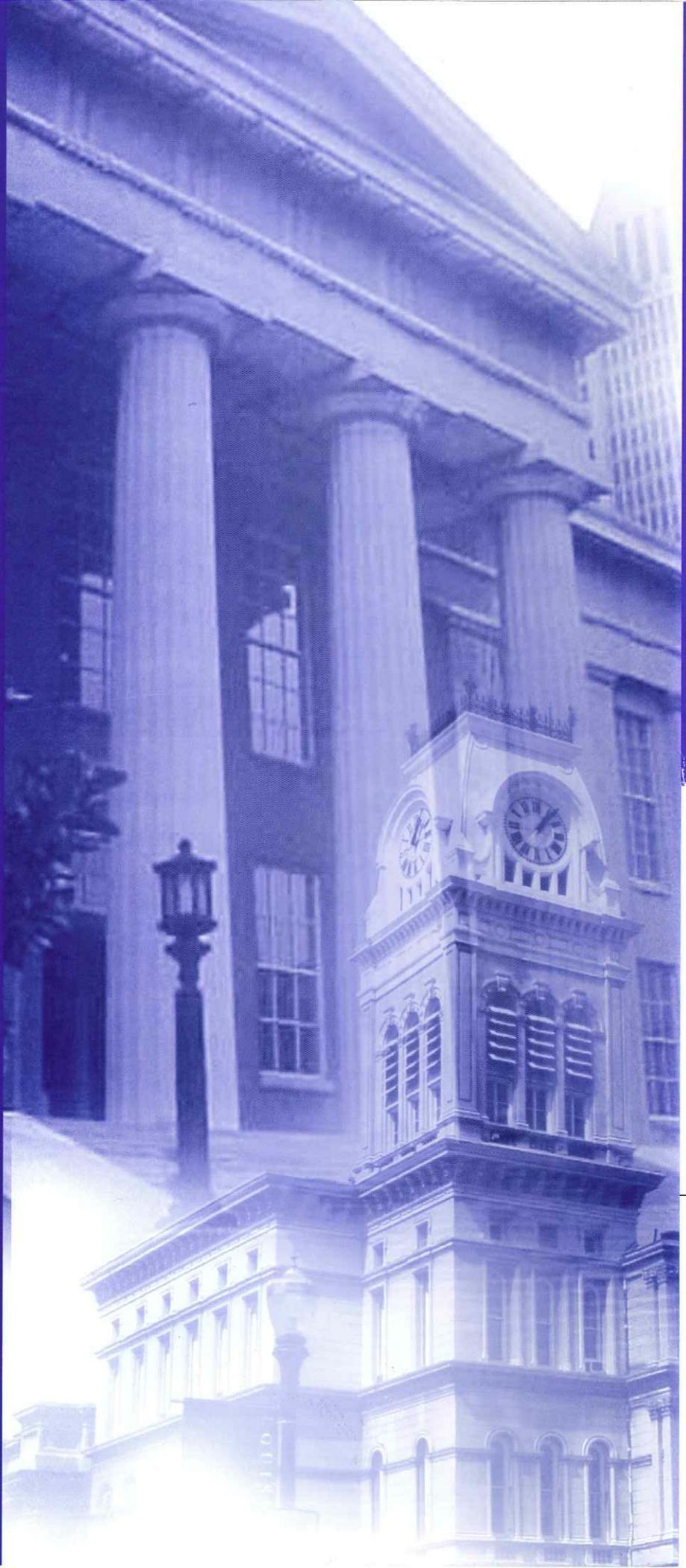




Jerry E. Abramson
Mayor

26 Member
Metro Council

The Office of Internal Audit provides independent, objective assurance and consulting services that adds value to and improves Louisville Metro Government.



Office of Internal Audit

Louisville Zoo

Louisville Nature Center
Fiscal Administration

Audit Report

Office of Internal Audit

Louisville Zoo

Louisville Nature Center Fiscal Administration

August 2007



Louisville Zoo

Louisville Nature Center
Fiscal Administration

Table of Contents

Transmittal Letter	2
Introduction.....	2
Scope.....	3
Opinion	3
Other Matters	4
Corrective Action Plan	4
Internal Control Rating.....	5
Background.....	6
Summary of Audit Results.....	6
Observations and Recommendations.....	8
#1 - Contract Administration	9
#2 - Monitoring and Reconciliation.....	11
#3 - General Administration	13
Amount Owed to the Zoo by LNC.....	15
Louisville Zoo Director’s Response.....	17
Louisville Nature Center Business Plan	18



OFFICE OF INTERNAL AUDIT
LOUISVILLE, KENTUCKY

JERRY E. ABRAMSON
MAYOR

MICHAEL S. NORMAN, CIA, CFE, CGAP
CHIEF AUDIT EXECUTIVE

RICK BLACKWELL
PRESIDENT, METRO COUNCIL

Transmittal Letter

August 15, 2007

The Honorable Jerry E. Abramson
Mayor of Louisville Metro
Louisville Metro Hall
Louisville, KY 40202

Subject: Audit of Louisville Nature Center Fiscal Administration

Introduction

An audit of the Louisville Nature Center (LNC) fiscal administration was performed. The LNC is administered by the Louisville Zoo in accordance with an operating agreement. The primary focus of the audit was the operational and fiscal administration of LNC activity. This included how LNC and the Zoo processes, records, and monitors the activity.

The examination was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

As a part of the review, the internal control structure was evaluated. The objective of internal control is to provide reasonable, but not absolute, assurance regarding the achievement of objectives in the following categories:

- Achievement of business objectives and goals
- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations
- Safeguarding of assets

There are inherent limitations in any system of internal control. Errors may result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personnel factors. Some controls may be circumvented by collusion. Similarly, management may circumvent control procedures by administrative oversight.

