AUDIT REPORT

Oversight of Contractors At Smithsonian Business Ventures

Number A-07-05

February 25, 2008

Smithsonian Institution

Office of Inspector General

Smithsonian Institution
Office of the Inspector General

In Brief

Oversight of Contractors at Smithsonian Business Ventures

Report Number A-07-05, February 25, 2008

Why We Did This Audit

This audit is the second phase of our coverage of executive compensation at Smithsonian Business Ventures (SBV). The audit follows up on accounting weaknesses and weaknesses in contractor oversight noted in earlier audits.

Our objectives were to assess whether SBV has adequate procedures for ensuring the accuracy of revenues reported by contractors; SBV's practices for collecting and recording proceeds; and whether SBV adequately oversees contractors to ensure compliance with key contract terms.

What We Recommended

We made five recommendations to strengthen oversight of contractors. We recommended that management develop written procedures that clearly define employee responsibilities for monitoring contracts, provide for periodic audits of contractor cash receipts, and require detailed monthly reconciliations of contractor revenues.

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

What We Found

SBV in many instances did not ensure revenues from contractors were collected timely or recorded accurately. SBV needed to improve its procedures for financial monitoring in two divisions, Journeys and Concessions. In contrast to financial contract provisions, SBV generally provided effective oversight of operational issues, such as the quality of contractor activities, which was sufficient to provide reasonable assurance that contractors were complying with non-financial contract terms.

For Journeys, we found that SBV did not adequately or timely reconcile cash received from its call center contractor to amounts due from its travel tour operations. As a result, SBV did not timely identify cash shortfalls of $607,000 from over 100 tours completed through the end of FY 2006. After further examination, SBV Accounting identified an additional $75,000 due from a travel tour contractor in FY 2007. As of September 30, 2007, SBV had recovered $607,000 of these shortfalls.

For Concessions, we found that SBV overpaid a contractor and did not record the correct amount of revenue from motion ride simulators during the period August 2004 to January 2007. SBV omitted credit card sales and used incorrect commission rates in calculating concessions revenue from this contract. As a result, SBV overpaid the contractor and understated revenue by about $283,000. SBV identified the problems in February 2007 and recovered the money due from the contractor and corrected its accounting records by the end of FY 2007.

SBV's contractor monitoring weaknesses were caused by an absence of written procedures, inadequately defined responsibilities, insufficient financial staff coupled with high turnover rates, and a lack of periodic financial audits and detailed reconciliations of cash receipts. To its credit, SBV initiated actions in FY 2007 to address some of the weaknesses we identified. For example, the SBV Controller implemented a policy requiring that all journal entries into the accounting system be approved by a supervisor in order to detect irregularities more timely.

Overall, for the contracts we reviewed, we did not find incorrect reporting of contractor revenues to a degree that would have had a material effect on SBV's executive compensation.

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.

Smithsonian Institution

Memo

Office of the Inspector General

Date February 25, 2008

To Cristián Samper K., Acting Secretary
Thomas Ott, Acting Chief Executive Officer, SBV

cc Greg Bokman, Chief Financial Officer, SBV
Beth Cunigan, Comptroller, SBV
Paul Flickinger, Chief Operating Officer, Museum Retail Operations, SBV
John E. Huerta, General Counsel
Amy Kotkin, Director, Journeys, SBV
Alison McNally, Acting Under Secretary for Finance and Administration
Alice C. Maroni, Chief Financial Officer
Toby Mensforth, Vice President, Concessions and Theaters, SBV

From A. Sprightley Ryan, Inspector General

Subject Report on the Audit of Oversight of Contractors at Smithsonian Business Ventures, Number A-07-05

This audit is the second phase of our coverage of executive compensation at Smithsonian Business Ventures (SBV). We initiated this audit to follow up on weaknesses noted in accounting for revenues and expenses in phase one,[1] as well as weaknesses in contractor oversight noted in an earlier audit of SBV simulators.[2] Our objectives were to assess (1) whether SBV has adequate procedures for ensuring the accuracy of revenues reported by contractors; (2) SBV's practices for collecting and recording proceeds from contractors; and (3) whether SBV adequately oversees contractors to ensure compliance with key contract terms.

Our audit focused on revenue-generating contracts greater than $75,000 from fiscal year (FY) 2004 through the first quarter of FY 2007. Revenues from these contracts totaled about $38 million, including $25.7 million from Concessions, $7.2 million from Journeys, and $4.6 million from Licensing. From this total, we reviewed 10 contracts with revenues totaling $18.7 million. We also conducted a limited review of two fulfillment contracts in the Catalogue and Magazine divisions that support revenue generation. We include a detailed description of our scope and methodology in Appendix A.

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[1] *Audit of Executive Compensation at Smithsonian Business Ventures, Phase 1,* No. A-06-02, January 19, 2007.

[2] *Audit of National Air and Space Museum Mall Simulators,* No. A-04-10, February 25, 2005.

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RESULTS IN BRIEF

We found that SBV in many instances did not ensure revenues from contractors were collected timely or recorded accurately. SBV needed to improve its procedures for financial monitoring in two divisions, Journeys and Concessions. In contrast to financial contract provisions, SBV generally provided effective oversight of operational issues, such as the quality of contractor activities, which was sufficient to provide reasonable assurance that contractors were complying with non-financial contract terms.

