board minutes were at a summary level, it could not provide us with any details on its deliberations.

To its credit, FONZ has drafted an operational plan for the 2007 to 2010 period that contains steps for enhancing its customer service program, improving merchandise and food services, and increasing membership. However, the version provided to us did not include developing a longer-term financial plan that is tied to its operational plan and future annual budgets so the Board can better measure financial progress and make a more informed decision on the outsourcing issue.

We will keep this recommendation open until FONZ can provide more detailed information on its financial targets. We request that by February 28, 2008, FONZ provide us with its approved 2008 budget along with information on the key metrics that it used to measure financial performance and how the metrics are linked to aggressive targets in its budget as well as the longer term.

On recommendation 9, we applaud management for working with the Office of Policy and Analysis to develop a more scientific visitor survey to establish a baseline to gauge trends in customer service. These surveys and secret shopper reports should provide management with excellent information to implement improvements where needed. However, we do not plan to close this recommendation until the 2007 surveys and secret shopper reports are completed and analyzed. Moreover, we want to observe how well FONZ documents its follow-up efforts to resolve visitor complaints and other customer service issues raised in the surveys. We have established a target date of January 31, 2008.

Regarding recommendation 16 on the master plan, by the time the plan is finalized and approved (by June 2008), FONZ and the Zoo will have fully considered the expansion of retail facilities, special events facilities, parking alternatives, and amusements and entertainment amenities. We understand that the Zoo would like this recommendation closed, but we will keep it open until the master plan has been finalized. We expect the Zoo and FONZ to weigh all options and document their decision-making.

We recognize the difficult challenge in balancing the Zoo Director's resolve to expand the footprint for animal exhibits with the need to maximize revenues from concessions and other visitor amenities. It is critical to consider the costs of sustaining the new animal exhibit areas along with the need to self-fund operations to the maximum extent, given federal budget constraints. The Zoo currently suffers from lost revenue opportunities and diminished visitor amenities because of prior decisions to expand exhibit space at the

expense of up-front planning for visitor services. We plan to keep this recommendation open until the Secretary and Board of Regents review this matter and the final master plan receives the required approvals (projected for June 2008). We expect that the Zoo, OFEO, and FONZ will weigh the benefits and costs for all options and document their analyses.

Comments on Responses Regarding General Issues

Finally, we would like to address FONZ's two biggest concerns: our survey methodology and the age of our data.

FONZ's chief concern with our methodology for comparing FONZ with other zoos is that our analysis did not factor in significant differences among zoos, such as size of usable property for concessions, zoo philosophies regarding amenities, and cost allocations. Because these complex factors could not be addressed, FONZ maintains that we did not provide true apple-to-apple comparisons in the report. Consequently, FONZ believes that comparisons of net contributions with other zoos are invalid and that we should not have made findings based on the comparisons.

While we found the comparative analysis helpful, our findings are based on multiple sources, not solely on the peer averages. These other sources included, in part, FONZ's retail consultant, consultants hired by the Institution to review retail services as well as to assist in the development of the master plan, SBV retail experts, data from the Association of Zoos and Aquariums, tours and discussions with seven other large zoos, and our own observations. And while our comparative analysis used the peer zoo average as a benchmark, we calculated peer averages based on approximately eight to ten respondents (with only minor adjustments or exclusions), thereby attempting to mitigate differences in accounting structures to the extent practicable.

FONZ was also concerned that our reliance on dated information means our report does not reflect current conditions. We believe our report makes clear that at the time of our verification work, the most recent annual financial data available from peer zoos and FONZ was 2005. We included FONZ's 2006 financial data throughout the report to better reflect current conditions at the Zoo. We also believe our report presents a fair and balanced assessment of actions taken by FONZ in the past year to improve operations as well as the visitor experience.

FONZ also included references to inaccuracies in our draft report. After considerable discussion and other communications, we either incorporated appropriate changes to the report, or FONZ generally agreed that its comments were not applicable.

APPENDIX A. SCOPE AND METHODOLOGY

Our audit primarily covered a three-year period, from 2003 through 2005, and we selectively reviewed additional information over a seven-year period, from 2000 through 2006. We conducted our audit largely in the Washington, D.C. area from November 2005 to July 2007 in accordance with ***Generally Accepted Government Auditing Standards***. We also visited seven zoos in several East Coast and Midwestern states.¹

Initially, we met with Zoo and FONZ officials to understand what financial data and documents were being prepared, how they were being utilized, and what other data were available. To ensure that FONZ's data were reasonably accurate, usable, and compatible with the Zoo's reporting needs, we analyzed FONZ's internal management reports and financial statements. Later, we met with FONZ's external auditors and different levels of management to understand internal controls and their effect on the financial statements and how departmental procedures affected operations. We reviewed the external auditors' workpapers for fiscal years 2004 and 2005 and noted that unqualified opinions were given for both years examined, as well as for 2006. We also obtained copies and reviewed activities related to selected policies that controlled aspects of cash, food, and merchandise operations. At the mid-point of our audit, we briefed FONZ and the Zoo on our interim findings. We also met later with the Institution's Office of Planning, Management, and Budget and a contractor the Institution had hired to provide data for an analysis of Smithsonian retail operations. Additionally, we reviewed other analyses and prepared documents, as well as numerous consultant studies and surveys.

We reviewed the prior OIG audit of the Zoo's parking operations.² That report had identified weaknesses concerning internal controls over the collections, deposits, and recording of parking operations revenues. To its credit, management has implemented actions to correct these weaknesses.

To develop a framework for understanding FONZ's profitability and operating efficiency, we obtained data from zoos and other comparable organizations for three fiscal years (2003 through 2005) to the extent available and performed trend analysis. We also examined museum and zoo association data. To improve comparability of data, we developed a survey to accumulate data from 32 U.S. zoos with the largest attendance levels, FONZ, and SBV. We did not verify the accuracy of this data for purposes of our analysis and we assumed that survey instructions were uniformly carried out by all participants. We acknowledge that there are numerous differences affecting the comparability of survey data such as regional differences, usable zoo acreage, and management philosophies, as well as differences in accounting methods and allocations. The survey primarily focused on merchandise and food and beverage operations, but we also obtained data on other areas such as parking, attendance, and membership. Of the 32 zoos we surveyed, 18 provided us financial data and answered other operating questions.

¹ We visited the Cleveland Metroparks Zoo, Columbus Zoo and Aquarium, Lincoln Park Zoo, Philadelphia Zoo, Saint Louis Zoo, Toledo Zoo, and Zoo Atlanta.

² ***Parking Operations at the National Zoological Park***, No. A-04-09 (December 27, 2004).

Concurrent with our efforts to collect data by survey, we visited seven zoos and met with financial, merchandise, and food managers; toured Zoo grounds for ideas and information on additional revenue-generating activities and to better understand how zoo concession operations were managed; and gathered additional documents to help make our comparisons. For SBV, we spoke with the managers of concession operations and obtained financial statements. However, SBV did not complete our survey and provided only limited concession information. We met with the Chief Financial Officer and Chief Operating Officer of SBV and reviewed the agreement between the Institution and FONZ to determine whether both parties were meeting their responsibilities as laid out in the agreement. We also toured the Zoo with SBV's then-President of Retail Operations to obtain his observations on store presentation as well as on merchandise pricing and selection.

We developed criteria consisting of peer survey averages based on various operational data and financial ratios to compare and evaluate FONZ's revenue-generating activities. In our analyses, we made allowances for differences in zoo and other entity-reported data to improve comparisons to FONZ to the extent practicable. For example, we excluded General & Administrative expenses because of vast differences in incurred expenses and accounting treatment by survey respondents. Also, we obtained comparative third-party concessionaires' data.

To determine the extent to which the Zoo's future plans included revenue-generating operations, we held numerous discussions with OFEO, Zoo, and FONZ officials on the Zoo's ten-year master planning process. We also obtained and reviewed draft planning documents and related consultant studies.

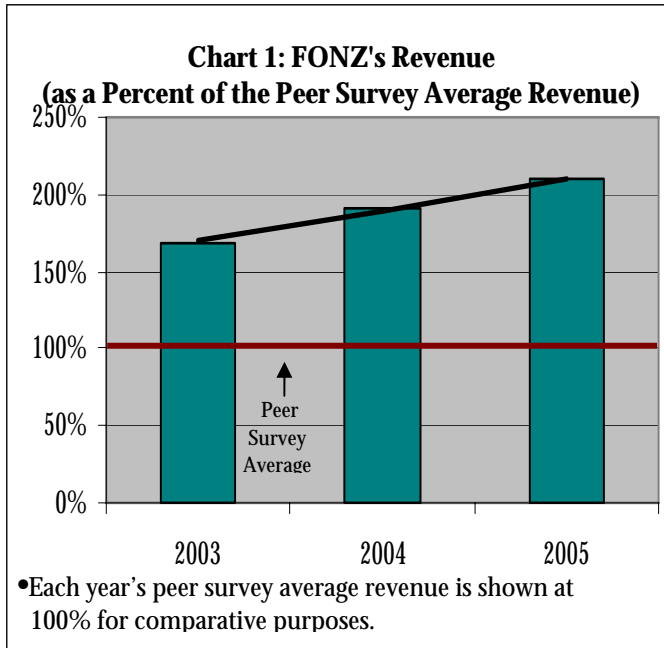
Finally, we noted that FONZ's internal reports were not always consistent or easy to use, and Zoo officials indicated that they were having difficulty comparing financial data from one period to another. At the request of the Zoo's Director, we reviewed FONZ's internal management reporting format. We also compared FONZ's reports to reports obtained from other zoos we visited. We discussed the various reports with FONZ and Zoo officials and provided examples to them for their consideration and use.

