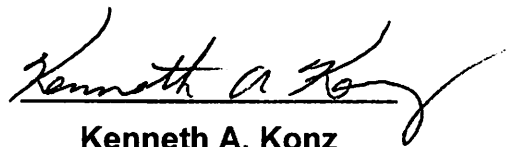


**CORPORATION FOR PUBLIC BROADCASTING
OFFICE OF INSPECTOR GENERAL**

**EXAMINATION OF
AGAPE BROADCASTING FOUNDATION, INC.,
LICENSEE OF KNON-FM, DALLAS, TEXAS
FOR SELECTED GRANT PERIODS AND FISCAL YEAR 2008**

REPORT NO. ESR909-1004

September 30, 2010

A handwritten signature in black ink, appearing to read "Kenneth A. Konz", with a long, sweeping flourish extending to the right.

**Kenneth A. Konz
Inspector General**

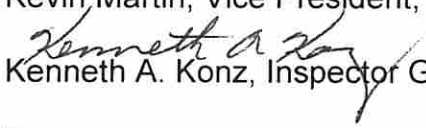


Corporation
for Public
Broadcasting

Office of Inspector General

Date: September 30, 2010

To: Bruce Theriault, Senior Vice President, Radio
Mark Erstling, Senior Vice President, System Development & Media Strategy
Kevin Martin, Vice President, Station Grants & TV Station Initiatives

From: 
Kenneth A. Konz, Inspector General

Subject: Examination of AGAPE Broadcasting Foundation, Inc., Licensee of KNON-FM, Dallas, Texas, for Selected Grant Periods and Fiscal Year 2008, Report No. ESR909-1004

We have completed an examination of the Fiscal Year (FY) 2008 Community Service Grant (CSG), Digital Conversion Grant (Digital) and Internet Service Acquisition Grant (ISA) awarded to AGAPE Broadcasting Foundation, Inc. licensee of KNON-FM (KNON). We initiated this review in conjunction with another public broadcasting station audit where we identified accounting issues. Both stations used the same accounting services provider.

The objectives of the examination was to determine whether KNON: a) claimed Non-Federal Financial Support (NFFS) on its 2008 Annual Financial Report (AFR) in accordance with Corporation for Public Broadcasting (CPB) Financial Reporting Guidelines; b) complied with the Certification of Eligibility requirements and the statutory provisions of the Communications Act of 1934, as amended (Act); and c) expended CSG, ISA, and Digital funds in accordance with grant requirements. Our scope and methodology is discussed in Exhibit F.

Based upon our examination we found material noncompliance with CPB requirements, as follows:

- \$87,741 in questioned CPB costs under the Digital, CSG, and ISA grants;
- \$3,005 was overpaid to KNON under the Digital grant, which we have reported as funds put to better use;
- the lack of discrete accounting for CSG revenues and expenditures did not facilitate our audit of grant funds and limited the scope of our testing to verify that CSG funds were fully spent within the two year grant period; and

- noncompliance with CPB requirements for establishing procedures for explaining the station's compliance with the five Act requirements for Open Meetings, Open Financial Records, Community Advisory Board (CAB), Equal Employment Opportunity (EEO), and Donor Lists and Political Activities.

Overall, we found a lack of adequate oversight and controls at the station to ensure compliance with CPB's requirements for activities performed by third party providers. Specifically, we found that the Board of Directors (Board) and station management did not maintain adequate control over its finances and compliance requirements to ensure CPB grant funds were spent on allowable activities or expenditures were adequately documented for the CSG, Digital, and ISA grants.

In response to the draft report, KNON officials disagreed with the questioned costs for the digital grant, related party transactions, and the internet streaming costs. They also implemented corrective actions to discretely account for CPB grant revenues and expenditures, implemented operating procedures to comply with Communication Act requirements, and instituted Board controls to oversee CPB grant requirements. KNON's written response to the draft report is attached in Exhibit G.

This report presents the conclusions of the OIG. The findings and recommendations contained in this report do not necessarily represent CPB management's final position on these matters. Accordingly, this report contains recommendations the OIG believes would be appropriate to resolve these findings.

In accordance with CPB audit resolution procedures, CPB management is responsible for determining the corrective actions to be taken. Based on KNON's response to the draft report, we consider recommendations 1(a) – 1(c), 3(b) – 3(d), and 6(a) – 6(c) resolved but open pending a final management decision by CPB on the recommendations. We consider recommendations 2(a) – 2(e), 3(a), and 5 unresolved, pending a CPB management decision.