Scope

The operating procedures for the Louisville Nature Center's fiscal administration were reviewed through interviews with key personnel. The focus of the review was the operational and fiscal administration of activity. Tests of sample data were performed for transactions from July 1, 2006 through March 31, 2007. Activity reviewed included contractual agreements, expenditure documentation, revenue receipts, bank activity, the LNC financial accounting system and Metro financial system postings.

The review included assessing whether activity was processed, recorded, and monitored accurately and appropriately. The details of the scope and methodology of the review will be addressed in the Observations and Recommendations section of this report. The examination would not identify all issues because it was based on selective review of procedures and data.

Opinion

It is our opinion that the fiscal administration of LNC is weak. The internal control rating is on page 5 of this report. This rating quantifies our opinion on internal controls, and identifies areas requiring corrective action. Opportunities to strengthen the fiscal administration of LNC activity were noted in several areas. Examples include the following.

- **Contractual Terms.** The Louisville Nature Center is administered by the Louisville Zoo in accordance with a Master Operating Agreement and lease agreement. Some issues were noted regarding compliance with these agreements.
 - The Louisville Zoo did not consistently receive quarterly contributions from the LNC board to support operating costs. These contributions are required by the Master Operating Agreement.
 - An unauthorized petty cash fund was used for LNC activity. This activity was not administered or monitored by the Louisville Zoo business office.
 - It is not clear whether the terms of the LNC lease agreement are being complied with.Inconsistently enforcing the terms of the agreements increases the risk of non-compliance, budget overruns and unauthorized spending.
- **LNC Financial System.** The LNC financial system was not updated in a timely manner. This is used for LNC activity that is not included on the Metro financial system. Untimely input of activity limits the usefulness of the system as a reporting and oversight tool.
- **LNC Bank Account.** LNC bank statements are not routinely reconciled to the ancillary financial statements. This does not ensure unauthorized activity is identified or potential errors are detected in a timely manner. This could impact the ability to pursue corrective actions with the bank.
- **Accountability.** Issues associated with the accountability of assets were noted. This could result in loss of assets or the inability to properly monitor activity. The risk exposure is dependent on the level of activity and the amount of funds held at the facility.

- LNC revenue receipts are not maintained in a secure manner. Cash and checks are stored in a small locked box in an unlocked drawer. This may not provide for adequate security.
- LNC does not use a cashier system or receipt documentation to record revenue activity. In addition to program registrations and donations, LNC conducts events that generate revenue. There is not an established receipt system to document transactions in a consistent manner.

The implementation of the recommendations in this report will help improve the internal control structure and effectiveness of the administration of Louisville Nature Center activity.

Other Matters

Assurance of amount owed the Zoo. A review of financial records was performed to assess the amount of funds due to the Louisville Zoo by the Louisville Nature Center as of March 31, 2007. *The results presented were not considered for the purposes of assessing an audit opinion. The information is dependent upon the appropriateness of activity recorded on the financial statements. Therefore, the amount due the Zoo from LNC is presented with limited assurance.*

- Financial reports record \$108,390 due to the Zoo as of March 31, 2007. This is a result of several years of deficits of the LNC. Ultimately, Metro funds are used to supplement LNC activities.

Zoo officials were aware of the operating deficit associated with the LNC. Louisville Metro funds were used to supplement LNC activities. The Zoo is considering potential alternatives regarding the management of LNC.

Corrective Action Plan

Representatives from the Louisville Zoo have reviewed the results and are committed to addressing the issues noted. The Zoo's corrective action plans are included in this report. We will continue to work with the Zoo to ensure the actions taken are effective to address the issues noted.