APPENDIX B. FINANCIAL MEASURES

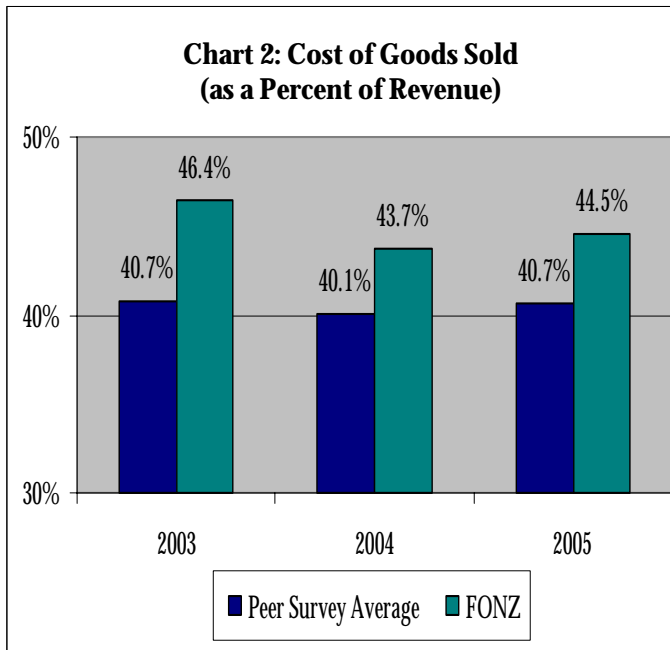
This appendix presents various financial measures for FONZ and comparisons to other zoos and Smithsonian Business Ventures. We define our terms and provide additional notes at the end of the appendix.

We calculated the figures we present here for cost of sales, direct labor, and net contribution as a percent of revenue.

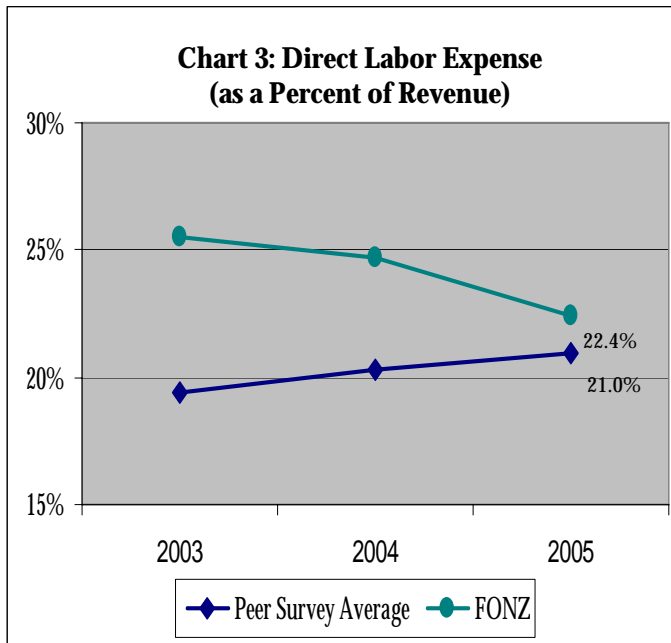
Merchandise Comparisons to the Peer Survey Average



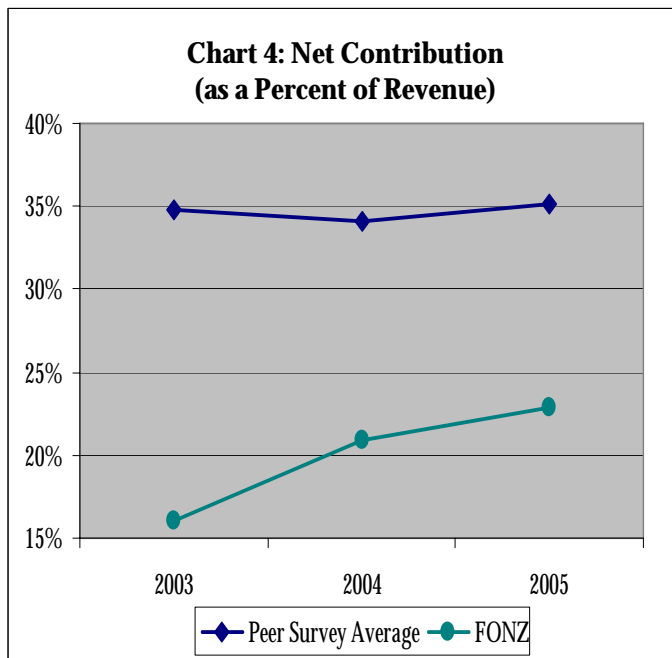
FONZ's revenue from merchandise operations well exceeded peer survey averages and increased from 2003 to 2005. In 2003, FONZ's revenue was approximately 70% higher than the peer survey average and by 2005, FONZ's revenue had increased to 110% higher than the average.



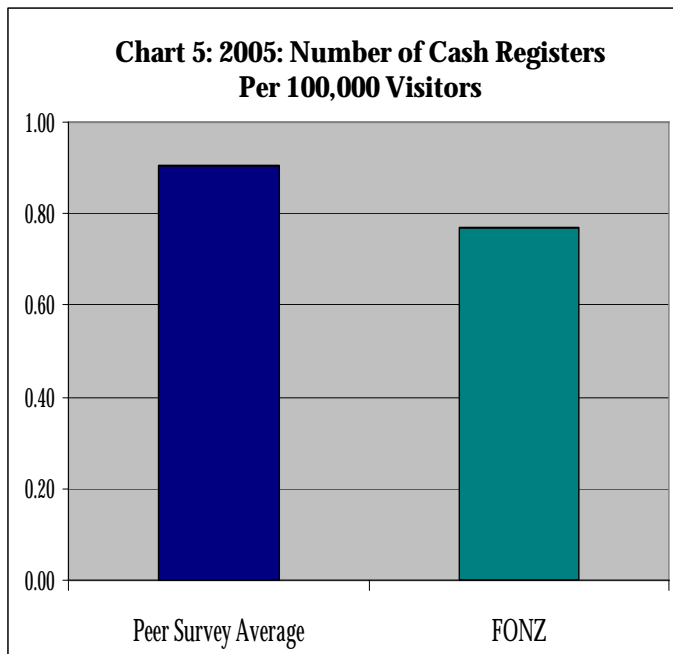
FONZ's cost of goods sold (COGS) was higher than the peer survey average, which equated to a lower net contribution than other zoos. This means that FONZ may have paid too much for the merchandise that it sells. A high COGS could also reflect a lower than average markup on the price charged to customers. FONZ's 2005 COGS was about 4 percentage points higher than the peer survey average.



Direct labor expense showed a declining trend and almost closed the gap with the peer survey average.



While FONZ's net contribution improved from 2003 to 2005, it was considerably lower than the peer survey average. FONZ's higher than average COGS (see Chart 2) and direct labor expense (see Chart 3) contributed to FONZ's lower than average net contribution.



Perhaps related to its lower than average square footage, FONZ also had a lower than average number of cash registers per 100,000 visitors.

- 2005 Peer Survey Average: 0.91
- 2005 FONZ: 0.77

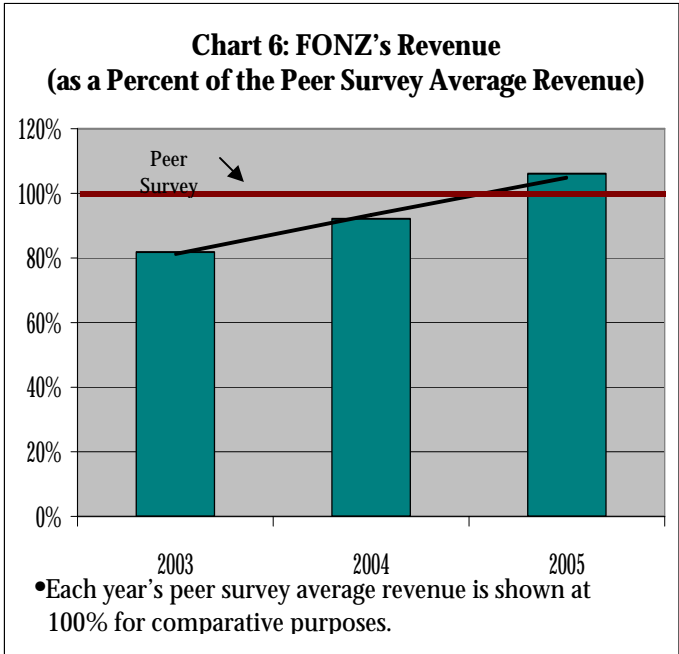
We note that FONZ has recently added a cash register to the Panda Gift Shop.

However, despite its small square footage, FONZ's capture rate (total transactions divided by total visitors) was similar to other zoos.

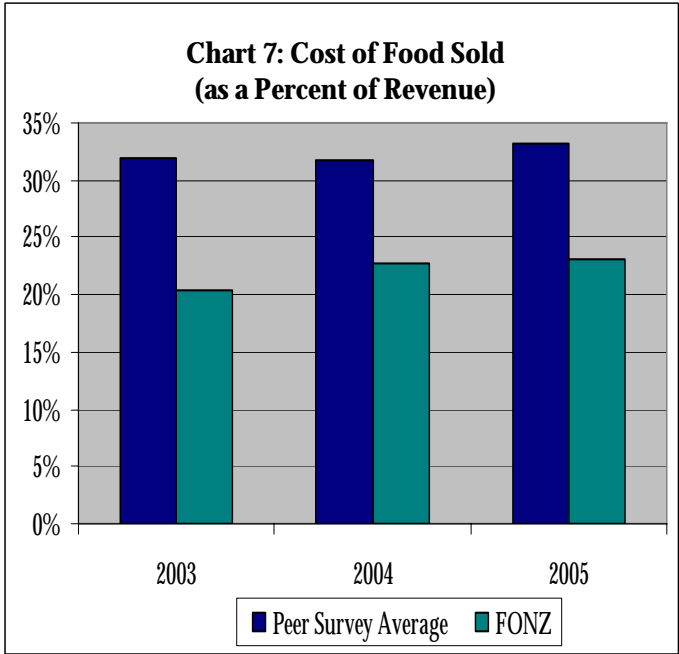
- 2005 Peer Survey Average: 12.6%
- 2005 FONZ: 12.8%

One area that has not been hampered by FONZ's limited square footage is its online merchandise sales (2005 online sales: \$146,993). Based on our survey and zoo visits, most other zoos have not developed a strong online store presence.