BACKGROUND

KNON is a community radio station located in Dallas, Texas. It is licensed to the AGAPE Broadcasting Foundation, Inc. (AGAPE). KNON is a listener-supported radio station, deriving its main source of income from on-air pledge drives and from underwriting or sponsorships by local small businesses. KNON's format is music and talk, with diverse programming.

KNON's independent financial audit identified nine related parties in its notes to the financial statements. These included the Association of Community Organizations for Reform Now (ACORN), Citizens Consulting, Inc. (CCI) and the Affiliated Media Foundation Movement, Inc. (AM/FM), which all provided administrative services to KNON. CCI was KNON's accounting service provider and AM/FM personnel served as our audit coordinator.

KNON received a variety of other business services from other related organizations¹ for internet, telephone, health benefits, office space, etc. Currently, KNON has transitioned from CCI to another accounting service in Dallas, Texas.

CSG award amounts are determined by the NFFS reported to CPB by stations on its AFR. The CSG calculation process starts with separate amounts appropriated for the television and radio CSG pools adjusted by the base grant, distance and local service grant amounts. The funds that remain are called the Incentive Grant Pools, one is for television and the other is for radio. The Incentive Rate of Return (IRR) is calculated by dividing the Incentive Grant Pools by the total amount of NFFS claimed by all television and radio stations. The IRR is then multiplied by the station's reported NFFS to calculate the incentive award amount of the station's total CSG. There is a two year lag between the reported NFFS and CPB's calculation of the fiscal year's CSG award amount. CPB used the NFFS claimed on KNON's FY 2006 AFR to determine the amount of its FY 2008 CSG award.

In 2005 CPB awarded KNON an ISA Grant for \$15,000 to help rural and minority stations use state-of-the-art web technology to increase service to their listeners. CPB's vision was to improve the station's web presence to enhance station outreach, deepen community relationships, improve public transparency and accountability, and offer listeners an easy and secure way to support stations financially. The Grant was amended in 2006, modifying the grant period to October 1, 2004 to December 31, 2007. The Grant was to be paid out in two installments; the first \$10,000 payment was made in March 2005 to cover expenses for the period October 1, 2004 - December 31, 2006. The second payment of \$5,000 was made in October 2008 to cover calendar year 2007 expenses.

CPB awarded a Digital Conversion Fund Grant of \$85,000 (\$80,000 in cash and \$5,000 iBiquity credit) to KNON in November 2005 to purchase and install digital equipment by November 2006, with KNON providing matching funding of \$82,031. The station could have selected any combination of eligible equipment and related items listed in the grant agreement available from vendors that CPB identified as providing discounts to stations.

CPB's FY 2008 CSG award to KNON was \$103,839. This award included \$74,929 in unrestricted CSG funds and \$28,910 in restricted funds. Restricted funds were to be spent on the production, acquisition, or distribution of national programming. The FY 2008 CSG award could be spent over a two year period from October 1, 2007 to September 30, 2009. CPB annually awards new CSGs to stations, so the FY 2008 grant's spending period overlapped the first year of the FY 2009 CSG grant period.

¹ In addition to the three organizations identified above, the notes to the financial statements identified the following related parties: ACORN Housing Corporation, COUNCIL Health Plan (CHP), COUNCIL Beneficial Association (CBA), Peoples Equipment Resource Corporation (PERC), Arkansas Broadcasting Foundation, Inc., and the 4415 San Jacinto Street Corporation.

CPB's cash payments for the ISA Grant, Digital Grant, and the FY 2008 CSG are identified on Exhibit A. KNON reported total revenues of \$694,938 on its 2008 AFR, Exhibit B, and \$445,266 as NFFS, Exhibit C. KNON's 2008 AFR covered the period January 1, 2008 - December 31, 2008.

RESULTS OF REVIEW

We examined management's assertions of compliance with CPB's CSG agreement terms, Financial Reporting Guidelines, Certification of Eligibility requirements, and Act requirements for FY 2008. We also examined KNON's CSG, Digital, and ISA expenses. Management is responsible for KNON's compliance with CPB's requirements. Our responsibility is to express an opinion on management's assertions about its compliance based on our examination.

Our examination was conducted in accordance with the *Government Auditing Standards*, for Attestation engagements, and accordingly, included examining, on a test basis, evidence of KNON's compliance with those requirements and performing such other procedures as we considered necessary. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination of KNON's compliance with specified requirements.