For Journeys, we found that SBV did not adequately or timely reconcile cash received from its call center contractor to amounts due from its travel tour operations. As a result, SBV did not timely identify cash shortfalls of $607,000 from over 100 tours completed through the end of FY 2006. After further examination, SBV Accounting identified an additional $75,000 due from a travel tour contractor in FY 2007. As of September 30, 2007, SBV had recovered $607,000 of these shortfalls.

For Concessions, we found that SBV overpaid a contractor and did not record the correct amount of revenue from motion ride simulators during the period August 2004 to January 2007. SBV omitted credit card sales and used incorrect commission rates in calculating concessions revenue from this contract. As a result, SBV overpaid the contractor and understated revenue by $283,000. SBV identified the problems in February 2007 and recovered the money due from the contractor and corrected its accounting records by the end of FY 2007.

SBV's contractor monitoring weaknesses were caused by an absence of written procedures, inadequately defined responsibilities, insufficient financial staff coupled with high turnover rates, and a lack of periodic financial audits and detailed reconciliations of cash receipts. To its credit, SBV initiated actions in FY 2007 to address some of the weaknesses we identified. For example, the SBV Controller implemented a policy requiring that all journal entries into the accounting system, including those related to contractor revenues, be reviewed, approved, and initialed by a supervisor in order to detect irregularities more timely.

Overall, for the contracts we reviewed, we did not find incorrect reporting of contractor revenues to a degree that would have a material effect on SBV's executive compensation. However, to further strengthen oversight of all its contractors, we are recommending that SBV develop written procedures that clearly define employee responsibilities for monitoring contracts, provide for periodic audits of contractor cash receipts, and require detailed monthly reconciliations of contractor revenues.

BACKGROUND

Most of SBV's revenue-generating operations are operated in-house by SBV employees. Of SBV's five major income-producing divisions, SBV uses contractors to produce a large portion of the revenue in three: Smithsonian Journeys, Licensing, and Concessions (a part of the Museum Retail division, which also includes stores and theatres). Table 1 shows the total reported SBV revenues for the three activities we reviewed for the period FY 2004 through the first quarter of FY 2007.

Table 1
Total SBV Revenues for Selected Activities*

Fiscal Year	Journeys	Licensing	Concessions
2004	See footnote 3	$3,900,000	$6,967,000
2005	$4,507,000	$2,637,000	$9,017,000
2006	$5,442,000	$4,236,000	$8,538,000
2007[4]	$1,054,000	$1,102,000	$1,485,000
Totals	$11,003,000	$11,875,000	$26,007,000

*dollars rounded to the nearest (000)

Contractors operate travel tours, licensing activities, and food and other concessions under a number of different agreements. SBV generally receives a percentage of the contractors' revenues as provided for in the respective agreements. A brief description of each activity follows.

Journeys. Smithsonian Journeys is an educational group tour program. SBV programming and marketing staff manage the programs in cooperation with travel partners nationwide. Journeys contracts with third-party tour operators to operate most of the travel tours.

Licensing. The Licensing group contracts with third parties to sell Smithsonian-branded products and services. Partnerships usually take the form of an agreement in which SBV licenses to the third party the right to use the Smithsonian brand or access the content of the Institution. Licensing comprises four primary activities: Consumer Products, Smithsonian Books, Smithsonian Networks, and Smithsonian Student Travel.

Concessions. The Concessions organization is part of SBV's Retail Division. Concession vendors generally own and/or manage the on-site business operations and fall into two types of commercial enterprises: 1) food and beverage concessions such as restaurants, outdoor food carts, and vending machines; and 2) other

[3] SBV did not take over travel tours until FY 2005.
[4] Reported revenues for the first quarter FY 2007.

concessions, which include experiential attractions such as flight simulators and a carousel.

For the period FY 2004 through the first quarter of FY 2007, Smithsonian contracts with revenues of $75,000 or more produced revenues of approximately $7.2 million for Journeys, $4.6 million for Licensing, and $25.7 million for Concessions (see Table 2 below). We selected a sample of contracts from this universe to review.

Table 2

Revenues from Contractors for Revenue-Generating Contracts of $75,000 or More*

Fiscal Year	Journeys	Licensing	Concessions
2004	See footnote 3	4 contractors $ 787,000	11 contractors $6,888,000
2005	13 contractors $2,855,000	6 contractors $ 930,000	11 contractors $8,938,000
2006	13 contractors $3,621,000	8 contractors $2,183,000	10 contractors $8,440,000
2007[5]	8 contractors $699,000	7 contractors $ 688,000	7 contractors $1,425,000
Totals	$7,175,000	$4,588,000	$25,691,000

*dollars rounded to the nearest (000)

SBV also awards fulfillment contracts for the Catalogue and Magazine divisions that support revenue generation. Fulfillment houses provide services such as call handling, order processing, billing, and information management. We performed a limited review of SBV's oversight of fulfillment contracts. Table 3 shows the total revenue processed through these fulfillment houses during the audit period.

Table 3

Revenue Processed Through Fulfillment House Contractors*

Fiscal Year	Catalogue	Magazine
2004	$26,669,000	$35,900,000
2005	$26,880,000	$36,900,000
2006	$26,186,000	$37,000,000
2007[6]	$12,376,000	$8,830,000
Totals	$92,111,000	$118,630,000

*dollars rounded to the nearest (000)

For all income-producing divisions, responsibility for monitoring revenue-

[5] Reported revenues for the first quarter FY 2007.