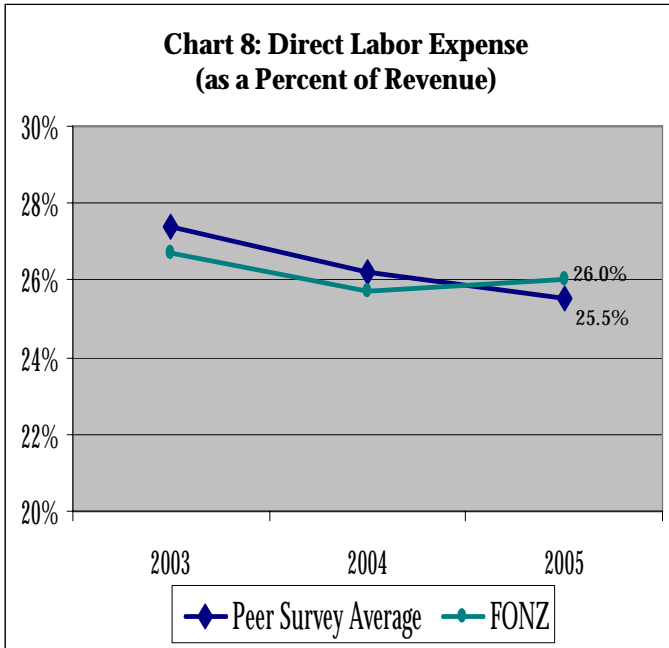
Food and Beverage Comparisons to Peer Survey Averages



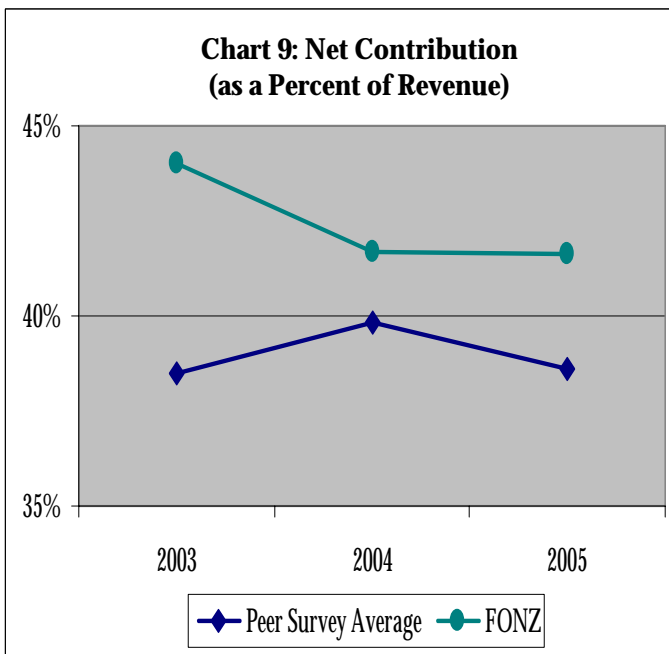
FONZ's Food & Beverage revenue started out below the peer survey average in 2003, but it increased to 6% above the average in 2005. Food & Beverage brought in slightly less revenue (\$3.8 million) than merchandise (\$4.2 million) in 2005.



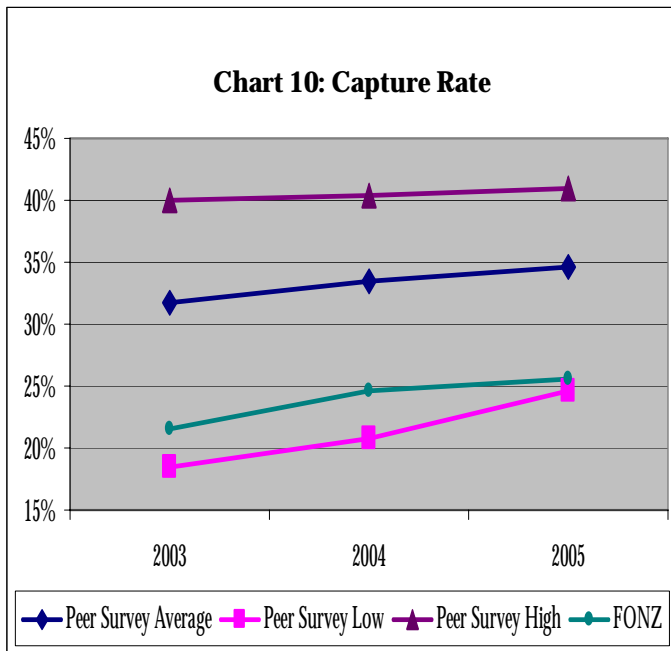
FONZ's cost of food sold was consistently below the peer survey average from 2003 through 2005, signifying that FONZ paid less for its food than other zoos, helping to increase net contribution. Alternatively, a low cost of food sold could indicate that FONZ charged customers a higher markup than other zoos.



From 2003 to 2004, FONZ's direct labor expenses were lower than the peer survey average, positively affecting net contribution. In 2005, FONZ's expenses approximated the peer survey average.

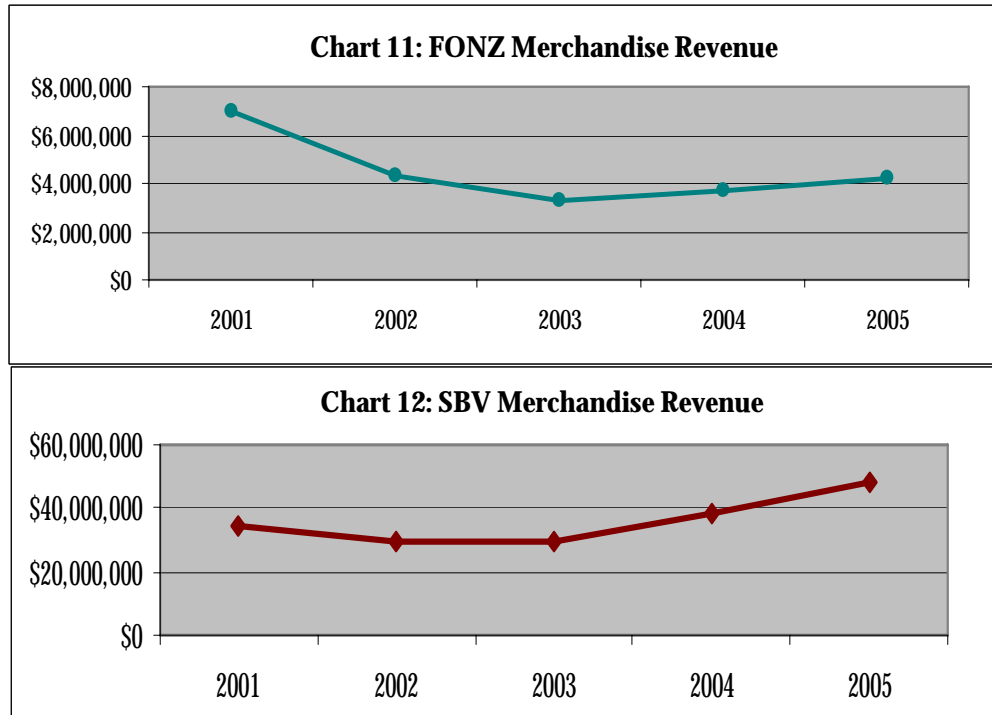


FONZ's net contribution was higher than the peer survey average because its cost of food sold (see Chart 7), and direct labor expenses (in 2003 and 2004) were lower than the average (see Chart 8).



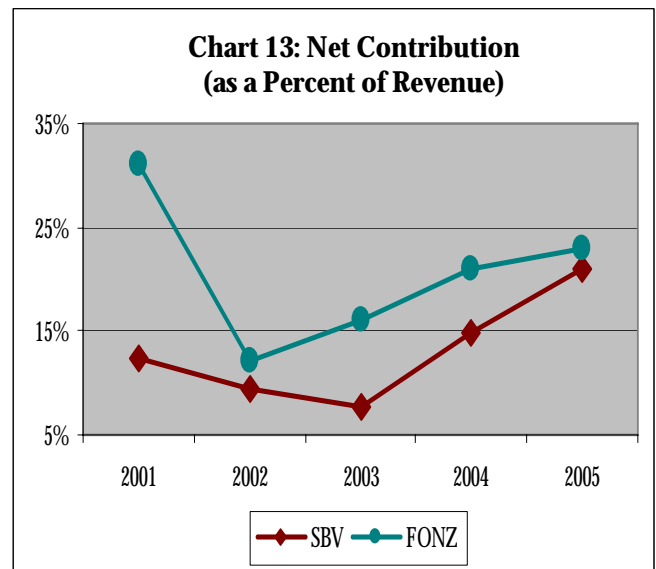
FONZ's Food & Beverage capture rate (total transactions divided by total visitors) appeared low compared to four other zoos who provided data in our survey. This may be an indication of FONZ's limited service ability, such as FONZ's lower than average number of cash registers per visitor. In 2005, FONZ had 1.43 cash registers per 100,000 visitors, while the peer survey average was 1.86 (a 30% difference). However, FONZ has recently increased the availability of food service cash registers.

Merchandise Comparisons to Smithsonian Business Ventures (SBV)

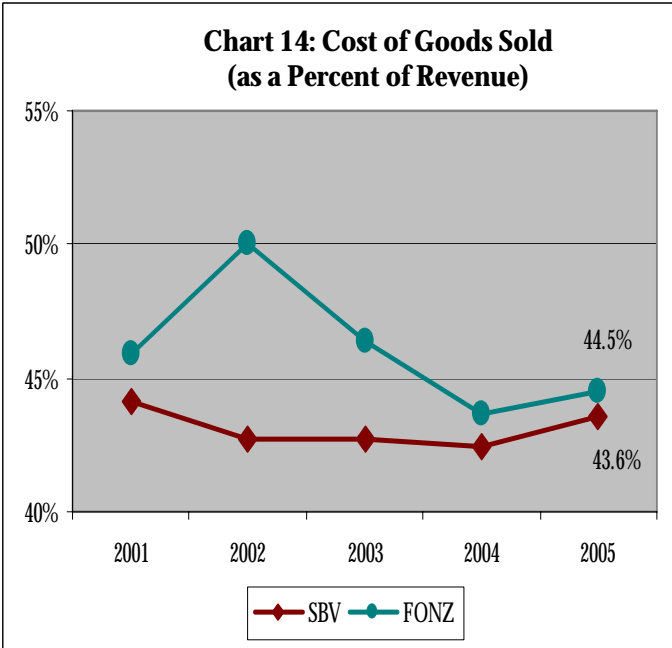


FONZ and SBV Comparisons and Trends:

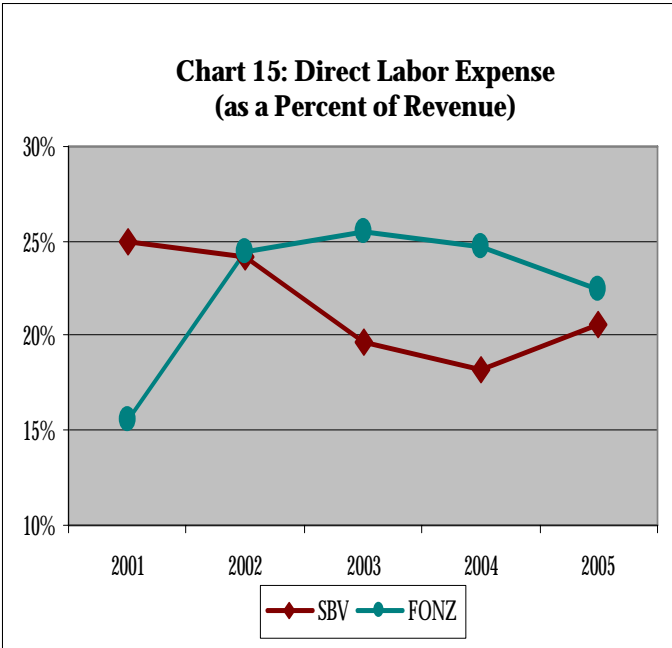
- FONZ's merchandise revenue is approximately 1/10 the amount of SBV's.
- FONZ's revenue and net contribution in 2005, with the debut of Tai Shan, was still not as high as it was in 2001, after the arrival of two new pandas and before the impact of the 9/11 terrorist and D.C. sniper attacks.
- SBV revenues have been increasing since 2003 but increases in net contribution were not realized for another year.
- SBV's net contribution declined between 2001 and 2003, and showed recovery in 2004 and 2005.
- Net contribution was higher for FONZ than for SBV from 2001 through 2005. However, by 2005, FONZ and SBV had similar net contribution percentages.



Note: FONZ operates on a calendar-year basis while SBV operates on a fiscal-year basis (October 1 – September 30).

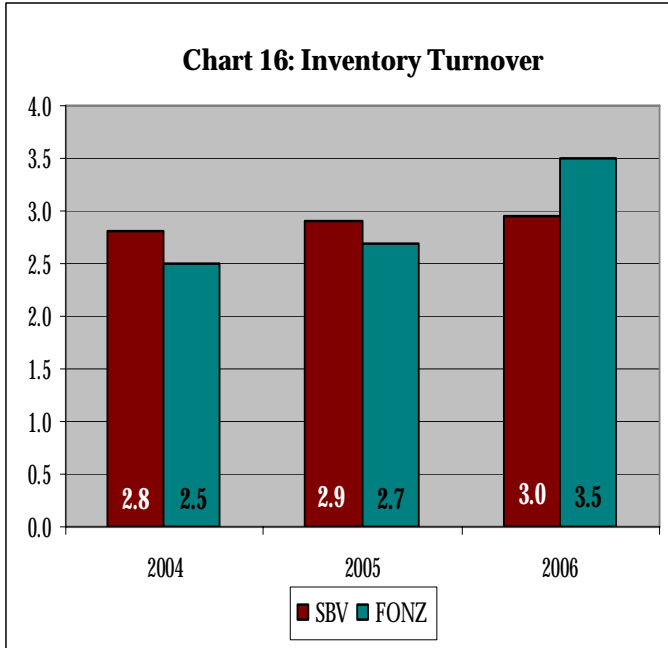


SBV's COGS for merchandise stores was consistently lower than FONZ's COGS. However, FONZ's COGS generally decreased over the years and was only slightly higher than SBV's in 2005.

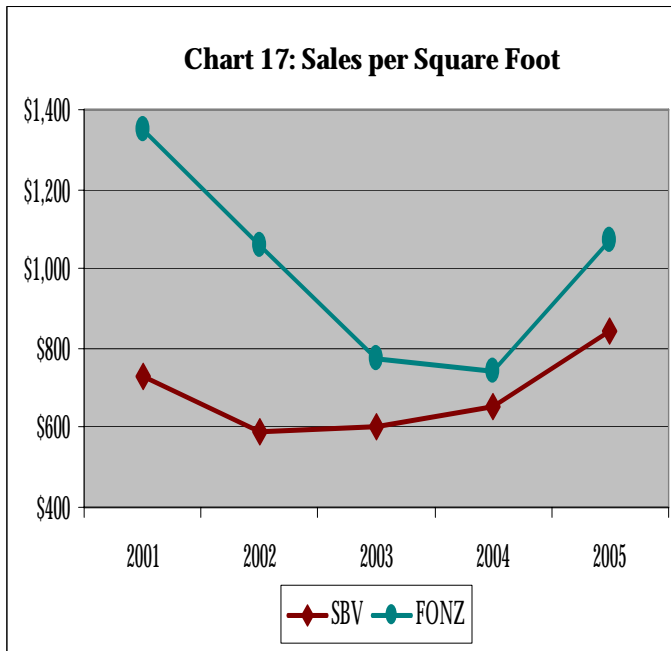


This chart illustrates the effect changes in revenue have on our depiction of expenses. FONZ's direct labor expenses initially increased as revenues declined but have since tapered off as revenues rebounded.

SBV has had a general decline in its direct labor costs, except for an increase experienced in 2005.



FONZ and SBV both improved their inventory turnover from 2004 to 2006. While FONZ's 2005 turnover was just below SBV, by 2006 FONZ had reversed the trend and improved to well above SBV.



FONZ had higher sales per square foot than SBV from 2001 through 2005.

Key to financial measures

- Revenue: total merchandise or food and beverage sales (less discounts)
- Expenses (3 categories)*:
 - Cost of Goods Sold (COGS) or Cost of Food Sold: cost of merchandise or food and beverage (including paper products) that was sold
 - Direct Labor Expense: salaries and benefits for management and staff
 - Other Direct Expenses: other expenses directly related to the operation, such as supplies, shipping, telephone, and the like.
- Net Contribution: Revenue less all Expenses listed above

*Excludes General & Administrative expenses.

Notes:

See Appendix A: Scope and Methodology for additional details regarding financial measures comparisons.

We did not verify the data provided for our analysis. We relied solely on the statements and data provided by respondents. We also made certain adjustments to the data to improve comparability. We computed peer survey averages based on our survey of 32 large zoos, with 18 respondents. The averages only include those zoos that operate their own concessions, approximately ten for merchandise and eight for food service.

While we factored other direct expenses into the calculation for net contribution, we did not fully analyze them because zoo expense structures and allocation methods vary considerably.

APPENDIX C. MANAGEMENT RESPONSES



June 18, 2007

TO: A. Sprightley Ryan, Inspector General

Cc: Christian Samper K., Acting Secretary
William W. Brubaker, Director, Office of Facilities Engineering and Operations
Sheila P. Burke, Deputy Secretary and Chief Operating Officer
Gary Beer, Chief Executive Officer, Smithsonian Business Ventures
Ira Rubinoff, Acting Under Secretary for Science

From: Robert J. Lamb, Executive Director, Friends of the National Zoo *Robert J. Lamb*

Subject: Response to Draft Audit Report A-06-01

This letter responds to your audit report on the revenue operations of Friends of the National Zoo (FONZ), dated June 8, 2007. The report recommends several improvements that might strengthen the management and profitability of the revenue operations (food service, merchandise, and parking) that produce substantial revenue for the Smithsonian's National Zoo in accordance with a long-term agreement between FONZ and the Smithsonian Institution. The report acknowledges that "FONZ has provided significant contributions to the Zoo" and offers recommendations to continue to improve its operations.

The report focuses on the years 2003-2005, covering a period now nearly four and a half to two and a half years in the past. Regrettably, because of the dated audit period, the report may give readers the inaccurate impression that it reflects current conditions and practices. The report does indicate that, more recently, the FONZ Board of Directors has hired a new Executive Director, adopted a new strategic plan, and initiated and implement a number of improvements consistent with recommendations contained in the report.

The report makes 16 recommendations. We believe eight were satisfactorily completed before the discussion draft report was issued in late April and we provided this information in our comments on the discussion draft report; two more have been completed since then.

FONZ offers the following specific comments on the recommendations:

IG Recommendation: To strengthen management of FONZ's merchandise operations, we recommend that the Executive Director, FONZ:

1. Develop detailed inventory aging reports and perform appropriate analyses to ensure optimum stock levels and improve overall inventory management.

Corrective Action: FONZ concurs in part with this recommendation.

FONZ agrees that ensuring optimum stock levels is a desirable goal and performing effective analyses to achieve this objective is important. However, the report recommends the adoption of a specific inventory management tool, an "aging report," as the means by which optimum stock levels might best be realized. FONZ disagrees that this specific inventory management tool should be the methodology used to realize inventory management improvement.

FONZ uses a state-of-the-art inventory management software system. The version of this product, called "Premier Suite," does not include the inventory aging report generator recommended in the report. Instead, FONZ uses other reports generated by Premier Suite that provide useful information on what is selling quickly and what is not. With experienced staff in place and other inventory tools in hand, FONZ believes it has the means to continue to improve its inventory management.

FONZ considers this recommendation completed.

2. Determine why FONZ's COGS (Cost of Goods Sold) appears to be higher than the peer survey average and make appropriate changes as necessary, including possible joint purchasing opportunities with SBV.

Corrective Action: FONZ concurs with this recommendation and will continue to review its purchase costs as well as its markups. At this time, we believe our higher cost of goods sold is due to lower than average markups above cost, not higher purchase prices. Beginning in early March, we increased the markup of items to match zoo averages. As a result, COGS through the end of May is 37.9%, which is consistent with the zoo peer survey average.

We consider this recommendation essentially completed, but will pursue possible joint purchasing opportunities with SBV to see if we can further reduce our COGS.

3. Increase efforts to expand the use of carts, tents, tables, and other temporary structures to grow merchandise net contributions.

Corrective Action: FONZ concurs with this recommendation. In fact, FONZ has been using a tent and carts since the spring of 2006. In 2006, sales from these temporary outlets were almost 12% of total sales. We will continue to use these sales outlets.

FONZ considers this recommendation completed.