Our examination disclosed the following issues of material noncompliance with CPB's CSG, Digital, and ISA grant agreement requirements, Certification of Eligibility requirements, and Act requirements, applicable to the period ending September 30, 2008.

- Questioned \$87,741 in CPB grant expenditures, including, \$54,292 in unallowable Digital funds (68 percent of Digital grant); \$19,778 in FY 2008 related party expenses for administrative support without adequate documentation (19 percent of CSG grant); and \$13,671 in unallowable or undocumented ISA expenses (91 percent of ISA grant).
- Overpaid KNON \$3,005 under the Digital grant, reported as funds put to better use.
- CCI's accounting system (KNON's accounting service provider) did not discretely account for the receipt and expenditure of CSG grant funds in accordance with CPB grant recordkeeping requirements to facilitate our audit. The lack of discrete accounting represents a scope limitation, which prevented us from verifying that CPB's CSG grant funds were expended within the two year grant spending period. Further, the lack of grant accounting did not facilitate our audit of the Digital and ISA grant expenditures.
- KNON was not in full compliance with CPB requirements for establishing operating procedures explaining how it complied with the five requirements of the Act for Open Meetings, Financial Records, CAB, EEO, and Donor Lists and Political Activities.

In our opinion, because of the effect of the material noncompliance issues described above, KNON has not complied with the aforementioned requirements for the period ending September 30, 2008.

FINDINGS AND RECOMMENDATIONS

Lack of Discrete Accounting

During our audit period, KNON's accounting service provider, CCI, did not discretely account for the receipt and expenditures of CSG funds in accordance with CPB grant recordkeeping requirements. Further, the lack of grant accounting for the CPB Digital and ISA grants prevented us from tracing KNON's final financial reports submitted to CPB to its accounting records. Station and CCI officials had to identify individual vendors and invoices to support charges incurred under the Digital and ISA grants. The lack of discrete accounting for CSG revenues and expenditures represents a scope limitation, as discussed further in our Scope and Methodology section, Exhibit F.

CPB's General Provisions and Eligibility Criteria for Radio CSGs, Section 10.B. Record Keeping and Audit Requirements, require stations to provide discrete accounting and proper documentation to support all CSG expenditures. It further requires that:

- CSG funds which cannot be accounted for because of the recipient's failure to comply with this requirement may be subject to repayment;
- grant recipients must maintain financial records that facilitate an effective audit; and
- records must be retained for no less than three years after the end of the expenditure period.

While a separate CPB bank account had been established to initially deposit and account for CPB funds, CPB revenues were commingled with other revenues in either a Grants-unrestricted or a Grants-restricted income account in the accounting system. The commingling of multiple years of CPB funding in either the unrestricted or restricted grant accounts did not provide an audit trail to enable us to verify that annual CSG grant awards were spent within the two year grant spending period authorized in the grant agreement. Further, since CPB expenses were also not separately identifiable in the accounting system's expense accounts we could not match CPB revenues by fiscal year to corresponding expenditures.

Additionally, because we could not identify ISA or Digital grant expenditures in the accounting system we had to have the auditee identify specific grant expenditures. As a result, financial records were not maintained by CCI to facilitate an effective audit of CPB's grant funds.

As previously mentioned, CCI maintained KNON's financial records. These records included four bank accounts: 1) a Bank of America account used by the station to

deposit local contributions; 2) a Whitney Broadcasting Foundation account, which CCI used as a general operating account to make broadcasting disbursements; 3) a "CPB" account used to make CPB restricted fund disbursements; and 4) a digital account. Although CCI had established a separate "CPB" bank account to segregate CPB funds, other non-CPB funds were also deposited into this account.

During our audit period a \$40,000 contribution received from a private donor to fund the digital conversion project was initially deposited into the CPB bank account. This \$40,000 contribution and an additional \$43,500 in CPB funds were subsequently transferred to the digital bank account in January 2008. Another \$88,798 from the CPB account was transferred to the Whitney Broadcasting Foundation account to pay operating expenses.

Since CPB CSG, Digital, and ISA funds were deposited into the CPB bank account, we attempted to use disbursements from the CPB bank account to identify FY 2008 CSG expenditures. However, only \$32,348 in expenditures was made from this account, considerably less than the \$103,839 in CSG funding awarded in FY 2008. The balance of the disbursements made from this account, totaling \$172,298, were large cash transfers to the Whitney Broadcasting Foundation account and the AGAPE/Digital account. Accountability over the CPB funds was lost for the \$88,798 transferred to the Whitney Broadcasting Foundation account because they were commingled with revenues from other sources in this bank account.