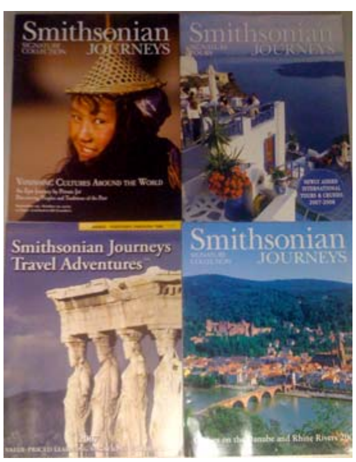
[6] Reported revenues for the first quarter FY 2007.

generating contracts is shared among business division program managers and financial staff, as well as SBV Accounting. Program managers monitor the contractor's execution plan and performance. The designated Contracting Officer's Representative (COR) is responsible for the administration of the agreement and serves as the liaison with the vendor for all contractual matters. Business division financial staffs assist management by reviewing contractor financial reports and comparing the contractor reports to revenue recorded and cash received. They also monitor budgeted to actual revenues and provide explanations for variances. SBV Accounting is responsible for recording entries, preparing accurate and timely monthly financial statements, and managing the month-end account closing process.

RESULTS OF AUDIT

SBV Journeys Did Not Adequately Monitor Payments from Travel Tour Contractors

While we found that Journeys provided extensive oversight of the quality of tour services, in many instances it did not adequately monitor payments from travel tour contractors. More specifically, we found that Journeys did not perform sufficient reconciliations of cash received from travel tour operations, made data entry errors on tour pricing information, and did not timely record receivables due from its call center contractor into SBV's accounting system. These deficiencies, which resulted in either late or under collections of tour proceeds of about $681,000, were caused by the lack of both written contract monitoring procedures and clearly defined responsibilities, and insufficient staff resources.



Journeys Travel Brochures

Journeys' domestic and international travel tours program depends on several outside tour operators to run approximately 250 travel tours per year. We observed that generally Journeys' oversight of the quality of tour operator services was extensive and provided reasonable assurance that tour contractors were fulfilling contract terms and amendments. Journeys' program managers routinely reviewed tour operator marketing information, monitored passenger reservations and cancellations, and used passenger surveys and team study leaders to evaluate the tours. Journeys' director also prepared financial reports that facilitated management analysis of tour-related revenue (budgeted and actual) during monthly operating review meetings with SBV's CFO.

Inadequate Reconciliations. We identified weaknesses in Journeys' monitoring of payments from tour programs. We selected a sample of seven travel tours[7] for detailed review. In four of the seven tours, Journeys staff did not adequately reconcile passenger payments received against the amounts due to SBV and did not collect passenger payments amounting to $15,300 from the call center operator promptly after the tours were completed.

We found:

- For a tour to Oman in February 2006, Journeys' reconciliation did not identify $5,700 in payments due Journeys.
- The call center operator owed Journeys $5,450[8] for a winter wildlife tour in February 2006.
- Journeys did not collect $2,545 owed from a tour to view Seattle glass art in May 2006.
- The call center operator owed Journeys at least $1,605 for a Trans Siberian railroad tour in September 2006.

While Journeys' staff compared the call center passenger payment listings and tour operator final invoices, their efforts in reconciling and following up on payments due were not sufficient. We saw little evidence, either on the reconciliation forms or other documentation, that Journeys financial staff ensured that the cash received by SBV from the call center agreed to the revenue due Journeys according to the contractors reports.[9] Because tour reconciliation forms did not identify whether the monies received agreed to the revenue due from the tours, management could not readily assess whether Journeys had received all monies that were due.

When we discussed our preliminary observations with SBV, Journeys officials indicated that its financial staff performed a detailed 2006 fiscal year-end analysis of over one hundred tours and identified a total of about $607,000 that was due SBV

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[7] We initially selected 11 tours for review. However, we combined five of the tours into one because they were a part of a separate bill representing one tour operator who submitted SBV-earned commissions on a monthly basis.

[8] This tour had an additional reconciliation problem. The program manager mistakenly recorded a single passenger rate of $2,595 on the tour reconciliation sheet, $400 lower than the $2,995 rate per the contract. We verified that SBV did receive payment for the higher rate of $2,995 for three passengers. However, the additional $1,200 (3 passengers times $400) was not shown on the reconciliation sheet and was not recorded as revenue to this particular tour code. At the time of our audit, SBV accounting was reviewing this transaction to determine the proper accounting treatment.

[9] SBV accounting receives details of passenger payments and downloads them by tour code into the Lawson accounting system. These payments are listed by passenger on a report titled "Activity Reconciliation Report." Journey's financial staff use the report to verify passenger payments to the call center's passenger paid list and the tour operator's final invoice.

from the call center for passenger deposits and other payments received for tours dating back as far as July 2005.[10] Journeys provided us with tour-level detail for about $297,000 of the total covering tours for the period July 2005 through FY 2006. Although the call center eventually provided Journeys with a summary attributing the majority of the remaining $310,000 balance to credit card fees and other credits due Journeys, SBV could not produce documents to support this remaining shortfall. And, while we were able to trace most of our sample findings to Journeys' analysis and the call center summary, we could not fully reconcile our results because of the lack of SBV documentation.

According to Journeys management, in June 2005, SBV outsourced Journeys' in-house call center to a private firm to process most tour deposits and some payments using that firm's own merchant number account rather than SBV's number account. This created a financial control problem for Journeys staff since they had to rely on this outside call center to provide them with an accurate accounting of passenger deposits and payments and timely submission to SBV. A Journeys official further stated that in February 2006, the call center advised SBV that it did not want to continue its relationship with Journeys. According to Journeys, its financial staff made many requests to the call center to provide a detailed accounting of amounts due to SBV. Journeys management stated that the call center was unresponsive to these requests until Journeys submitted the final FY 2006 year-end analysis of amounts owed to SBV.