4. Reexamine FONZ's overall staffing structure and make adjustments as warranted.

Corrective Action: FONZ concurs with the recommendation to re-examine its overall merchandising staffing structure to see if any adjustments may be warranted. With only a six-person management team and top executive-management salaries in the Federal GS-13 to GS-14 range, we believe our staff structure is relatively lean and cost effective. In fact, in 2006, direct labor costs were only 21.2% of sales, comparable with the peer survey average.

FONZ considers this recommendation substantially completed.

IG Recommendation: To maximize net contributions from merchandise operations, we recommend that the FONZ Board of Directors and the Zoo:

5. Establish aggressive, but achievable, financial targets for revenue and net contribution growth and explore all options, including the feasibility of outsourcing merchandise operations, for achieving these targets.

Corrective Action: FONZ concurs with the recommendation.

The FONZ Board of Directors, in the annual budget process, sets aggressive financial targets for revenue and net contributions. For 2007, the sales target is \$5.4 million and the net income goal is \$1.5 million, or 28%.

Recently, the FONZ board re-examined the feasibility of outsourcing its merchandise operations and recommended against it to the Acting Secretary.

FONZ considers this recommendation completed.

IG Recommendation: To increase food and beverage revenues and improve visitor services, we recommend that the Executive Director, FONZ:

6. Expand the use of its small permanent locations and portable carts by developing a more effective strategy for staffing the facilities and serving a wider variety of food items at these locations.

Corrective Action: FONZ concurs with the recommendation. In 2007, FONZ food service operations have implemented such a strategy, increasing profits, providing a wider variety of products, and providing Zoo guests with more food outlets to serve their needs. Staff recruiting efforts have been redoubled and seasonal staffing levels improved. These actions will continue.

FONZ considers this recommendation completed.

7. Increase efforts to award seasonal or longer-term contracts to third-party concessionaires for supplemental food services.

Corrective Action: FONZ concurs with the recommendation. In 2007, FONZ has put in place two seasonal contracts for five locations to provide the kinds and variety of services recommended in the report. FONZ will continue to evaluate the effectiveness of short-term versus long-term durations of these contracts.

FONZ considers this recommendation completed.

IG Recommendation: To improve visitor services, we recommend that the Executive Director, FONZ and the Zoo Director:

8. Continue to improve customer service training opportunities and incentive programs for permanent and seasonal retail and food operations staff. Training needs to stress courtesy to visitors and keeping facilities clean and organized.

Corrective Action: FONZ concurs with the recommendation. FONZ has implemented intensified customer service training, stressing courtesy to visitors, and keeping facilities clean, organized, and attractive. The FONZ Board and Executive Director have identified improvement in the customer experience as a key goal. A newly formed Board strategic committee is providing oversight of improvements in this area.

FONZ considers this recommendation substantially completed.

9. Establish a process for documenting and evaluating visitor feedback on FONZ's operations and the results of follow-up efforts to resolve customer service issues.

Corrective Action: FONZ concurs with the recommendation in part.

We believe that scientific surveys of visitor satisfaction with sound statistical analysis of the data are a far superior way of obtaining customer feedback and identifying both problems and areas of excellence compared to documenting and evaluating isolated comments received from individuals. FONZ does reply to customer complaints, observations, and suggestions.

With the help of the Smithsonian Office of Policy and Analysis, FONZ is implementing its first series of standardized, annual visitor surveys to establish baseline levels of visitor satisfaction with customer service and monitor them over time. We believe this action is responsive to the intent of the recommendation and will provide more consistent and reliable data to measure customer satisfaction.

FONZ considers this recommendation completed.

IG Recommendation: In view of the parking constraints at the Zoo, we recommend that the Executive Director, FONZ and the Zoo Director, in consultation with the Secretary:

10. Reevaluate the policy of allowing free parking for FONZ and Zoo employees and others.

Corrective Action: FONZ concurs with the recommendation and will do so in close consultation with the Zoo in conjunction with parking alternatives being considered in the master plan. According to the contract under which the parking lots are operated, the Smithsonian has the sole discretion to designate categories of visitors and/or vehicles that park for free.

11. Reexamine the unlimited free parking benefits enjoyed by FONZ members and consider adjusting benefits for free parking during the peak months.

Corrective Action: FONZ concurs with the recommendation, but does not agree to pursue such a re-examination at this point in time. A recent increase in membership fees took effect in 2006-2007--a stated benefit to members is free parking while visiting the Zoo.

FONZ considers this recommendation completed.

IG Recommendation: We recommend that the Executive Director, FONZ:

12. Establish a more disciplined system for developing, approving, and documenting formal, written operational policies and procedures. Provide oversight to ensure that policies and procedures are implemented as designed.

Corrective Action: FONZ concurs with the recommendation.

With FONZ's senior staff leadership approaching retirement, the FONZ Board and its Executive Director believe that a more systemized approach to developing and recording operating policies may be in order to document what has been standard operating procedures. Care must be taken, however, finding the balance in a small organization in delivering services and producing paperwork.

The FONZ Board, in the operation of its governance function, will work with the Executive Director to prioritize the areas for which written policies and procedures should be developed. The Board will provide oversight to ensure implementation.

13. Ensure a proper segregation of duties in financial operations and restrict financial system access to the greatest extent possible.

Corrective Action: FONZ concurs with the recommendation and believes that a proper segregation of duties and appropriate access to its financial system are already in place. As explained during the exit conference, redundancy in functions is essential when the financial staff size is small, and access is at present restricted to the greatest extent possible. In reviewing FONZ's financial operations for 2006, our outside independent auditors noted no weakness in FONZ's control environment.

FONZ considers this recommendation completed.

IG Recommendation: We recommend that the FONZ Board of Directors:

14. Direct the Executive Director to document a thorough risk assessment and report to the Board on FONZ's system of mitigating controls.

Corrective Action: The FONZ Board concurs with the recommendation. Care must be taken, however, in determining the extent of risk assessments to be undertaken. The FONZ Board, in the operation of its governance function, will work with the Executive Director to determine the areas for which risk assessments should be developed. The Board will provide oversight to ensure implementation of mitigating controls.

15. Implement oversight procedures in accordance with FONZ's investment policies.

Corrective Action: The FONZ Board does not concur with this recommendation. The Board has exercised appropriate oversight of FONZ's investment policies.

IG Recommendation: To increase future revenues and enhance the quality of the visitor experience, we recommend that the Directors of the Zoo and OFEO, and the Executive Director, FONZ, in consultation with the Secretary:

16. Fully examine the following options during the master planning process:

- a. Expand existing retail facilities to accommodate expected visitation levels and locate new facilities to maximize revenue and convenience for zoo visitors.
- b. Expand food and beverage operations, especially catering and special event facilities. Work with the Smithsonian Secretary to obtain needed waivers or to modify Smithsonian policy restrictions on hosting social events at the Zoo.
- c. Fully document ways that future attendance levels will be accommodated either through increased parking or other transportation alternatives.
- d. Add amusements and entertainment amenities, particularly a carousel and some type of train ride or tram throughout the Zoo to enhance future revenue streams and the enjoyment and educational experience for Zoo patrons.

Corrective Action: FONZ concurs with this recommendation and its staff is actively involved with the master planning process. The master plan is fully cognizant of the need to improve visitor amenities and has identified the need for improvements in this important area.

Finally, we have attached, as you requested, a listing of items in the report that we believe are in error. Of greatest concern, was the methodology employed in comparing FONZ with other zoos. All of the following, among other factors, make comparing existing revenue operations at different zoos a challenging task when there are:

Differences in climate and facilities that can or cannot accommodate year-round operations;

Differences in the size of usable zoo property for parking, amenities, and exhibit space;

Differences in the existing size and placement of retail and food operations;

Differences in zoo philosophies regarding zoo amenities;

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Differences in labor and other costs.

Smithsonian sensitivity to commercialization.

Because these factors could not be addressed, given their complexity, true apple to apple comparisons are not found in the report, considerably reducing its objectivity and utility. Hence, when examining the central focus of the report and looking for useful recommendations, the reader is left instead with averages, generalizations, and opinions requiring further analysis.

Perhaps most seriously, the many comparisons of net contribution may not be valid. As noted on page B-10, 'other direct expenses' were factored into the calculation for net contribution but were not fully analyzed because "zoo expense structure and allocation methods vary considerably." Yet, conclusions were drawn from these data and used to make judgments about FONZ. For example, in 2005, FONZ merchandise's other direct expenses, which include depreciation, made up 31% of total merchandise direct expenses. Some zoos do not include depreciation in merchandise financial reports, but that fact was not included in the analysis that found our merchandise net contribution considerably lower than the peer survey average. We do not believe such a significant finding can be or should be made when the methodology is questionable.

We do appreciate however, the opportunity to have an outside, independent review of our operation. In the process, much was learned by both parties. We are and will continue to utilize all information and recommendations generated by the report that will continue to improve FONZ revenue operations and support for the National Zoo.

Attachment

COMMENTS ON DRAFT AUDIT REPORT A-06-01

1. Page 1, 2nd paragraph: The net proceeds from FONZ concessions operations also support development, information and related guest services, and the website.
2. Results in Brief, 1st paragraph, page 2: FONZ notes, for the sake of accuracy, that most of the recommendations to improve operations were implemented in 2006 and 2007.
3. Results in Brief, 2nd paragraph, page 2: This wording suggests that “streamlining its management and staffing structure” could reduce expenses, which does not reflect recommendation 4, related to this issue, which states, “Reexamine FONZ’s overall staffing structure and make adjustments as warranted.”
4. Results in Brief, 1st paragraph, page 3: The net contributions comparisons in this report are a product of average zoo percentage comparisons. FONZ is interested in improving the overall net contributions of its operations. However, the information included in the report lacks the specificity needed to identify improvements. Finally, weakness in visitor experience is not directly tied to the net contribution calculation: increasing prices and reducing costs directly affect net contributions. See comments on scope and methodology below.
5. Results in Brief, 2nd paragraph, page 3: Programs to increase employee training and provide incentives were initiated in January 2007. See detailed information in comments 24 – 28 below.
6. Footnotes, page 3: See comments on scope and methodology on page 12, which discuss FONZ’s concerns over methodology.
7. Results in Brief, 1st paragraph, page 4: The recommendations related to future planning, while potentially useful, have no bearing on the subject of the audit—whether FONZ’s revenue operations are managed in the most efficient and profitable manner. FONZ will support, to the best of its ability, the options developed by the Smithsonian and the National Zoo.
8. Merchandise Operations, 2nd paragraph, page 4: An examination of the data in Appendix B indicates that FONZ performed better or about the same (not “worse”) as SBV on the “other measures” in 2005. To wit,

FONZ’s COGS was less than one point above SBV’s.
FONZ’s direct labor costs were less than one point above SBV’s.