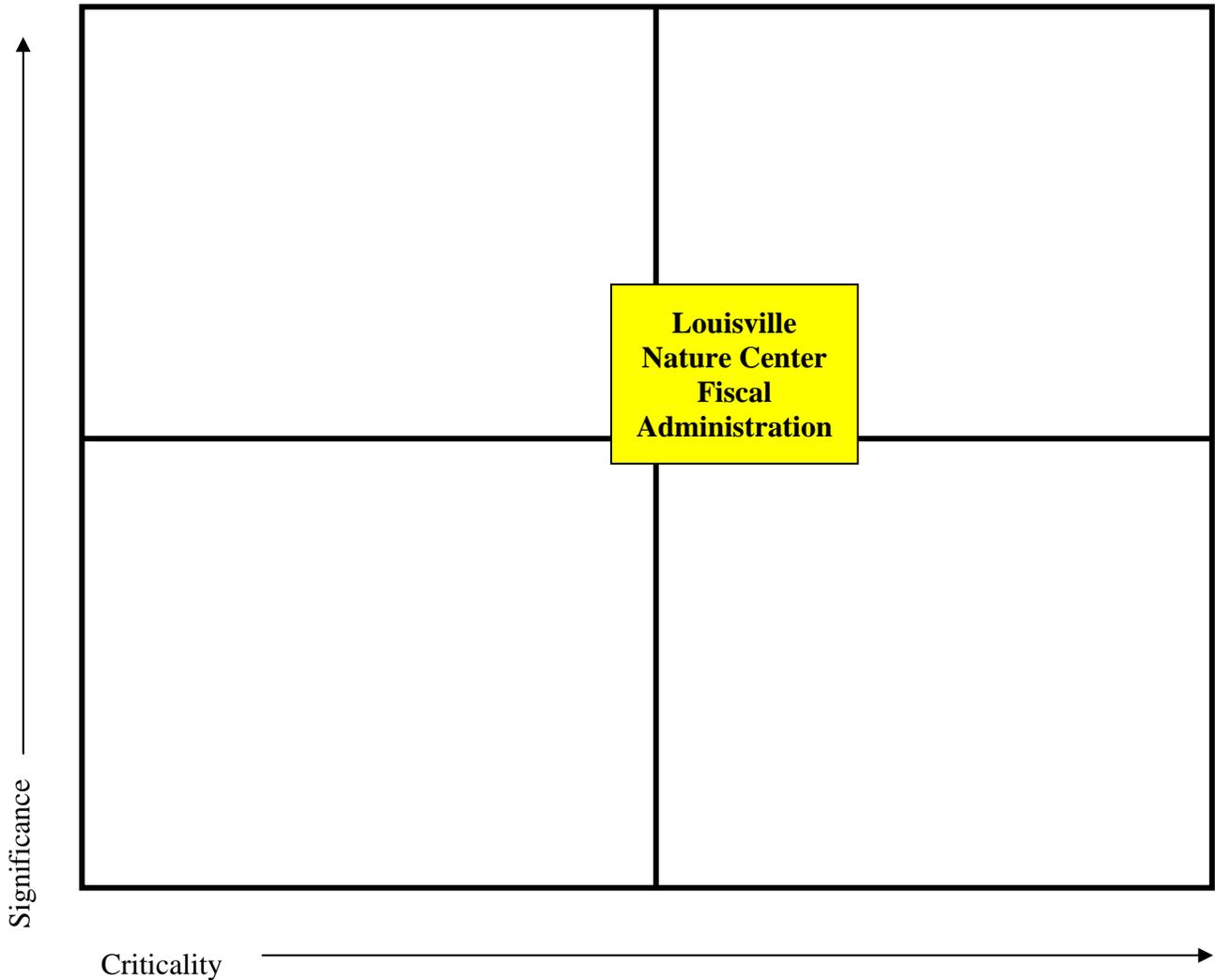
Sincerely,



Michael S. Norman, CIA, CFE, CGAP
Chief Audit Executive

cc: Louisville Metro Council Audit Committee
Louisville Metro Council Members
Deputy Mayors
Louisville Zoo Director
Louisville Metro External Auditors

Internal Control Rating



<u>Legend</u>			
<u>Criteria Issues</u>	Satisfactory Not likely to impact operations.	Weak Impact on operations likely contained.	Inadequate Impact on operations likely widespread or compounding.
<i>Controls</i>	Effective.	Opportunity exists to improve effectiveness.	Do not exist or are not reliable.
<i>Policy Compliance</i>	Non-compliance issues are minor.	Non-compliance issues may be systemic.	Non-compliance issues are pervasive, significant, or have severe consequences.
<i>Image</i>	No, or low, level of risk.	Potential for damage.	Severe risk of damage.
<i>Corrective Action</i>	May be necessary.	Prompt.	Immediate.

Background

The Louisville Nature Center (LNC) was established as a not-for-profit organization in accordance with Internal Revenue Service code section 501(c)(3). The entity manages a 41-acre tract in the Beargrass Creek State Nature Preserve. It functions as a public ecological awareness center providing research and educational programs to encourage stewardship in an urban forest. All LNC fiscal activity is administered by the Louisville Zoo in accordance with an operating agreement.

In accordance with the Master Operating Agreement, the Louisville Zoo administers all operating expenses for LNC. Funding is derived from memberships, donations, education programs, operating grants and an annual contribution of \$20,000 from the LNC board. The agreement further states that the Zoo's exposure for overall operating expenses shall not exceed the program revenues and LNC board contribution.

LNC's fiscal transactions are managed using one of two systems, depending on the nature of the transaction.

1. Operating activity is processed through the Louisville Metro financial system. LNC's fiscal year 2007 operating budget was \$78,500. The source of these funds is derived from memberships, donations, education programs, operating grants and an annual allocation of \$20,000 from the LNC board.
2. Other funds, such as donations, are received and overseen by the LNC board. Louisville Zoo staff operate the LNC facility and process fiscal activity on behalf of the board through the use of an ancillary bank account and accounting system. This activity is not reflected on the Louisville Metro financial system or bank account. As of March 2007, the LNC bank statements recorded a total balance of approximately \$66,500. This is comprised of one checking account and three Certificates of Deposit.

Zoo officials are aware of an operating deficit associated with the LNC. Louisville Metro funds are used to supplement LNC activities. The Zoo is considering potential alternatives regarding the management of LNC.

This audit was scheduled as a result of a request by the Zoo Director.

Summary of Audit Results

I. Current Audit Results

See Observations and Recommendations section of this report.

II. Prior Audit Issues

The Office of Internal Audit has not previously conducted any reviews of the Louisville Nature Center fiscal activity.

III. Statement of Auditing Standards

The audit was performed in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the International

Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

IV. Statement of Internal Control

A formal study of the internal control structure was conducted in order to obtain a sufficient understanding to support the final opinion.

V. Statement of Irregularities, Illegal Acts, and Other Noncompliance

The examination did not disclose any instances of irregularities, any indications of illegal acts, and nothing was detected during the examination that would indicate evidence of such. Any significant instances of noncompliance with laws and regulations are reported in the Observations and Recommendations section of this report.

VI. Views of Responsible Officials / Action Plan

A draft report was issued to the Louisville Zoo on July 13, 2007. An exit conference was held at the Office of Internal Audit administrative office on July 25, 2007. Attending were John Walczak and Jennifer Dalton representing the Zoo and LNC; Gena Redmon and Mark Doran representing Internal Audit. Final audit results were discussed.

The views of Zoo officials were received on August 9, 2007, with final responses received on August 15, 2007. The Zoo Director's response, including the Louisville Nature Center's business plan, is included as corrective action plans in the Observations and Recommendations section of the report. The plans indicate a commitment to addressing the issues noted.