SBV recovered about $607,000 from the call center and tour operators in FY 2007. SBV Accounting staff performed further analysis and identified an additional $75,495 that is due SBV as of September 30, 2007. Of the $75,495 shortfall, $47,057 was a result of the miscoding of a payment from another tour operator.

Data Entry Errors. For a June 2007 tour, both Journeys staff and the current call center made data entry errors that resulted in SBV collecting less revenue than due under the tour operator contract. Prior to making this tour available to the public for booking, Journeys' program manager electronically submitted an "Information Sheet" to the call center containing all contract information, including pricing details. However, she inadvertently submitted a single-passenger rate that was $40 lower than required by the contract. Also, the call center made a second input error when it published this passenger rate at an additional $50 lower than what Journeys had previously submitted. Consequently, some passengers made tour

[10] Journeys management explained that the contractor held back some funds from each tour in anticipation of passengers cancelling or changing their reservations, as the contract with SBV allowed. The contractor was able to do this since passenger credit card charges went through the contractor's own merchant account. However, the credit card companies were already deducting these amounts; therefore, cancellation amounts were being deducted twice. The contractor's actions effectively held back funds from Journeys that should have been sent promptly at the close of each tour.

payments that were lower than the contract rate, resulting in lost revenue to SBV of $720. As a result of our observation, SBV Journeys recovered $400 from the call center, reflecting the call center's portion of the input error, and subsequently implemented procedures to more closely check contract data input for future Journey's tours.

Accounting Issues. SBV did not properly classify the amounts due from tour operators and call centers in the Lawson accounting system. For example, SBV should have recorded entries to accounts receivable to recognize amounts due from contractors monthly as each tour ended. Instead, SBV delayed the recording of receivables until after its 2006 fiscal year-end review. As a result, until the year-end entry was made, SBV's balance sheets for FYs 2005 and 2006 understated both accounts receivable and deferred revenue. We also noted that not identifying the shortfall in passenger payments until the end of FY 2006 increased the risk to SBV that these payments might not have been recovered from the former call center contractor.[11]

In our view, the monitoring deficiencies were caused by the lack of written contract monitoring procedures, inadequately defined responsibilities, and lack of financial staff. For example, Journeys did not have written procedures to define (i) how Journeys program managers should monitor contractors and document its oversight, and (ii) how Journeys financial staff should reconcile cash received versus cash due from contractors. While Journeys program managers used a reconciliation form for part of the reconciliation process, Journeys financial staff did not document their reconciliations of the SBV accounting reports for all payments received to the final tour operator invoices and call center reports. We noted that at the end of our fieldwork Journeys initiated efforts to redesign its reconciliation form.

SBV also has not clearly defined the responsibilities of the Journeys program manager, Journeys financial staff, and SBV accounting staff. Additionally, Journeys management indicated that the primary reason SBV was not following up more timely on amounts due from contractors was because the Journeys financial staff was overburdened with only one full-time financial employee through most of FY 2006.

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[11] In our view, timely recording of the accounts receivable for the outstanding balances due SBV would have subjected the accounts to an aging analysis and thus Journeys could have monitored them more closely for recovery purposes. Although SBV ultimately was able to recover all monies identified in their analysis that was due to them from the contractor, SBV lost the opportunity to earn interest on the funds. Based on available documentation, we noted that on some tours, there was a period of over 17 months in lost interest from the close of the tour until SBV received the funds. SBV accounting has since implemented aging receivables reports which Journeys utilizes in tracking deposits and other payments due for its tour operations.

Recommendations

We recommend that the Director, SBV Journeys:

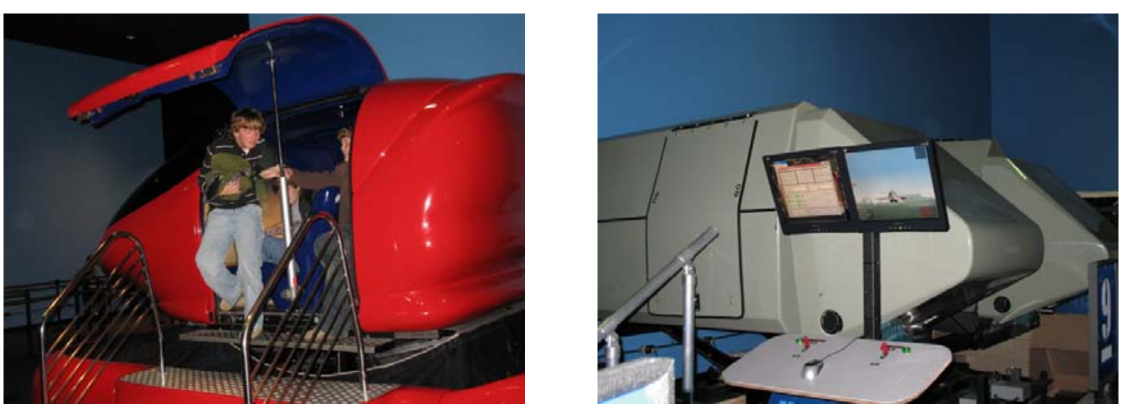
1. Develop written contract monitoring procedures, in coordination with the SBV Controller, that clearly define the responsibilities of the Journeys program manager and financial staff as well as the accountants in the SBV Accounting Department. These written procedures should require detailed monthly reconciliations of contractor activity, prescribe minimum requirements for documenting contractor oversight, and provide guidance on proper accounting treatment for tour activities.