Inventory turnover was about the same.
FONZ's sales per square foot were higher than SBV's..

9. Strengthen Inventory Management Practices, 1st paragraph, page 4: An aged inventory report is just one way of identifying which items, if any, need extra attention to improve sales and reduce inventory of that item. The software module to produce this report must be custom written for us, a cost that can not be justified in light of the fact that our inventory system software at present produces reports on product quantities, delivery dates, and shop placement. These reports are reviewed monthly to identify "slow sellers" and take action to improve their sales or remove them inventory.

FONZ does an end-of-year review of aged inventory; FONZ has not had aged inventory issues in our financial audit review process by an outside independent auditor over the past four years.

Further, the report's evidence that our inventory management needs improvement is weak. There is mention that the "consultant retained by FONZ noted in 2007 that the overbuy of some merchandise classifications needed to be kept under control and that other merchandise mix allocations should be reevaluated." But, the open to buy system is a dynamic process that starts with a planned amount of sales spread across the merchandise categories. Merchandise is ordered to meet those sales. As actual sales exceed or fall short of the plan, the mix must be adjusted. Thus, when the sales of plush fall short of the projection, what had been an appropriate amount of orders for future delivery may become an overbought position. If you look at the monthly open to buy spreadsheets over time, this movement is evident. Our consultant is trained to look at trends and see patterns. His advice is based on his analysis, indicating changes to be made in the future.

10. Strengthen Inventory Management Practices, 1st paragraph, page 5: In 2006, FONZ's inventory turnover was 3.5, the zoo average is 3.4. However, we question whether there is a causal relationship between inventory turnover and profitability, as suggested here.

11. Strengthen Inventory Management Practices, 2nd paragraph, page 5: The equally plausible hypothesis that lower mark-up accounts for higher COGS is noted only in the footnote. FONZ's higher than average COGS means one of two things: FONZ is paying too much for our products OR FONZ's mark-up is less, meaning FONZ prices are lower than those of other zoos. (This latter could account, in part, for FONZ's higher total sales volume.) In reviewing price mark-ups recently, FONZ found that the St. Louis Zoo uses a 3.5 mark-up on the same merchandise FONZs mark up between 2.0 and 3.0. Lincoln Park's mark-up is 3.0, and San Diego's Zoo ranges from 2.9 to 3.1. AZA average is 2.3 to 3.5. FONZ has evaluated mark-up and raised some prices based on this evaluation.

It is also possible that the zoos surveyed included different costs in calculating COGS. For instance, some retail operations include the cost of shipping in this calculation; others do not.

12. Strengthen Inventory Management Practices, 3rd paragraph, page 5: The consultant's study was based on analysis of individual SKUs. It is important to note here that, while some top-selling items are sometimes out of stock, some of the in-stock items are essentially identical products from different vendors. We order interchangeable bestselling items to improve availability. Lastly, the consultant used 6 or 8 weeks of supply as the measure of adequate stock. In February, when the consultants were evaluating FONZ, 6 to 8 weeks of supply is excessive, given low visitation at this time of year.

13. Strengthen Inventory Management Practices, 4th paragraph, page 5: FONZ will continue to explore opportunities for joint purchasing with SBV to achieve mutually beneficial greater volume discounts. It should be noted that this has been tried in the past and worked only with books published by the Smithsonian. With few exceptions, such as the panda bears mentioned, items sold by SBV are different from those sold by FONZ.

14. Increase Square Footage of Retail Space, 2nd paragraph, page 6: FONZ is well aware that its retail square footage is too small. However, proposed retail space was eliminated in the Zoo's planning and design of Kids' Farm and Asia Trail to enhance the footprint for animals and exhibits. In addition, in 1989, the FONZ Board made plans and initiated a capital campaign to fund a new Education/Visitor Center in the Zoo that would have included significant retail space. This project was terminated when a change of Zoo leadership resulted in changed Zoo priorities to focus on upgrading deteriorating animal exhibits.

FONZ is dismayed that this paragraph turns a positive indicator--sales per square foot THREE times higher than average--into a negative, especially given FONZ's limited ability to acquire more space. FONZ produced sales per square foot FOUR times higher than average in 2006, as noted in the 2007 consultant's report.

15. Increase Square Footage of Retail Space, 3rd paragraph, page 6: FONZ uses carts and tents to supplement the square footage available for retail. Their use, however, is weather dependent: during heavy rains and excessive heat or cold, these temporary facilities cannot be opened. These facilities are also extremely labor intensive, and storage space is also very limited.

In 2006, cart revenues were \$544,000, 12% of total in-park revenues. The gift shops have made a concerted effort to find spaces on the Zoo grounds to place temporary shopping locations. Some of these additional spaces include: a shop in the Giant Panda exit alcove,

a mobile cart at the Sloth Bears in Asia Trail, a temporary, themed mobile cart at all animal exhibit openings and during weekend special events, and, as staffing warrants, a mobile cart beside Lion/Tiger Hill. One note: while these areas do have electricity, there is no network connectivity at this time. This means the temporary locations run in the off-line mode with no credit card authorization capability. Revenue is lost due to declined credit cards.

16. Increase Square Footage of Retail Space, 4th paragraph, page 6: This anecdotal information does not offer any sound data or details to suggest that the Zoo would benefit by outsourcing. "Generally positive feedback" is not data. Fewer zoos in the sample outsource than not. Are there factors causing zoos to keep retail operations in house? The quotes related to outsourcing increasing sales or creating positive revenue payback are anecdotal and without substantive merit, if metrics prior to outsourcing are not revealed.

The specific references to a 2005 specialty retailer proposal about the benefits FONZ (and the Zoo) would receive under that proposal is inappropriate. The benefits are highly speculative and were independently reviewed and rejected. Listing the cash benefits such as annual net contribution increases and one-time cash payments (to purchase inventory) made in an initial bid proposal is not a sound way to evaluate the complex financial proposals, especially when the data are provided by the proposing organization under a sole-source proposition. The comments do not mention the significant cost that FONZ would continue to bear under this proposal (facilities, utilities, and fees to the Smithsonian).

17. Streamline Overall Staffing Structure, 1st paragraph, page 7: The headline of this section does not reflect the intent of recommendation 4, that "Reexamine FONZ's overall staffing structure and make adjustments as warranted."

Highlighting one zoo that appears to have a smaller staff than FONZ but similar revenues is not useful without also reporting the size of the staffs of any other zoos surveyed with similar revenues. We also note here that the three zoos we could identify, based on the images in Appendix B, and assuming they also provided survey data, generate average revenues of \$1.9 million, only about 35% of FONZ store revenues, making comparisons invalid.

Further, information on the totality of a department's responsibilities is necessary to draw a conclusion about staffing levels. The total operation managed by the staff in this department includes shops, shop operations, the warehouse function that supports deliveries and shipments for the entire FONZ organization, and network management (with technical support provided by the Zoo's IT staff as required).

FONZ also operates an on-line store that is maintained by the department. Because the on-line software is not integrated with the inventory package, the majority of the associated labor costs are due to our manually entering each order. In addition, a significant amount of the time of the department's clerical staff person is dedicated to providing service to our on-line customers. The on-line store grossed more than \$146,000 during 2006. In 2007, the system will be upgraded and fully integrated into the inventory software. While this will significantly reduce the manual portion of the operation, we must still provide service to our on-line customers.

We also do not know how these retail-related positions are distributed among different units in other zoos. For instance, the warehouse staff and/or network management staff may be accounted for separately. Similarly, a senior director of concessions may be in the administration budget despite being active in retail management.

In addition, merchandising staff supports most special events in the Zoo and the expenses for labor hours are offset by the retail revenue. Labor costs for ZooFari, Guppy Gala, Boo at the Zoo, and Zoo Morning are all absorbed and offset by our shops revenue. FONZ warehouse staff and labor costs are entirely absorbed by the Merchandise department, although all FONZ departments use their services. FONZ operates two warehouses and all their operating costs are absorbed by the Merchandise department.

Finally, it must be noted that the phrase "executive-level managers" may suggest salaries comparable to those of SBV executive-level managers. In fact, the executive-level salaries of concern here are comparable to the Federal GS 13/14 level.

18. Food Service, 1st paragraph, page 9: The first part of this sentence is imprecise. The accurate statement is "While FONZ's food and beverage revenues were lower than those of its peers in 2003 and 2004, and higher in 2005, . . ."

It should be noted that 2003 was the worst year for FONZ concessions since 1987. (Data from 2006, the best year in FONZ history, were omitted from the analysis.) The combination of weather, including a hurricane, CODE ORANGE conditions, and repercussions of 9/11 worked to reduce visitors and school groups from out of town and virtually eliminated visits by local school groups. These factors did not affect peer zoos around the country. The St. Louis Zoo increased food service revenues by 19.5% from 2003 to 2006. FONZ food service revenues over the same period increased by 71.6%.

Further, lower revenues than average in 2003 and 2004 when visitation was lower is influenced by the fact that FONZ is required, under our the contract with the Smithsonian, to provide food service 364 days per year, regardless of business. Food Service operates three months in the negative during some years for this reason. Unless other zoo food service operations work this way, the comparison is not valid.

19. Food Service, 2nd paragraph, page 9: "A key approach to staffing . . ." is somewhat misleading. The Zoo is located in the city and can be easily reached by city youth. It is natural that young people would seek employment close to their homes and food service jobs are often a "first" job. Plus, as a city Zoo and an educational institution, partnering with the local schools and providing employment opportunities to local students is and should be one of our goals.

Further, staffing entry-level food service positions is an industry wide challenge, and particularly difficult in city locations.

A trade press article in *Nation's Restaurant News* (Sept. 4, 2006) underscores this point:

"A challenge even in the best of time, recruiting and retaining employees has emerged as one of the most critical issues facing the foodservice industry as unemployment continues to decline in the United States."

Similar article, same trade press publication, August 28, 2006:

"Taco John's is encouraging its franchisees to put a premium on traditional recruiting methods," Dixon said.

"Find the really good kids in high school, get them to recruit their friends and build a wonderful working situation in the store," he said. "The affinity side will attract more than the money side."