LMCO §30.36(B) requires Louisville Metro Agencies to respond to draft audit reports in a timely manner. It specifically states that

*“The response must be forwarded to the Office of Internal Audit within 15 days of the exit conference, or **no longer than 30 days of receipt of the draft report.**”*

The Zoo's response was provided within this required timeframe.

Observations and Recommendations

Scope

The Louisville Nature Center (LNC) procedures for administering fiscal activity were reviewed. The focus of the review was the operational and fiscal administration of the LNC activity managed using either the Louisville Metro financial system or ancillary bank accounts that are not included on the Metro system. This included how activity is processed, recorded, and monitored. Applicable personnel from the Louisville Zoo and Louisville Nature Center were interviewed in order to gain a thorough understanding of the processes.

The review consisted of examining LNC fiscal activity for the period July 1, 2006 through March 31, 2007. A sample of activity was judgmentally selected from the population of transactions during the review period. This included reviewing contractual agreements, expenditure documentation, revenue receipts, bank activity, the LNC financial accounting system and the Louisville Metro financial system.

The review would not reveal all issues because it was based on selective review of data. The following issues were noted.

Observations

Issues were noted with the administration of LNC fiscal activity. As a result, the internal control structure is weakened and its effectiveness impaired. The observations are as follows.

- #1 Contract Administration
- #2 Monitoring and Reconciliation
- #3 General Administration

Details of these begin on the following page.

#1 - Contract Administration

The Louisville Nature Center is administered by the Louisville Zoo in accordance with a Master Operating Agreement and lease agreement. Issues were noted regarding compliance with these agreements.

- **Master Operating Agreement.** In accordance with the Master Operating Agreement, the Louisville Zoo administers all operating expenses for LNC. Funding is derived from memberships, donations, education programs, operating grants and an annual contribution of \$20,000 from the LNC board. The agreement further states that the Zoo's exposure for overall operating expenses shall not exceed the program revenues and LNC board contribution. The following issues were noted.
 - The agreement requires that LNC's \$20,000 annual contribution be made quarterly. The Louisville Zoo did not consistently receive quarterly installments as required by the agreement. The first payment (\$10,500) for fiscal 2007 was not received until the seventh month of the period.
 - LNC operating revenues may not be sufficient to cover costs. This could result in Metro funds being used to supplement the LNC. According to the minutes in the January 2007 LNC board meeting, there was an accumulated deficiency in the operations budget of \$13,641 for the period ending December 2006. This agrees to the amount reflected on the Metro financial system for LNC activity.
 - Zoo staff assigned to the LNC facility maintain unauthorized funds used for petty cash transactions. These funds are not administered by the Zoo business office. Initially, funds were collected from the LNC donations box to establish the petty cash fund and the petty cash has been replenished in the same manner without documenting the activity. A determination of the cumulative amount of petty cash expenditures could not be made. The Zoo business office was not consulted in the establishment or handling of the petty cash fund. This does not provide for adequate oversight of the funds, and does not appear to comply with the operating agreement.

- **Lease Agreement.** It is not clear whether the terms of the LNC lease agreement are being complied with. The lease agreement between Louisville Zoo and LNC is for 7 acres of park land where the Nature Center facility is currently located. LNC is obligated to make an annual payment on or before January 1 without notice or demand. While the actual payment amount is not significant, Zoo staff are not aware of any payments having been made. This could be indicative of inadequate monitoring and non-compliance with the terms of the agreement.

Recommendation

Appropriate Zoo personnel should take corrective action to address the issues noted. Specific recommendations include the following.

- ✓ The Zoo should enforce the terms of the operating and lease agreements. All personnel involved in the fiscal administration of LNC should be aware of the requirements and held accountable for adhering to them. Additional training of key personnel may be necessary to ensure consistent compliance.

- ✓ Routine supervisory review of the administration of contracts should be performed to assess adherence to contractual obligations. This includes oversight for the Master Operating Agreement and lease agreement.
- ✓ Appropriate personnel should establish financial accounts used for LNC programs, including petty cash funds. Routine reconciliation of the activity should be performed to strengthen controls. Monitoring such activities should be assigned to the Zoo business office staff to ensure accuracy, accountability of activity and proper reporting.
- ✓ The Louisville Zoo should examine its role in the management of the LNC. This includes the operational and fiscal administration of the activity. Consideration should include whether the mission of the LNC compliments the Zoo's. This is especially important if the Zoo is supplementing LNC activities related to an operating deficit.

Louisville Zoo's Corrective Action Plan

- Annual Contribution. The Louisville Nature Center board will begin making its \$20,000 annual payment to support the operation of the Louisville Nature Center in \$5,000 quarterly installments, as required by the Master Agreement. Since the Master Agreement is silent regarding whether the payment is due at the beginning or the end of the quarter, the Louisville Nature Center will make the payment at the end of each quarter, if such arrangement is agreeable with the Louisville/Jefferson County Metro Government.
- Deficit. The Louisville Nature Center's current staffing structure and level of expenses has allowed the amount of the operating deficit incurred by the Nature Center each year to stabilize. The deficit has decreased from \$57,602.58 in fiscal year 2004-2005 to \$11,518.50 in fiscal year 2005-2006 to an estimate of slightly less than \$10,000 for fiscal year 2006-2007. The Nature Center board and the Louisville Zoo are developing proposals for the repayment of previous deficits and restoring the Nature Center to profitability.
- Unauthorized Petty Cash Fund. A petty cash fund has been established and is being used for routine, small expenditures of less than \$25, rather than using the money from the donation box, as was the past practice. The money in the donation box is now being emptied every two weeks or after an event, whichever comes first. Less than \$20 typically accumulates in the donation box during a two week period unless the LNC hosts a major event.
- Lease Payment. The \$1 lease payment required by the lease agreement has not been made since at least 2004. Zoo staff have not yet been able to locate the records necessary to determine whether lease payments were made periodically in the past or in a lump sum at the inception of the lease agreement. By September 15, 2007, Zoo staff intends to locate the records and either initiate processing for the lease payments due to date or provide proof that the payments have already been made.