2. Conduct a detailed review of all tour activity codes for FY2007 and identify and collect any outstanding balances that may be due to SBV from the current call center operator.

SBV Did Not Adequately Monitor Revenue from the Flight Simulator Contract

SBV overpaid the contractor and did not record the correct amount of concessions revenue from flight simulator activities from August 2004 to January 2007. We found that SBV miscalculated the proper amount of concessions revenue because it inadvertently omitted credit card sales and applied an incorrect commission rate. These errors, which resulted in an overpayment to the contractor of about $283,000 and a similar understatement in SBV reported concessions revenue, were caused by the lack of written contract monitoring procedures, clearly defined responsibilities, and staff resources, as well as a failure to perform periodic audits of contractor receipts. The errors were detected by the SBV Concessions Manager in February 2007.

The current contractor operates motion ride simulators at both the Steven F. Udvar Hazy Center and Mall locations of the National Air and Space Museum.



Flight simulator rides at NASM

When the contractor began operations at the Udvar Hazy Center in December 2003, it did not process credit card transactions at the simulators and the contract with SBV did not address collection and deposit of credit card receipts. Subsequently, in August 2005, the contractor began accepting credit cards. Since then, the contractor and SBV collected simulator sales revenue by three different methods – cash at the simulator sites, credit cards at the simulator sites, and sales at SBV theater box offices.

Cash collected at the simulator site and theater box office sales were deposited into Smithsonian bank accounts. However, the contractor's credit card sales were processed through the contractor's merchant credit card account and were deposited into the contractor's bank account. And, even though the contractor submitted sales reports showing cash, credit card, and theater box office sales to Concessions financial staff and to SBV Accounting, SBV omitted the credit card sales in its calculations of SBV commission revenue until February 2007, when it detected the longstanding error.

SBV also erred when it calculated the commissions due the contractor. Unlike SBV's other concession contracts, in which the concessionaire collects the revenue and sends SBV a commission, for this contract SBV was responsible for calculating commissions due the contractor. This contract provided that for annual sales revenue up to a specified target, revenue would be divided according to agreed- upon percentages. For annual sales revenue in excess of the target, SBV's portion of the proceeds increased.

For two of the last three contract years (calendar years 2004 and 2006) SBV Accounting did not apply the correct commission rate for the respective periods when annual sales exceeded the target. As a result, SBV significantly understated its concessions revenue. We also noted that SBV Accounting sent sales report worksheets and division preliminary financial statements to the Concessions program and financial staff for review and approval and Concessions staff approved payment documents that contained the inaccurate calculations.

After SBV Concessions detected the errors, SBV held back payments to the contractor until the overpayment was fully recovered. In addition, SBV Accounting prepared a detailed analysis of the adjustment needed to correct the understatement of revenue as of September 30, 2007. We reviewed SBV's analysis and verified their calculations to supporting documentation.

In our view, these errors were caused by the lack of written contract monitoring procedures and clearly defined responsibilities, high personnel turnover and lack of financial staff, and a failure to perform periodic financial audits of cash and credit card receipts.

- Concessions lacked written procedures for monitoring contractors and did not clearly define monitoring responsibilities for the concessions program manager, financial staff, and accountants in SBV's Accounting Department. For example, SBV procedures did not specify who should receive documents from the contractor or who is responsible for performing reviews and reconciliations to ensure that revenue is promptly collected and accurately recorded. We noted that these responsibilities were not included in position descriptions of Concessions financial staff. Also, SBV did not have checklists or other requirements that specified what documents should be compared and reconciled. Written procedures and evidence of reviews are necessary to ensure that timely and effective contract oversight is consistently performed.

- SBV experienced high staff turnover in both the Concessions financial area and the SBV Accounting Department. From August 2004 through September 2007, four different individuals performed Concessions financial duties. During this same period, six individuals held the Concessions accountant position in SBV Accounting, and two of the six were temporary contractors. Overall, as of October 2007, the SBV Accounting Department had five open positions, of which three were filled by temporary contractors. In addition, the Concessions financial analyst position was vacant.

- SBV did not perform periodic audits of cash and credit card receipts. We noted the simulator contract provides that each party has the right to inspect, audit, make extracts from, and copy the other party's financial and business records related to the performance of the contract. Best practices for revenue-generating contracts suggest that SBV should examine receipts on a random basis from the simulator operations and periodically accompany and observe the contractor's employees during cash collection and counting.

To its credit, SBV has since implemented actions to address some of the contract monitoring weaknesses. The SBV Controller established a policy requiring that all journal entries into the accounting system be reviewed, approved, and initialed by a supervisor. Also, as part of SBV's month-end closing process, business divisions must send a communication to SBV Accounting (via e-mail) confirming that they have reviewed and approved the division preliminary financial statements. In addition, the Concessions program director drafted an amendment to the contract simplifying the procedures for handling both cash and credit cards, making it similar to the process used by SBV with its other concessionaires.

Recommendations

We recommend that the SBV Vice President for Concessions, working with the SBV Controller:

1. Develop written contract monitoring procedures that clearly define the responsibilities of the Concessions program manager and financial staff as well as the accountants in the SBV Accounting Department. These procedures should require detailed monthly reconciliations of contractor activity and prescribe minimum requirements for documenting contractor oversight.