The Zoo faces a particularly difficult challenge in its recruitment of concession staff, a challenge different than that faced elsewhere at the Smithsonian. Because the Zoo is an outdoors experience, visitation peaks early in the spring (April is traditionally the largest visitation month) before high school and college students are available for employment. Recruiting and retaining a full-time but nonetheless seasonal staff is a more difficult challenge than filling a stable, year-round, indoors concessions operation.

To meet this challenge, FONZ has expanded its recruitment efforts in 2007, hosted five successful interdepartmental job fairs with direct concession management and existing staff involvement, animal displays, refreshments, and a targeted recruitment presentation.

To increase staff's affinity with the Zoo, a concessions staff enrichment program is being developed this year in cooperation with the Zoo's Animal Programs to provide behind-the-scenes animal tours, a commissary tour, and other events to connect the seasonal workforce more closely with the Zoo itself.

FONZ offers a recruitment incentive for existing workers who are able to recruit friends and colleagues. FONZ staff who successfully recruit new employees receive a cash payment bonus of \$50 for each new recruit who works for us for 30 days and another \$50 after that individual works 90 days.

FONZ attempts to attract a diversified applicant pool by reaching out to the greater metropolitan community. This includes advertising in a variety of mainstream print and web publications, partnering with community organizations, attending university job fairs, and encouraging all Zoo staff to refer qualified candidates.

20. Food Service, 1st paragraph, page 10: Anecdotal evidence, as offered here, does not constitute analysis on which to form a conclusion. Additional data, including how many visitors were queried about their experience, whether they were selected at random or some other appropriate sampling method, and what their comments were, are required. Also, while FONZ is responsible for vending machine operations, the actual work is performed by Coca-Cola, not FONZ staff.

21. Customer Service, 1st paragraph, page 12: A closer look at the data indicates that customer service has not declined from 2005 to 2006. The 2005 Average Score for customer service at the gift shop registers was 74.7% for 72 shops. The 2006 Average Score for customer service at the register (noted as Transaction at the Register on the reports) was 74.7% for 70 shops.

Note: In 2006 the report was modified to score two types of gift shop employees – ones at the register transaction (Transaction at the Register) and ones on the sales floor (Customer Service). A valid comparison, as noted above, is the average scores of the employees on the registers.

The IG report states a visitor survey from 2004 documented 21% of the visitors rated food quality as excellent compared to the benchmark of 52%. The shoppers' reports reflect 46% rating the food as outstanding. The IG report also notes cold food. The shoppers' reports indicate food was served at the appropriate temperature as above 90% each year.

While shoppers reports indicate the customer service standard remained unchanged, in the fall of 2006 FONZ began an initiative to place greater emphasis on providing improved levels of service. After interviewing two firms, Customer Service Experts was engaged to assist with changing the culture of FONZ to one that truly values exemplary customer service.

On April 19, 2007, FONZ directors and key employees participated in an interactive workshop to intensify its focus on customer service training and performance. A

customer service theme, standards, and behaviors were developed and adopted for the entire organization. These will be used to develop a training program to reinforce the new service-oriented culture with all staff members. Trainers will be selected from various departments so that all employees and departments will own the new initiative. Every current employee will participate and new employees, as they join the organization, will attend the training program on their first day of employment.

22. Customer Service, 2nd paragraph, page 12: With regards to the 2004 survey, the information is outdated and not relevant to a report being released in 2007. A 2005-2006 survey completed by Customer Service Experts was available, but not used in this report. This survey indicates Food Service scored higher than average with regards to service time. FONZ tracks hourly sales, which indicate service times currently average 2 minutes 18 seconds per order with a per cap of \$7.80. In 2007, FONZ increased window service, cash registers, added supplementary vendors, and more.

23. Customer Service, 3rd paragraph, page 12: A single anecdote, as offered here, does not constitute analysis on which to form a conclusion. Additional data, including how many visitors were queried about their experience, whether they were selected at random or some other appropriate sampling method, and what their comments were, are required.

24. Customer Service, 4th paragraph, page 12: FONZ has used secret shoppers consistently for the past five years and takes all comments seriously. FONZ responds and takes follow-up action on all complaints. FONZ also receives complimentary letters regarding service.

25. Customer Service, 1st paragraph, page 13: FONZ believes that scientific surveys of visitor satisfaction with sound statistical analysis of the data are a far superior way of measuring customer feedback and identifying both problems and areas of excellence compared to reviewing the anecdotes on comment cards. The Smithsonian Office of Policy and Analysis is now conducting thrice-yearly scientific surveys of visitors, beginning in Spring 2007.

26. Opportunities Exist to Increase Parking Revenues, 2nd paragraph, page 14: The National Zoo/FONZ website also encourages visitors to use public transportation, in line with the Zoo's sustainability goal, and provides information on Metro rail and bus.

27. Opportunities Exist to Increase Parking Revenues 3rd paragraph, page 14: The contributions of those people who park free should be factored into the analysis. The value of work provided by volunteers in 2006 was \$2.2 million. The parking revenues from the 10,900 volunteers who parked free would be \$175,000. The total number of members parking free in 2006 was 73,150—on average, members parked free fewer than two times during the year. In addition, membership generated revenues of \$2.5 million in

APPENDIX C. MANAGEMENT RESPONSES (CONTINUED)

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2006, and members form an overwhelming proportion of special event ticket buyers, generating most of the \$1.2 million from fundraising events in 2006.

28. Opportunities Exist to Increase Parking Revenues, 4th paragraph, page 14: The National Zoo is one of only three zoos with free admission. But the true cost of a day at the zoo includes much more than the admission price. Extra paid attractions generate revenue and provide extra value to support a higher membership price.

The other two zoos, St. Louis and Lincoln Park, have no admission to enter but have paid attractions within their zoos. The attractions include special shows, exhibits, transportation/rides, and theme park rides. The National Zoo does not currently have any of these items to use as a sales incentive to justify a higher cost of membership. Listed below is the average cost a family of four would pay for a day at the zoo:

St. Louis Zoo	\$33
Lincoln Park Zoo	\$38
The National Zoo	\$24 (National Zoo cost based on parking for 3+ hours and a stroller rental [\$8]--but note that a relatively small number of visitors rent strollers.)

Members consider free parking their most important benefit. The FONZ Membership Committee has recently reviewed the parking benefits for members when it raised the membership rates effective in 2006.

Regarding one of the two zoos mentioned here, Lincoln Park Zoo took over parking operations from the Chicago Park District two years ago. Previously, members had to pay for parking whenever they visited the zoo. So, Lincoln Park added a benefit with a range of free parking privileges, depending on membership level.

29. Policies and Procedures, 1st paragraph, page 16: Operational policies and procedures of the departments are not approved by the Board of Directors. Instead, the Board's responsibility is to oversee broader issues and set policy where required.

FONZ is an organization of diverse functions. Each department prepares and follows policies and procedures necessary to perform their functions. The examples cited by the report serve as good examples.

The procedures (not policies) for purchasing merchandise for resale are not relevant to other FONZ departments. With a purchasing staff of only two, detailed procedural guides are not required.

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Likewise, formal written policies on the process for awarding vendor contracts are not needed. The staff of two do this annually and such contracts are reviewed by FONZ management.

Food Service has always used a competitive bidding process when awarding vendor contracts. That this simple rule does not take the form of a formal written policy is irrelevant so long as the policy is following. In 2006, we requested bids on food and paper from 18 companies. The success of our competitive bidding process is reflected in our lower than average food costs, which the report notes. Further, some of the vendors we select also generously donate products to various special events.

FONZ did have formal procedures for performing detailed bank reconciliations. As noted by our outside independent auditors in the audit of 2005, the staff, under the direction of the previous controller, was not following the procedures. Following the departure of that person, bank audits have been performed monthly and this was recognized in the 2006 audit.

30. Policies and Procedures, 3rd paragraph, page 16: The report implies that FONZ controls on the financial accounting and check writing are lax. FONZ has numerous controls on use of funds and the payout of those funds. No one in the Business Office has signature authority for checks. The payroll is processed by one person and approved by another. Similar controls exist for other electronic payments.

The payroll person has access to the accounting systems because she performs other accounting duties. In our small organization, every member of the accounting team has multiple duties. Internal controls cannot be maintained by separation of duties alone, but by approval levels and multiple reviews.

Further, no such weaknesses were identified in the recently completed financial audit by an outside independent audit firm.

The FONZ Business Office does have firm segregation of duties and a monitoring system to track all transactions. The FONZ Business Office staff does have full access to the financial system. However, this is because we are a small department responsible for a large facility and our duties are dynamic. Most important, cross training has proven to be vital part of our ability to be successful. (For example: The Staff Accountant is responsible for month-end journal entries and Accounts Receivable, which require access to both modules. The Staff Accountant also assists Accounts Payable during extremely busy times and as a result has access to Account Payable. The Staff Accountant does not complete the bank reconciliations.) All receivable, payable, and journal entries and balance sheet reconciliations are thoroughly reviewed and approved by either the Controller and/or Assistant Controller. The journal entries numbers are monitored

monthly and reviewed during the interim and yearly public audit. These measures ensure the protection of our assets from theft and incomplete books of accounting.

We can provide the Review and Approval Schedule used by the Business Office on request.

It should be noted that the OMB Circular cited in the footnote does not apply to FONZ, which is not a Federal entity.

31. Oversight of Policy Implementation, 1st paragraph, page 16: Minutes of meetings of the full FONZ Board are maintained. Only the full Board is empowered to exercise the governance function in a nonprofit organization. Recommendations regarding budget and other financial matters are brought to the full Board by the Finance and Audit Committee.

FONZ committees do not maintain minutes because their decisions are not official until approved by the full FONZ Board.

Three of the four missing months of Board minutes in early 2005 appear to be related to the short tenure of an Executive Director who is no longer with the organization.

Review and approval of Board minutes is a standard operating procedure as evidenced by Board performance and minutes over the past 24 months.

32. Oversight of Policy Implementation, 1st paragraph, page 17: While the audit papers may contain such a comment, we have been unable to locate a record of such a direction nor do the Committee members remember such a tasking. Discussion with the senior member of the external audit staff revealed no knowledge of such a tasking either. FONZ performed detailed risk assessments by department in 2002, following 9/11. These are available for review. Since then, as new risks have been identified, procedures have been changed as required.