#2 - Monitoring and Reconciliation

Louisville Zoo staff manage fiscal activity for the Louisville Nature Center. This includes transactions processed using the Metro financial system, as well as, an ancillary bank account that is not included on the Metro financial system. The following issues were noted regarding the monitoring and reconciliation of LNC fiscal activity.

- **LNC Financial System.** The LNC financial system used is only for activity processed through the LNC ancillary bank account that is not included on the Metro financial system. Fiscal year 2007 activity was not input until the ninth month of the period. Untimely input of activity limits the usefulness of the system as a reporting and oversight tool.
- **LNC Bank Reconciliations.** LNC bank statements are not routinely reconciled to the ancillary financial statements. These records are reconciled annually. This does not ensure unauthorized activity is identified or potential errors are detected in a timely manner. This could impact the ability to pursue corrective actions with the bank.
- **LNC Financial System Reporting.** One LNC financial system report does not reflect accurate amounts. There is a flaw in the system balance sheet report that results in the restricted balance remaining unchanged regardless of recorded activity. While the overall fund balance is correct, the breakdown of the fund balances (restricted and unrestricted) are incorrect. This problem limits the usefulness of the report for management analysis.

Recommendations

Appropriate Zoo personnel should take corrective action to address the issues noted. Specific recommendations include the following.

- ✓ Efforts should be made by Zoo staff ensure that the LNC financial system is updated in a timely manner. This will help ensure that the system contains complete and accurate information. This will improve the usefulness of the system for monitoring and reporting purposes.
- ✓ A major component of any reporting system is proper reconciliation and monitoring. It is imperative that the Zoo business office review financial activities on a regular basis. This includes monitoring individual transactions for appropriateness, completeness, and adherence to requirements. The LNC financial system transactions should be reconciled to bank statements to ensure the accurate and timely reflection of activity. Routine reconciliations of activity help strengthen controls and accountability. In order to promote proper segregation of duties, an administrator independent of the actual processing of activity should perform this function.
- ✓ Routine supervisory review should be performed to assess the completeness and accuracy of data. This includes activity processed on the Metro financial system and activity using ancillary accounts. Verification of reconciliations will improve the

completeness and accuracy of activity reports. Ultimately, this will help ensure the reliability of information for management analysis.

- ✓ A comprehensive financial system should include reporting functions and processing capabilities to promote accountability and efficiency for the administration of activity. Reports should provide information in a clear, concise and reliable manner. The format of records should be updated as necessary to help ensure the information is presented in a manner to promote efficient and effective monitoring. Zoo personnel may want to contact the Metro Information Technology department for assistance.

Louisville Zoo's Corrective Action Plan

- LNC Financial System. The LNC financial system is now updated each month. The Business Manager I is responsible for entering the Louisville Nature Center's financial information into the LNC financial system each month. This update was not previously made a priority because the Nature Center board did not use the reports because they thought they were confusing and because of time and staff constraints in the Business Office. However, Internal Audit's point that updating the system provides a means of ensuring that the reports the board does use are accurate is excellent and the information in the LNC financial system is now used to verify the accuracy of the board reports each month, not just periodically. A software update was recently made to the LNC financial system that hopefully will correct the error that causes the Restricted Fund Balance to remain unchanged even if there was activity in the Restricted fund. We will continue to work with the software vendor to resolve this issue.
- LNC Bank Account. The LNC bank account is now reconciled each month to the information contained in the LNC financial system, rather than being reconciled periodically, as was the past practice. While previously the bank account was not reconciled to the general ledger each month, the bank statement was reviewed by the Business Manager I monthly for unusual activity. Unauthorized withdrawals were made from this account a couple of years ago that were detected during this review. These unauthorized withdrawals were the result of a clerical error which caused an individual's direct debit for a product ordered from a TV infomercial to be withdrawn from the LNC account. The funds withdrawn in error were refunded and the account was closed to prevent further unauthorized activity and a new account opened.

#3 - General Administration

Louisville Zoo staff manage fiscal activity for the Louisville Nature Center. This includes transactions processed using the Metro financial system, as well as, an ancillary bank account that is not included on the Metro financial system. The following issues were noted regarding the general administration of LNC fiscal activity.

- **Accountability.** Issues with improper safeguarding of assets were noted. This could result in loss of assets or the inability to properly monitor activity.
 - LNC revenue receipts are not maintained in a secure manner. Cash and checks are stored in a small locked box in an unlocked drawer. Depending on the amount of funds held, this may not provide for adequate security.
 - LNC does not use a cashier system or receipt documentation to record revenue activity. In addition to program registrations and donations, LNC conducts events that generate revenue, such as the holly and ivy sale. While handwritten receipts are provided to customers upon request, there is not an established receipt system to document transactions in a consistent manner.

- **Policies and Procedures.** While LNC does have documented policies and procedures for revenue activity, they have not been updated to reflect current practices and forms. This increases the risk of non-compliance with intended policies and procedures. This can also lead to inconsistencies and inefficiencies with activity processing.
 - There is not a documented policy to ensure the timely deposit of all revenue receipts. Funds are normally deposited within two weeks, with higher-dollar checks being deposited within a couple of business days.

- **Sales Tax.** Reimbursements to employees routinely included sales tax. LNC staff did not use the sales tax exemption number for the entity in order to avoid paying the additional costs.

Recommendations

Appropriate Zoo personnel should take corrective action to address the issues noted. Specific recommendations include the following.