2. Establish procedures for periodic independent audits of contractor cash and credit card receipts, including review of daily cash settlement documents and observation of the daily cash counts.

We recommend that the SBV CFO, working with the COO, Retail:

1. Implement a more effective strategy for recruiting and retaining financial and accounting staff for key contract monitoring functions.

Other Matters

We also performed a limited review of SBV's contractor oversight for its Licensing and Catalogue divisions. We found their oversight generally adequate and we are not making any formal recommendations at this time. A brief summary follows.

Licensing

We selected three agreements from two of the four Licensing divisions for review, Product Development and Licensing (PDL) and SI Books. These agreements accounted for $2.2 million out of $4.6 million in revenue generated from all Licensing agreements over $75,000 during the audit period.

Based on our limited review, we found that SBV provided effective oversight to ensure its contractors complied with key contract terms and performance standards. For example, Licensing prepares quarterly updates on the progress of each large contract. Further, PDL staff monitors product quality on a regular basis through facility visits, attendance at trade shows, and reviews of all product-related documentation, including specification sheets for new products, and obtaining input from museum curators before final approval. SI Books staff review quarterly sales reports, attend marketing and editorial meetings, and review books to ensure appropriate content.

Licensing obtains monthly and quarterly financial reports from each of these contractors and compares cost and pricing data to the contract terms as well as reported sales to estimated budgeted figures. While the monthly financial reports are not independently certified, some contracts require that the contractor furnish an independent CPA-certified financial statement of Smithsonian sales in the event that the Smithsonian has a reasonable basis for needing this statement. Also, the contracts generally provide SBV the right to conduct audits of the contractor's books and records. Licensing has contracted with a private firm to conduct financial audits of three of its contractors, effective FY 2008.

We also note that Licensing has developed draft procedures for monitoring contractor operations. We believe these procedures provide a good structure for overall contract oversight and encourage Licensing to finalize the procedures as soon as practicable.

Catalogue

Catalogue contracts out its catalogue transaction services to a fulfillment contractor. Fulfillment services include web order processing, inbound call handling for orders, warehousing and distribution, credit card processing, and information management. The contract in place at the time of our review was effective from May 2002 through early May 2007. SBV awarded a contract to a new fulfillment contractor in May 2007 when the prior contract expired.

Based on our limited review of accounting entries, we did not find any discrepancies that warranted further review other than minor differences between detail and monthly summaries, which were less than one-tenth of 1 percent of total sales. These minor differences resulted from cut-off dates and timing differences between the reported months.

We observed that management uses numerous reports to track inventory and contractor operating performance. We selected a key performance indicator from the contract to review, the abandoned call rate, which indicates the number of customers' calls that the call center did not answer when customers call in orders. The contract requirement was that this rate should not exceed 3 percent. In our review of six sample months we found one month - December 2004, at the height of the holiday season when call volume was extremely high - where the abandoned call rate was 4.12 percent.

Catalogue operations experienced a much worse abandoned call rate problem the following year during the first quarter of FY 2006. In an April 2006 assessment, the SBV CFO identified about $600,000 in lost revenue attributable to an under-forecasting of call orders and a staff shortage at the contractor's call center. As a consequence, the call center could not handle call volumes and dropped over 5,000 call orders, reflecting an abandoned call rate that exceeded 14 percent. Because much of the Catalogue division's annual profits are earned during the holiday season in the first quarter of each fiscal year, Catalogue could not recover the lost revenue and reported a disappointing net loss for FY 2006 of over $100,000 versus a budgeted net gain of $1.8 million. According to Catalogue management and our test sample review of subsequent months' reports, the problem with dropped calls did not recur in FY 2007.[12]

SUMMARY OF MANAGEMENT RESPONSE

Management's February 5, 2008, response to our draft report concurred with all five recommendations. By June 30, 2008, Journeys' management will conduct a review of FY 2007 tours to ensure collection of any outstanding balances due to SBV. For both Journeys and Concessions, by September 30, 2008, management will develop contract monitoring procedures that clearly delineate responsibilities between program and financial staff as well as the SBV Accounting department, including more detailed and timely reconciliations. In addition, Concessions management will formulate appropriate policies and procedures for periodic independent audits of contractor receipts and documentation. Moreover, management will continue to recruit for any existing open positions and document roles, responsibilities and procedures in the contract oversight functions to ensure mitigation of any future vacancies.

With regard to the facts presented in the report, SBV indicated that subsequent to the issuance of the draft report, it located supporting detail for $286,148 of the $310,000[13] shortfall related to credit card refunds.

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

OFFICE OF THE INSPECTOR GENERAL COMMENTS

Management's planned actions respond to the recommendations, and we consider the recommendations resolved. Regarding the additional detail SBV provided, the information only covered the period October 2005 to February 2006, while the $310,000 unsupported shortfall was for the period April 2005 to September 2006. The additional documentation SBV provided was still not sufficient to fully reconcile the shortfall.

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

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[12] Beyond contract oversight issues, we also observed that SBV Catalogue's year-end financial results for FY 2007 were about break-even, $500,000 short of its budgeted net gain, and only a small improvement from the loss in FY 2006. We urge SBV to examine all the causes for the poor financial performance in its Catalogue operations and implement appropriate measures to restore profitability.

[13] We rounded to $310,000.