Likewise, we initially attempted to use disbursements from the digital bank account to identify Digital grant expenditures. However, KNON officials subsequently identified additional Digital grant expenditures that were not disbursed from either the digital bank account or the CPB bank account. We also identified that \$20,000 was transferred from the digital bank account to the Whitney Broadcasting Foundation account, where CPB accountability was lost because these funds were commingled with other revenues.

Discussions with CCI officials and our audit coordinator disclosed that this was the way CCI had performed its accounting services. They stated that having a separate CPB bank account was adequate for their needs.

At the beginning of our fieldwork, KNON officials acknowledged their dissatisfaction with CCI's performance and were engaged in finding another accounting service provider to perform its accounting functions, which subsequently occurred in April 2009. Regarding CCI's performance, KNON officials said that CCI had represented to KNON that they had been accounting for the receipt and expenditures of CPB funds in accordance with CPB grant recordkeeping requirements. Further, CCI had been known to manage grants for other entities from a variety of sources and there were no known problems. KNON felt CCI had the experience necessary to properly account for CSG grant funds. It was only in recent years that doubts about CCI's abilities had surfaced.

Further, KNON believed that CPB restricted funds were maintained in the CPB account, where all National programming expenses were tracked. Non-restricted CPB funds

were transferred into the general operating account and were only used to pay broadcasting expenses. Additionally, they said that the National Program Director's expenses were also paid out of this general operating account.

Recommendations

- 1) We recommend that CPB require KNON to:
 - a) Comply with CPB's discrete accounting requirements and maintain sufficient financial records to facilitate an effective audit of CPB revenues and expenditures. Such records should discretely account for all CSG income and expenditures against grants awarded on a fiscal year basis and include tracking expenditures over the two year grant period.
 - b) Reconstruct its accounting records for FY 2008 – 2010 to identify unrestricted and restricted CSG expenditures against CPB revenues on a fiscal year authorization basis and report to CPB whether all the CSG funds were spent within the two year grant spending period.
 - c) Annually report to CPB the revenues received by grant (unrestricted and restricted), opening cash balances, expenditures, and ending cash balances as of September 30th of each year.

Management Response

KNON officials provided the following responses to these recommendations.

Recommendation 1(a): KNON officials said they understood the need to have accounting records that facilitate an audit of the revenue and expenditures of the CPB grants. After changing to their new accounting company in April 2009, CPB grant funds received have been deposited into separate bank accounts, one for restricted funds and one for unrestricted funds. Only CPB expenditures are paid out of these accounts. Beginning in July 2010 the accounting company provided KNON with a monthly report of CPB revenues and expenditures by grant and fiscal year.

Recommendation 1(b): KNON officials reconstructed its accounting records of CPB's FY 2008 and FY 2009 CSGs and submitted them to CPB. Additionally, KNON asked its accounting company to retroactively add class codes to each revenue and expenditure (as identified in the reconstructed reports) in the general ledger to identify it as Restricted or Unrestricted and by the Fiscal Year of the Grant to which it relates. With these class codes, any future audit of these past fiscal years would be facilitated.

Recommendation 1(c): KNON officials said they will report to CPB every October the revenues received by grant (CSG unrestricted, CSG restricted, and any special grants), opening cash balances, expenditures, and ending cash balances as of September 30th of each year.

OIG Review and Comment

Based on KNON's response, we consider recommendations 1(a), (b) and (c) resolved but open pending CPB's final decision on KNON's corrective actions.

Questioned CPB Expenses

Based on our examination of KNON expenses, we questioned \$87,741 in CPB expenditures as summarized in Exhibit D. This total included \$54,292 in unallowable Digital expenditures; \$19,778 in undocumented related party expenses for administrative support; and \$13,671 in unallowable or undocumented ISA expenses. Additionally, we identified \$3,005 that was overpaid to KNON (reported as funds put to better use) when KNON was reimbursed the full CPB grant amount of \$80,000 instead of CPB's portion of total net eligible costs of \$76,995. Our audit of CPB expenditures was complicated by the lack of discrete accounting of CSG revenues and expenditures, as previously discussed in our finding on discrete accounting. This level of questioned costs is materially noncompliant with CPB grant requirements.