- ✓ Zoo staff should assess the feasibility of a cashier system / cash register and safe for the LNC facility. A cost / benefit approach should be taken that considers the amount of activity actually processed and the amount of funds held at the location. At a minimum, a receipt system should be implemented for revenue transactions. This could be a pre-numbered manual receipt for the customer, with a copy for LNC records.

- ✓ LNC should update the documented internal policies and procedures manual. The manual should include sufficient detail for each job duty performed and copies of forms used in the processing and depositing of associated revenue activity. The Zoo business office should be consulted in the development of the manual.

- ✓ All funds should be deposited in a timely manner. Timeliness should be based on cash management best practices (e.g., based on a defined threshold amount, or weekly, whichever occurs first). This will help ensure security of funds, promote timely reporting of activity and optimize investment income opportunities.
- ✓ Internal policies and procedures should consider the proper safeguarding of assets (e.g. cash and checks). The manual should address how revenue receipts should be secured, the documented custody of funds and identifying avoidable expenditures (fees, sales tax). The internal policy and procedures manual should be distributed to all applicable personnel. In addition, training of key personnel will help ensure consistent adherence to the requirements.
- ✓ Employees making purchases for LNC purposes should use the sales tax exemption number. Reimbursements to employees should not include sales tax.
- ✓ Routine supervisory review should be required. The review requirements should be included in the documented policies and procedures. The reviews should be performed to assess the completeness of files and the accuracy of the activity, including adherence to applicable guidelines. The reviews should be documented and signed by the reviewer.

Louisville Zoo's Corrective Action Plan

- Accountability of Assets. The LNC staff now bring their checks and cash to the Zoo money room for keeping in the safe on a daily basis. The LNC has implemented procedures to better document revenue receipts. The Zoo Business Manager I will follow up with the LNC to make sure that the procedures are being followed and are adequate.
- Sales Tax. The LNC staff has been advised that sales tax is not to be paid and have been provided with the proper forms to provide to vendors so that they will not be charged sales tax. We have also been working with the LNC staff to reduce the number of reimbursements to staff members rather than vendors.

Amount Owed to the Zoo by LNC

Scope

A review of financial records was performed to determine the amount of funds due to the Louisville Zoo from the Louisville Nature Center as of March 31, 2007. This review was performed using the following information.

- **Contracts.** Contractual agreements were reviewed to gain an understanding of the Louisville Nature Center's financial obligations. This included the Master Operating Agreement and the Lease Agreement.
- **Audited Financial Statements.** Audited financial statements for LNC for the fiscal year ending June 30, 2005 were obtained. These statements were prepared by an independent external auditing firm and were relied upon for the amounts owed to the Zoo as of June 30, 2005.
- **LNC activity for fiscal 2006 and 2007.** Financial records for LNC activity processed through the Louisville Zoo business office for fiscal years 2006 and 2007 were reviewed. This included transactions processed using the Metro financial system and the LNC ancillary bank account that is not included on the Metro financial system.

A review of a sample of financial transactions and reports for the period July 1, 2006 through March 31, 2007 was performed. The purpose was to assess the processing of transactions in accordance with the contractual agreements and the presentation of financial reports. Ultimately, this was intended to obtain assurance for the financial reports used to determine the amount due the Zoo.

The review would not reveal all issues because it was based on selective review of data. The results presented were not considered for the purposes of assessing an audit opinion. The information is dependent upon the appropriateness of activity recorded on the financial statements. Therefore, the amount due the Zoo from LNC is presented with limited assurance.

Observations

The Louisville Nature Center is administered by the Louisville Zoo in accordance with a Master Operating Agreement. The Zoo administers all operating expenses for LNC. Funding is derived from memberships, donations, education programs, operating grants and an annual contribution of \$20,000 from the LNC board. The agreement further states that the Zoo's exposure for overall operating expenses shall not exceed the program revenues and LNC board contribution. The following deficit has been incurred by the Zoo for LNC.

- Financial reports record \$108,390 due the Zoo as of March 31, 2007. This is a result of several years of deficits of the LNC. Ultimately, Metro funds are used to supplement LNC activities.

Zoo officials were aware of the operating deficit associated with the LNC. Louisville Metro funds were used to supplement LNC activities. The Zoo is considering potential alternatives regarding the management of LNC.

Recommendation

Appropriate Zoo personnel should take corrective action to address the issue noted. Specific recommendations include the following.

- ✓ The Louisville Zoo should examine its role in the management of the LNC. This includes the operational and fiscal administration of the activity. Consideration should include whether the mission of the LNC compliments the Zoo's. This is especially important if the Zoo is supplementing LNC activities related to an operating deficit.
- ✓ The Zoo should enforce the terms of the operating agreement and document the reason for any deviations. This might require the assistance of legal counsel to ensure the rights / interests of the Zoo are adequately protected.

Louisville Zoo Director's Response

Thank you for your thorough Audit Report of the Louisville Nature Center (LNC). We learned several things and have already implemented improvements to alleviate the concerns expressed in the report.

As you are aware, I requested this audit proactively in November of 2006 to determine a baseline of LNC operations to assist the Zoo and Metro in determining our future involvement with this organization. The accounting and business practices of the LNC have been reviewed annually through the independent services of Monroe- Shine CPA's.

The Louisville Zoo has managed the operations of the LNC for 12 years. Fundamental to this business arrangement is the obligation of LNC's independent Board to raise funds to support their mission and facilities, and to supplement operational costs by paying the Louisville Zoo/Metro \$20,000 per year. In the early years of this agreement the LNC Board had financial reserves accomplished through contributed income. The LNC Board's fund raising efforts did not meet the \$20,000 annual fee to the Zoo and the financial reserve was exhausted. This resulted in the LNC beginning to incur debt to the Zoo in 2002-2003. The debt as of March 31, 2007 stands at \$108,390.