33. Oversight of Policy Implementation, 2nd paragraph, page 17: This paragraph was revised from the discussion draft when that version was found to be incorrect. We believe the current version is also incorrect.

The FONZ Investment Policy states that the services of an investment professional will be contracted to manage the Intermediate and Long-Term Funds. In accordance with these policies, US Trust was retained to manage the Intermediate and Long-Term Funds in a discretionary manner and there was no direction required from FONZ in regard to specific transactions. (The Short-Term Fund is managed by the FONZ Controller, as specified in the Investment Policy, and is held in an account outside US Trust.

The 2005 investment objectives were that the investment time horizon is *at least* 3-5 years. This meant that large draws of funds to support construction projects at the Zoo would not be required for 3-5 years, i.e., no draws would be made in the next two years.

34. Oversight of Policy Implementation, 3rd paragraph, page 17: It should be noted that the audit found no waste, fraud, or abuse, no improper activities by FONZ leadership or staff, and no significant risks.

Comments on Scope and Methodology

The scope of and methodology used to conduct this audit, while laudatory, is a bit troubling. Comparing zoos, museums, and aquariums is difficult. This audit took the understandable step of attempting to develop a benchmark or zoo average upon which to judge the profitability and operation efficiency of FONZ. A survey to accumulate data was undertaken. Eighteen of the 31 zoos surveyed replied, and data from only the "approximately" ten retail operations and eight food service operations that do not outsource these functions were used to generate zoo averages (see footnote page 3). Further, during the exit conference, the lead auditor reported that outlier data points were discarded, so the actual number of zoos used to generate the averages may have been even fewer. The audit team did not verify the accuracy of the data. An assumption was made that the survey instructions were understood and uniformly carried out by 18 separate entities, all with their own cost structures and operating practices and policies, and that the survey yielded uniform data upon which to base the analyses required to accomplish the scope of this audit. According to the footnote on page 2, "certain adjustments to respondent data were made to improve comparability." These adjustments are not described.

All of the following, among other factors, make comparing existing revenue operations at different zoos a challenging task when there are:

- Differences in climate and facilities that can or cannot accommodate year-round operations;

- Differences in the size of usable zoo property for parking and exhibit space;

- Differences in the existing size and placement of retail and food operations;

- Differences in zoo philosophies regarding zoo amenities;

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Differences in labor and other costs. (To cite one example, Washington, D.C.'s, minimum wage is, by law, \$1 more than the federal minimum wage.)

Smithsonian sensitivity to commercialization.

Because these factors were not addressed, true apple to apple comparisons cannot be found in this report, considerably reducing its objectivity and utility. Hence, when examining the central focus of the report and looking for useful recommendations, the reader is left instead with averages, generalizations, and opinions upon which little action can be taken.

Given that only a few zoos have truly comparable attendance and concessions revenue, the results of the survey may be skewed by the figures provided by zoos that are less comparable than others, depending on which zoos failed to respond. A list of the zoos asked to participate and those that actually participated would have helped FONZ evaluate comparability and follow up on any "best practices" we might incorporate.

Also, it should be noted that data from only "approximately" ten retail operations and eight food service operation were used to generate the zoo averages. However, Chart 10 on page B-6, only four other zoos provided data for comparison.

Because SBV did not complete the auditors' survey and provided only limited concession information, the results of these comparisons may be very misleading or even spurious.

Excluding data on general and administrative expenses could have had a significant impact on the results reported here. For example, if some zoos account for some retail or food service staff under General and Administrative expenses, while FONZ's administrative staff does not include retail and food service staff at any level. We also wonder whether "vast differences" in this area carried over into data that were analyzed.

More significantly, on page B-10 is the "Key to financial measures." As defined here, Net Contribution = Revenue less all Expenses listed above. Expenses listed above = COGS, Direct Labor Expenses, and **Other Direct Expenses** [emphasis added]. Yet, according to the last bullet point under Notes, "While other direct expenses are factored into the calculation for net contribution, we [the auditors] did not fully analyze them because **zoo expense structure and allocation methods vary considerably** [emphasis added]."

The conclusion of the above is that comparisons of net contribution with other zoos are invalid. As a result, significant findings based on the comparisons can not and should not be made when the methodology is so questionable.

The auditors reported obtaining comparative data from outside contractors, but these data do not appear in this report, although they would be potentially useful, especially regarding the issue of outsourcing FONZ's retail operations. In comparing retail operations above, the ten zoos that outsourced their retail operations were specifically excluded from the zoo averages used in comparative analysis.

Regarding the review of the prior OIG audit of Zoo parking (paragraph 3, page A-1): The audit, Number A-04-09, dated December 27, 2004, stated, "controls were adequate to ensure that parking revenue was properly collected, deposited, and recorded in the FONZ accounting system." The audit recommended changes in the controls on safes in the FONZ vault room, physical security improvements in the rooms used to count receipts, and improvements to reconciliation documents. These improvements have been made. The recent 2006 Financial Audit by Johnson Lambert & Company detected no such existing weaknesses. The IG audit, Number A-04-09 did not "identify weaknesses concerning internal controls" as mentioned in this paragraph.

Appendix B

35. Chart 5, page B-3: Visitation data for the National Zoo are estimated. Basing comparisons on such data may produce errors. And, almost certainly, 0.14 fewer registers per 100,000 visitors (if this number is accurate) relates to FONZ's lower than average square footage. Adjusted for square footage, FONZ would have more than the average number of registers. Regarding the capture rate comparison, it should be noted that this is an extremely positive result that shows FONZ doing an excellent job with less than an ideal amount of space.

36. Chart 6, page B-4: It should be noted that 2003 was FONZ's worst year ever, with Zoo visitation and related revenues affected by factors that did not affect other zoos. See comment 18 on page 5 above.

We don't understand the point of the apparently negative comment and inference. At the National Zoo, food service has always had lower revenues than merchandise, but, due the difference in cost of goods sold, the contribution has been greater.

37. Chart 7, page B-4: The comment on this chart implies that we overcharge for food. All prices are set using comparative information from similar venues in the city and are approved by the Smithsonian.

38. Chart 10, page B-6: Other factors not mentioned here influence food and beverage capture rate. A notable one is the presence or absence of food service alternatives conveniently located just outside a zoo's gates. FONZ competes with dozens of food service operations--from carts to white tablecloth restaurants--between zero and four

blocks north and south of its main entrance at Connecticut Avenue, and with a major dining destination in Adams-Morgan about six blocks south of its Harvard Street entrance.

Comparing FONZ merchandise operations to SBV's is questionable given the auditors' difficulty getting complete information from SBV.

39. Chart 11, 12, page B-7: The scales skew the comparison so FONZ's performance does not look as good as it is. In fact (if the comparison is based on good data), from 2003 to 2005, FONZ revenues increased by 75% while SBV's increased by 60%.

Regarding the following: "FONZ's revenue and net contribution in 2005, with the debut of Tai Shan, was still not as high as it was in 2001, after the arrival of two new pandas and before the impact of the 9/11 terrorist and D.C. sniper attacks." This suggests that FONZ was not performing well in 2005, despite Tai Shan's debut. Tai Shan's debut was in December of 2005, so there was only about a month when he impacted revenues, not long enough to have a significant affect on 2005 revenue. Tai Shan's first full year, however, led to record 2006 revenues.

40. B-10 Key to financial measures

As defined here, Net Contribution = Revenue less all Expenses listed above. Expenses list above = COGS, Direct Labor Expenses, and **Other Direct Expenses** [emphasis added]. Yet, according to the last bullet point under Notes, "While other direct expenses are factored into the calculation for net contribution, we [the auditors] did not fully analyze them because **zoo expense structure and allocation methods vary considerably** [emphasis added]."

As mentioned earlier, we believe that comparisons of net contribution with other zoos are invalid. As a result, significant findings based on the comparisons can not and should not be made when the methodology is so questionable.



Smithsonian's
National Zoological Park

Memo

Director

Date: June 15, 2007

To: A. Sprightley Ryan, Inspector General

From: John Berry, Director *John Berry*
Mary R. Tanner, Deputy Director *Mary R. Tanner*

cc: Cristian K. Samper, Acting Secretary
Robert J. Lamb, Executive Director, FONZ
Robyn S. Kravit, President, FONZ Board of Directors
William W. Brubaker, Director, OFEO

Subject: Draft Report on the Audit of Revenue Operations at FONZ, Number A-06-01

Thank you for providing a copy of the draft Audit of FONZ Revenue Operations. Attached is a specific response to each recommendation on behalf of the National Zoo.

We would like to note that many of the recommendations are ones that have been actively addressed, or are in the process of being addressed, over the past year by new FONZ management. These recommendations confirm the direction that the FONZ-Zoo partnership is taking to improve visitor services and provide effective and profitable concession opportunities.

NATIONAL ZOO COMMENTS ON OIG FONZ DRAFT AUDIT

June 2007

Rec	Description	Comments
1	Aged Inventory Reports	See FONZ response
2	Cost of Goods Sold	See FONZ response
3	Expand Use of temporary retail structures	Concur, underway; circulation and aesthetics must also be considered
4	FONZ staffing structure	See FONZ response, however, managers are paid at the equivalent of the lower end of GS-13/GS-14 pay scale and would not be considered executive level in SI system.
5	Establish financial targets for revenue and net contribution growth	Concur
6	Expand temporary and permanent food services	Concur, underway; circulation and aesthetics must also be considered
7	Increase seasonal, long-term contracts to support food services	Concur, underway; circulation and aesthetics must also be considered
8	Improve customer service training	Concur, underway
9	Document & evaluate visitor feedback and follow-up	Concur
10	Evaluate free parking for FONZ and Zoo employees and other tenants	Concur but need to assess with FONZ Board & AFGE Union. Would like to defer until 2009 due to AZA accreditation and ZIMS implementation in 2008. FONZ employee parking options should follow SI employee decisions.
11	Examine unlimited free parking for FONZ members	FONZ Board action.
12-15	FONZ operations & governance	See FONZ response
16	Incorporate revenue producing factors into Zoo master planning	Concur and underway.

APPENDIX D. CONTRIBUTORS TO THE REPORT

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

Stuart A. Metzger, Assistant Inspector General for Audits
Joan T. Mockeridge, Supervisory Auditor
Douglas Kodish, Senior Auditor
Mary Stevens, Auditor