Lack of Accountability Over Digital Radio Conversion Grant Funds

KNON submitted a final financial report dated October 9, 2008, reporting total eligible equipment costs of \$152,731 (net total eligible equipment cost of \$147,731). However, based on information provided by KNON officials and our review of the accounting records, we could only identify \$76,121 in expenditures through September 30, 2008. Our review of the \$76,121 identified only \$46,333 in allowable grant expenditures (CPB's portion represented \$22,703).² As a result, we have questioned \$54,292³ of the \$80,000 CPB grant paid to KNON. Additionally, we identified that the grant agreement period was not modified to reflect delays in purchasing and installing the equipment, and CPB Digital revenues were not properly recorded in the accounting records in a timely manner.

Under the Act, public broadcasting entities that receive funds from CPB must establish and maintain adequate accounting records and supporting documentation. CPB's Digital agreement stated that, "Grantee shall keep such records as may be reasonably necessary to fully disclose the Total Eligible Project Costs . . . and such other records as will facilitate an effective audit." Further, grant reporting requirements specified that the final report should include actual costs and expenditures incurred to complete the digital conversion project.

KNON's final digital report misrepresented actual costs and expenditures incurred to date through September 30, 2008, by approximately \$71,610. KNON's final report did

² CPB's portion calculated as follows: \$80,000 (CPB cash)/\$162,031 (total cash contributions) = 49 percent. \$46,333 x 49 percent = \$22,703.

³ \$80,000 (CPB payments) - \$22,703 (allowable CPB costs) = \$57,297 - \$3,005 (CPB overpayment) = \$54,292 (questioned costs).

not represent actual costs incurred to date, but projected expenditures through June 2013 to purchase the equipment under a lease purchase agreement.

Equipment Purchased Under Lease Purchase Agreement

Our review of digital disbursements identified a \$46,333 payment to Harris Corporation on March 6, 2008, as a down payment for the equipment. The invoice identified this amount as one third of the equipment costs of \$138,185. The \$46,333 was recorded as an equipment asset to be capitalized. The balance of the recorded expenditures, totaling \$29,788, was identified as either non-eligible expenditures (\$15,717) or unallowable expenses (\$14,071). We considered the \$14,071 in leased equipment charges through September 30, 2008, as unallowable, because the lease purchase agreement was not approved by CPB. Discussions with CPB officials disclosed that they were not informed that the equipment was being leased. Further, KNON did not disclose in its final report to CPB that the equipment was being obtained under a lease purchase agreement and the final report included lease payments to be made through June 2013. Finally, the station had not received title to the equipment. CPB officials said the grant was given to purchase equipment.

As background, in June 2008, KNON entered into a lease purchase agreement with Tiger Leasing, LLC to lease digital equipment over a 60 month period ending on June 30, 2013. We were told the lease was subsequently sold to Sterling Bank and the monthly lease payments of \$2,225.61 were made to Sterling Bank. At the end of the lease as an option under the agreement the station can purchase the equipment for \$100.

We were further told that KNON had to enter into a lease agreement to finance the purchase of the digital equipment, because the station could only raise \$40,000 of the \$82,031, required as KNON's matching share under the grant agreement to purchase the equipment. The station said it tried to secure a loan to purchase the equipment but given the economic times, its bank was unwilling to make the loan despite KNON's long relationship with the bank and history of paying past loans on time. KNON told us they looked for alternative financing and found Tiger Leasing, who agreed to finance the project.

KNON officials explained that the lease purchase agreement with Tiger Leasing was a capital lease and was recorded as such. They further explained that a capital lease is simply another form of financing the equipment and that the substance of the transaction is a purchase not an operating lease.

While KNON argued that this was just another form of a purchase, Tiger Leasing took title to the equipment when CPB funds were used to make the initial \$46,333 down payment to purchase the equipment. This was contrary to Sections 7 and 19 of the Digital agreement. Section 7 states:

There are no third party beneficiaries of this Agreement, and no third parties shall have any recourse against CPB with respect hereto or to the Project.

Section 19 states:

Grantee shall not assign or transfer its rights of obligations under this Agreement in whole or in part without the prior written consent of CPB. Any assignment or transfer or attempted assignment or transfer of rights or obligations under this Agreement by Grantee without the prior written consent of CPB may be deemed null and void, at the option of CPB.

While KNON's accounting treatment of the capital lease may have been adequate, under the grant agreement this matter should have been discussed with CPB and a written consent obtained.