Numerous meetings have taken place and efforts made to encourage the LNC board to fulfill their fund raising responsibility, with no substantive result or improvement. In recent years we have reduced LNC staff and controlled operations to manage the deficit in contributed income. We have kept the Zoo Foundation Board and Metro Budget, Finance, and Administration aware of this situation.

The LNC historically has benefited from the services of several Zoo departments (Business Office, Education, Horticulture & Maintenance) under the terms of the existing agreement. I have not expanded our other revenue generating departments into the LNC operations because this responsibility currently belongs to the LNC Board. Because of the deficit situation, I had a business plan prepared by Schultz and Williams Company in June 2006 to evaluate the potential of the Zoo and Zoo Foundation Board expanding our role in the management and governance of the LNC. The rationale being the Zoo and Zoo Board could succeed in achieving the annual contributed funds needed to run the LNC on a balanced budget. However if those efforts are to be made those funds should also be managed by the Zoo and Zoo Board.

The essence of the 2006 business plan is to dissolve the LNC Board's management of the LNC and expand the Zoo's management role. This would include the involvement of Zoo revenue generating departments and contributed funds would be controlled by the Zoo Foundation Board. Beyond the LNC building, the LNC assets largely consist of a three party land lease and a little over \$40,000 in their account (the amount was almost \$60,000 when the business plan was completed in 2006). These funds would be utilized as an operational reserve to give the Zoo a 2- 3 year period to increase revenues, especially in the area of contributed funds, and balance the LNC budget.

This brings us to where we are today. In addition to the debt owed the Zoo / Metro, the audit has revealed several previously unknown weaknesses which we have already corrected or are being corrected. I believe none of the audit findings are of a nature that would discourage the Zoo/Metro and Zoo Foundation Board from expanding our role in the operation of LNC.

If we continue with our current arrangement, LNC Board past practice would indicate they will exhaust their financial reserve to pay their obligation to us while we struggle to control debt accumulation with limited ability to invest in revenue opportunities. The LNC Board leadership is aware of this study and willing to consider the change conditional to the mission of the LNC being furthered by a new agreement.

The Mission of the LNC is complementary to the Zoo's and allows us to teach environmental responsibility here at home to visitors inspired by the plight of charismatic megavertbrates such as the Gorillas they meet at the Zoo. The expanded relationship of the LNC as part of the Zoo organization can provide unique educational synergies for our children in the heart of our urban center. This will be a significant step toward obtaining the vision of being the Green City we desire to be.

I look forward to working with your agency in undertaking this next step of evaluating the business potential of the LNC. Time is of the essence.

Louisville Nature Center Business Plan

The Louisville Nature Center business plan was provided as part of the Louisville Zoo Director's response. The plan begins on the following page.



Business Planning Opportunity

*Louisville Nature Center
&
Louisville Zoo*

*Schultz & Williams, Inc.
June 2006*



Opportunity

- *Merge the operational, management and financial responsibilities for the Louisville Nature Center into the Louisville Zoo*
- *Rationale for the merger:*
 - *Complementary “missions” between the Zoo and the Nature Center*
 - *Builds the Zoo role as the conservation resource in the region*
 - *Strengthens the Zoo’s position as the State’s Zoo and as a manager of a State Nature Center/Preserve facility.*
 - *The Zoo could leverage funding opportunities beyond the initial two year “transition period” - thereafter moving towards a “growth” oriented funding model...current model is “under-utilized”*
 - *Potential donor synergy between the Zoo and the Nature Center*
 - *Net operating costs of the Nature Center could be managed with support from the Nature Center’s current unrestricted quasi-endowment funds*
 - *Funding/fund-raising functions could be managed by the Zoo: development, grant-writing, marketing and membership activities*



Organizational Profile (1 of 3)

- Mission: provide nature education and encourage stewardship in an urban forest
- Concept: a unique community resource that offers wonderful opportunities for nature study and recreation....within the City of Louisville....occupies 44 acres; reports 445 members with approximately 50% actual dues-paying members...provides \$6,500 in membership fees with members receiving discounts to fee-based programs. Family fees of \$45
- Operations: closed weekends and holidays; opened Monday thru Friday only. Managed with 1.5 FTE's. Visitor log reports approximately 800+ visitors to the site. Some facility services are provided by Metro Parks
- Programs:
 - Hiking in Beargrass Creek State Nature Preserve and through native gardens
 - Plant sales, summer camps and membership
 - Observing wildlife up-close through the use of bird blinds
 - Children's activities within classroom settings
 - Positioned as Center for water-shed/environment education with focus on urban youth programs and initiatives
 - Utilizes web-site as source of information and program enrollment



Organizational Profile (2 of 3)

- Funding: free admissions to the Nature Preserve with programs supported through the Louisville Zoo, member fees, donations, fee-based education/activity programs and grants. Quasi-endowment (unrestricted) funds of ~\$60,000 as of July `06 , after \$20k payment to the Zoo
- Audiences: community residents, school children, scouts and other community groups
- Governance: Separate Board of Directors (Louisville Nature Center Foundation)
- Financial Impact:
 - Deficit funded organization - approximately \$113k for the past three years...annual operating deficit of \$28k prior to any commitments to the Zoo
 - Committed to providing the Zoo with \$20,000 in annual support...as not committed these funds for the past 18 months
 - Receives funding from Metropolitan Sewer District grant of \$25,970 for educational programming (restricted funds with balance of ~\$10k as of July `06



June 2006

Schultz & Williams, Inc.