APPENDIX A. SCOPE AND METHODOLOGY

Our review focused on revenue-generating contracts greater than $75,000 from fiscal year (FY) 2004 through the first quarter of FY 2007 in the Journeys, Concessions, and Licensing divisions. We also conducted a limited review of the fulfillment contracts for the Catalogue and Magazine divisions that support revenue generation. For each of these divisions, we interviewed division program managers and financial staff to determine how contracts are monitored. We reviewed contracts and licensing agreements to determine contract terms. We interviewed SBV Accounting to determine how SBV ensures that accounting information is accurately recorded. We detail below the work we did in each division.

JOURNEYS

We selected five tour operator contracts with revenues totaling $4,714,891 out of a total of $7,174,501 in revenue generated from all agreements over $75,000 for FY 2005 through the first quarter of FY 2007. Based on observations from our initial walkthrough of the process, we also included two additional contracts under the $75,000 limit. From these seven contracts, we limited our test to seven tours in FY 2006 and FY 2007.

For six of these tours, we traced all data listed on the Tour Reconciliation Sheet back to the supporting documentation. This work included verifying passenger payments from the Call Center listing to the tour operator's invoice to the Activity Reconciliation report downloaded from Lawson and the related general ledger entries. We verified passenger rates per the contract rate sheets to the Journeys Information Sheet, which is used to transmit rates to the Call Center. The seventh tour we selected was actually five Travel Adventure tours listed for a one-month commission reporting period (November 2006). For the November 2006 Commission report, we verified each line-item commission percentage for all five tours. We traced the number of passengers and gross receipts back to the periodic statements and invoices maintained by Journeys staff for each tour. We next traced the commission to the bank wire statement and general ledger entries. We also visited the current call center for additional follow-up review on one contract. We obtained study and team leader reports and passenger evaluation questionnaires for selected tours in our sample.

CONCESSIONS

We selected two contracts, one food concession contract and one flight simulator contract, with revenues totaling $11,863,511 out of $25,690,603 in revenue generated from all agreements over $75,000 for FY 2004 through the first quarter of FY 2007. In addition to interviews with SBV staff, we also met with contractor management officials and reviewed the contractor's internal controls over cash receipts and financial reporting. We reviewed monthly financial reports, certified annual financial statements and audited consolidated financial statements from the contractors.

For the food service contract, we selected five months for detailed review: March 2007, December 2006, June 2006, August 2005, and August 2004. We traced concession payments to contractor sales reports, general ledger entries, and bank statements. For the simulator contract, we reviewed the revenue adjustment prepared by SBV Accounting and verified their calculations by reviewing the supporting documentation for selected months, including July 2007, March 2007, December 2006, June 2006, and August 2005. We examined documents from the contractor, reports prepared by the Concessions financial staff, monthly Sales Report worksheets prepared by SBV Accounting, bank statements, and e-mails.

LICENSING

We selected three agreements from two of the four Licensing divisions for review, Product Development & Licensing (PDL) and SI Books. These three agreements provided revenues totaling $2,158,683 out of $4,587,666 in revenue generated from all agreements over $75,000 for FYs 2004 through the first quarter of FY 2007 for the Licensing group.

For the PDL contracts, we selected royalty, development, and product fees as required for each contract for the following periods: May 2006, January-June 2005, January-March 2006 and October-December 2006. For the SI Books contract, we reviewed guaranteed payments and development fees for 2005 and 2006. We reviewed monthly statements and documentation verifying these receipts, including bank lockbox records and monthly statements, cancelled checks, input vouchers, and general ledger entries. We also reviewed a Licensing quarterly update report.

CATALOGUE

We conducted a limited review of financial and operational monitoring procedures for the Catalogue division's fulfillment contract. We reviewed accounting entries that record revenue and tested one key performance measure required by the contract. We interviewed financial and operational managers as well as SBV accounting officials regarding key reports, accounting procedures, and general ledger entries. We selected four months, August 2004, December 2004, June 2006, and March 2007, and compared general ledger entries to monthly reports supporting each entry. We reviewed the following financial reports: Shipped Sales by Department, Product Sales-Cost, Inventory Value, Web Sales, and the General Ledger Extract showing entries made. We traced revenue for these months to the income statements. From the operations side, we reviewed one of the key reports, the Call Center Performance Report. We selected the Call Center Performance reports for these four months plus two additional months (November and December 2006), for further review and tested the abandoned call rates. These reports track, in part, the number of abandoned calls by day and by month that the call center did not answer from customers who called to make an order.

MAGAZINE

We conducted a limited review of financial and operational monitoring procedures for the Magazine division's fulfillment contract. We reviewed accounting entries that record revenue and tested two key performance measures required by the contract. We interviewed financial and operational managers as well as SBV accounting officials regarding key monthly reports, accounting procedures, and general ledger entries. We reviewed the SAS 70 ***Independent Service Auditor's Report on Controls Placed in Operation and Tests of Operating Effectiveness*** for the period of May 31, 2006, to December 8, 2006 for the contractor. We selected four months, August 2004, August 2005, June 2006, and March 2007, and compared the contractor's monthly summary financial reports to general ledger entries. From the operations side, we reviewed one of the key reports, the Performance Scorecard report. We selected the Performance Scorecard report for four months, March 2005, June 2006, January 2007, and March 2007, for further review and tested the abandoned call rate and the timeliness of mailings.

We conducted our audit in Herndon, Virginia, and Washington, D.C. from February to December 2007 in accordance with ***Government Auditing Standards*** as prescribed by the Comptroller General of the United States.