> Organizational Profile (3 of 3)

■ Facilities:

- *3,000 sq/ft meeting space utilized for programs and activities*
- *Minor rental fee accessed to groups*
- *Could be utilized for after-hour activities: sleep-overs with nature walks; birthday parties; camps; special program events/activities*

■ Contributed Revenues:

- *Limited donation revenues....high budget expectations for programs but low actual results creates:*
 - *failed financial expectations*
 - *deficit-funding*
 - *untapped/under-utilized donor pool/prospects*
 - *Under-utilized venues for the community*



Strategic Recommendation (1 of 2)

- Phased Integration of Nature Center
 - *Phase 1: Transition & Stabilization (FY `07 & FY`08)*
 - *Manage the Nature Center at “breakeven” however, any potential deficit funding during transition would be secured against current unrestricted quasi-endowment funds*
 - *Nature Center would transfer all cash balances to the Zoo Foundation*
 - *Under current available cash balances could support (offset), if needed, the projected conservative deficits over two years of transition*
 - *Develop new programs that generate new sources of funding: sleepovers, rentals and camp programs should be a focus*
 - *Cultivate new potential donors that have environmental education/nature center interests to strengthen future existence of the Nature Center*
 - *Promote “merger” of Louisville Nature Center with the Zoo...both internally and externally*
 - *Increase awareness of Nature Center events and activities through the Zoo’s web-site*
 - *Create “value” in Nature Center membership and integrate with Zoo’s households....could be check-off or small incremental increase*
 - *Offer member-only programs at the Nature Center targeted to the Zoo’s members*



> Strategic Recommendation (2 of 2)

- Phased Integration of Nature Center (continued)
 - Phase 2: Expansion of Program Resources (FY `09 & beyond)
 - Institute new conservation & environment resource programs that are donor, partnership and/or marketing supported
 - Expand contributed revenue programs:
 - School groups, sleepovers & camps
 - Donor-focused operating programs: restricted funds from individuals to support water-shed education and environment education programs
 - Cultivate State as a potential funder
- Louisville Nature Center Board
 - Is dissolved during the "transition" period
 - Has no management, operations or fund-raising role in the Nature Center
 - Would have an ex-officio position on the Zoo Foundation Board
 - Volunteers would be utilized to help maintain the Park and implement programs/activities





Financial Baseline Profile - Current

Program Revenues:	Projection FY `06	Notes
Camps	\$8,000	Fee-Based Programs
Outreach/Scout Programs	\$3,000	Fee-Based Programs
School Programs	\$6,000	Fee-Based Programs
MSD - Watershed Programs	\$15,000	Metropolitan Sewer District Grant (Annual)
Plant Sale	\$2,000	Annual Event
Miscellaneous Revenues	\$3,500	Smaller venues
Subtotal Program Revenues	\$37,500	
Contributed Revenues:		
Membership Fees	\$7,000	~200 paying members @\$35
Donations	\$3,500	High expectations; low results
Subtotal Contributed Revenues	\$10,500	
Total Operating Revenues	\$48,000	
Operating Expenses:		
Salaries & Benefits	\$67,000	1.5 FTE (includes contract employee)
Operating Supplies	\$7,600	Telephone & Electric expenses
Printing & Materials	\$3,000	Printing/copying expenses
Total Operating Expenses	\$77,600	
Operating Deficit	(\$29,600)	Must be supported thru contributions & new fees



Operating Revenues/Expense Projections

Program Revenues:	Projection	Conservative Forecast				Notes
	FY '06	FY '07	FY '08	FY '09	FY '10	
Camps	\$8,000	\$8,000	\$15,000	\$20,000	\$22,000	Growth through marketing programs
Outreach/Scout Programs	\$3,000	\$3,000	\$8,000	\$12,000	\$14,500	Growth once marketing is established
School Programs	\$6,000	\$6,000	\$10,000	\$12,000	\$13,000	Growth in 2 years
MSD - Watershed Programs	\$15,000	\$15,000	\$15,000	\$15,000	\$15,000	Continuation of existing program
Plant Sale	\$2,000	\$2,500	\$3,300	\$3,500	\$4,000	Minor growth
SleepOvers	\$0	\$3,600	\$8,400	\$12,000	\$15,000	Per head \$12 - \$15 with 300 - 1000 users
Miscellaneous Revenues	\$3,500	\$3,500	\$3,500	\$3,500	\$3,500	Same programs
Subtotal Program Revenues	\$37,500	\$41,600	\$63,200	\$78,000	\$87,000	
Contributed Revenues:						
Membership Fees	\$7,000	\$8,400	\$9,625	\$12,000	\$14,000	Increasing to 350 NC only members
New Development Efforts	\$0	\$2,500	\$7,500	\$15,000	\$25,000	Gifts from individuals and foundations
Donations	\$3,500	\$4,000	\$4,200	\$4,500	\$5,000	Current funders with minor growth
Subtotal Contributed Revenues	\$10,500	\$14,900	\$21,325	\$31,500	\$44,000	
Total Operating Revenues	\$48,000	\$56,500	\$84,525	\$109,500	\$131,000	
Operating Expenses:						
Salaries & Benefits	\$67,000	\$69,680	\$72,467	\$75,366	\$78,381	1.5 FTE
New Program Costs	\$0	\$2,000	\$7,200	\$16,000	\$20,000	Supports "program" growth
Operating Supplies	\$7,600	\$8,056	\$8,539	\$9,052	\$9,595	Inflationary growth
Printing & Materials	\$3,000	\$3,300	\$3,630	\$3,993	\$4,392	Inflationary growth
Total Operating Expenses	\$77,600	\$83,036	\$91,837	\$104,411	\$112,368	
Operating Deficit	(\$29,600)	(\$26,536)	(\$7,312)	\$5,089	\$18,632	