APPENDIX B. MANAGEMENT RESPONSE

Smithsonian Business Ventures

Date: February 5, 2008

To: Sprightley Ryan, Inspector General

Cc: Alison McNally, Acting Under Secretary for Finance and Administration
John E. Huerta, General Counsel
Alice C. Maroni, Chief Financial Officer
Greg Bokman, Chief Financial Officer, SBV
Beth Cunigan, Controller, SBV
Paul Flickinger, Chief Operating Officer, Museum Retail Operations, SBV
Amy Kotkin, Director, Journeys, SBV
Toby Mensforth, Vice President, Concessions and Theaters, SBV

From: Thomas Ott, Acting Chief Executive Officer, SBV T.O.

Subject: Management Response on Oversight of Contractors at SBV, Number A-07-05

Thank you for the opportunity to respond to the draft audit report on Oversight of Contractors at Smithsonian Business Ventures (SBV). The report contains five recommendations to improve oversight of contractors at SBV to which we have provided responses below. We were also asked to review the facts presented in the report to which we have included some additional clarifying information.

Overall, we agree with the recommendations of the report as follows:

Recommendation 1: The Director, SBV Journeys develop written contract monitoring procedures, in coordination with the SBV Controller, that clearly define the responsibilities of the Journeys program manager and financial staff as well as the accountants in the SBV Accounting Department. These written procedures should require detailed monthly reconciliations of contractor activity, prescribe minimum requirements for documenting contractor oversight, and provide guidance on proper accounting treatment for tour activities.

Response: We agree with the recommendation. Contract monitoring procedures are being developed to clearly delineate responsibilities between Journeys program and financial staff as well as the SBV Accounting department.

The period covered by the audit involved a prior call center operator that entailed a cumbersome and complicated reconciliation process. Journeys has subsequently switched call center providers and made improvements to the tour payment system, simplifying the reconciliation process. Financial and program staff have been clearly tasked with assuring that reconciliations are correct and accurate commission payments are received in a timely manner.

Full implementation is anticipated by September 30, 2008.

Recommendation 2: The Director, SBV Journeys conduct a detailed review of all tour activity codes for FY2007 and identify and collect any outstanding balances that may be due to SBV from the current call center operator.

Response: We agree with the recommendation and will expeditiously conduct a review of FY2007 tours to ensure collection of any outstanding balances due to SBV. Full completion of this activity is anticipated by June 30, 2008.

Recommendation 3: The SBV Vice President for Concessions, working with the SBV Controller develop written contract monitoring procedures that clearly define the responsibilities of the Concessions program manager and financial staff as well as the accountants in the SBV Accounting Department. These procedures should require detailed monthly reconciliations of contractor activity and prescribe minimum requirements for documenting contractor oversight.

Response: We agree with the recommendation. Contract monitoring procedures are being developed to clearly delineate responsibilities between Concessions program and financial staff as well as the SBV Accounting department. Full implementation is anticipated by September 30, 2008.

Recommendation 4: The SBV Vice President for Concessions, working with the SBV Controller establish procedures for periodic independent audits of the contractor's cash and credit card receipts, including review of daily cash settlement documents and observation of the daily cash counts.

Response: We agree with the recommendation. SBV will formulate appropriate policies and procedures for periodic independent audits of contactor's receipts and documentation with full implementation anticipated by September 30, 2008.

Recommendation 5: The SBV CFO working with the COO, Retail implement a more effective strategy for recruiting and retaining financial and accounting staff for key contract monitoring functions.

Response: We agree with this recommendation and note that employee retention and recruiting in both the Retail Finance and Corporate Accounting departments have experienced significant improvement over the past 6-9 months.

The Retail Finance Director position was filled in May, 2007 after an eight month vacancy. One of the two open Retail Senior Financial Analyst positions was subsequently filled, greatly improving key capacity in financial oversight.

The recently released SBV Task Force report recommended against outsourcing of the SBV Retail store operations, removing a significant organizational uncertainty, which will improve recruiting and retention in the Retail business moving forward.

Recent staffing improvements in the SBV Corporate Accounting department have stabilized the oversight function and the completion of the contract oversight procedures in Recommendations 1 – 4 will allow the effect of any future staff turnover to be minimized.

We will continue to recruit for any existing open positions and to document roles, responsibilities and procedures in the contract oversight functions to ensure mitigation of any future vacancies which inevitably will occur. We anticipate continued improvements in staff hiring and retention and that the documented procedures will be fully implemented by September 30, 2008.

Clarifying information:

Journeys
On page 7 of the existing draft report it was noted "Although the call center eventually provided Journeys with a summary attributing the remaining $309,000 to credit card fees and other credits due Journeys, SBV could not produce documents to support this remaining shortfall.".

The Journeys Senior Financial Analyst left the Smithsonian prior to the IG audit of contractor oversight. The existing management team was not able to locate certain supporting documents during the field work phase of the audit. Subsequently, management has located supporting detail for $286,148 of the above amount relating to credit card refunds leaving $22,852 without supporting detail. We ask that you review the additional documents and amend the draft report as appropriate.

Concessions
On page 9 of the draft report, it states "the Virginia Udvar Hazy Center". Please update with the proper name of the Museum: The Steven F. Udvar-Hazy Center of the National Air and Space Museum.

APPENDIX C. 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
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Lisa V. Leonard, Senior Auditor
William J. Balach, Senior Auditor