Our review found that the leasing company paid \$96,766 for the equipment (\$92,666 for the equipment and \$4,100 for shipping) and KNON would incur an additional \$36,771 in financing charges under the terms of the leasing agreement through June 2013. We estimate that for the period where accounting records were made available to us (June 2008 – June 2010), KNON paid approximately \$41,663 against the principal and \$16,202 in financing and insurance charges.

Grant Period Not Modified

Additionally, we found no evidence that KNON requested in writing that the grant agreement be amended to extend the grant period beyond the November 1, 2006 ending date, as required by the Digital agreement terms. The agreement period ran from May 27, 2005 to November 1, 2006. Our review of the reported disbursements identified that they started in 2008, over a year after the grant agreement ended on November 1, 2006.

In response, KNON officials said that they talked with CPB officials and asked about an extension. They said CPB told them they would fund the grant past the November 2006 ending date. However, we were not provided any documentation that KNON requested an extension in writing, as required by Section 2 of the Digital grant agreement, or CPB granted the extension by written note. Section 2 states:

In no event shall the Project extend beyond the Project End Date without prior written approval by CPB. If any unforeseen circumstance arises that may cause a delay in the completion of the Project beyond the Project End Date, Grantee shall promptly notify CPB in writing. CPB shall have the option, to be exercised in CPB's sole and exclusive discretion, to extend the Project End Date by written notice to Grantee.

Revised Final Digital Costs

In response to our preliminary finding, KNON officials identified additional eligible expenses of \$4,100 for shipping the equipment to KNON and \$12,845 for the station's contract engineer to install the equipment. This reconstruction of KNON's digital costs increased the total net eligible costs to \$155,944 versus the \$147,731 previously reported. In the October 9, 2008 final report submitted to CPB, the station's contract engineer expenses had been classified as non-eligible expenses. However, in reviewing the engineer's invoices, we could not distinguish the engineer's costs for installing the digital equipment from routine maintenance charges. As a result, we could not determine whether all of the \$12,845 qualified as eligible costs under this grant. In KNON's application for the digital grant, the engineer's installation costs were budgeted at \$5,000.

Additionally, in reconstructing the total eligible costs under the digital grant, KNON's analysis identified that they owed CPB \$3,005 under this grant. This amount was calculated using the revised total eligible costs of \$155,944 and apportioning the actual costs by CPB's portion of the original budget of 49 percent. The \$155,944 was less than the \$162,031 in total eligible costs in the grant agreement.

Section 4.(d) of the Digital agreement states:

Grantee . . . will return to CPB, without request, any of the Total CPB Commitment that has not been spent, or for which authorized liabilities have not been incurred, by Grantee by the Project End Date.

For audit reporting purposes, we classified the \$3,005 overpaid to KNON as funds put to better use.

Recording CPB Digital Receipts

Our review also identified that CPB digital receipts were not properly handled by KNON officials. We identified that the initial CPB Digital payment of \$37,500 was properly recorded in the CPB bank account maintained by CCI in May 2006. However, the second payment of \$42,500 was not deposited into a CCI maintained bank account or initially recorded in the accounting system by CCI. It was deposited into a bank account established by KNON in December 2008. This bank account was not reflected in the official accounting records maintained by CCI through April 2009. It was subsequently accounted for when the new accounting service took over in April 2009. The new accounting service added the KNON bank account to its reconstructed accounting records beginning in January 2009. The account's opening balance in January 2009 was \$42,466.

Discussions with station officials indicated that they had lost confidence in CCI's ability to use the second CPB payment of \$42,500 funds for the digital equipment and set-up their own account to make their future monthly lease payments. Review of the 2009

and 2010 accounting records identified that \$44,806 was paid to Sterling Bank under the terms of the lease agreement from October 2008 through June 2010.

While not initially recording the receipt of CPB's \$42,500 payment in CCI's accounting records was a violation of the CPB grant agreement to maintain accounting records in accordance with generally accepted accounting practices, the Treasurer of the Board informed us that the Board authorized the General Manager to set-up this new bank account. However, we could not verify this approval because the Board's decision was not memorialized in any Board minutes or correspondence.

Our concern remains that any off the books transaction creates vulnerabilities for fraud, waste, and abuse and should be avoided. While station officials countered that these funds were properly addressed by its new accountant in 2009 and were reflected in its calendar year 2008 financial statement audit report issued in June 2009, there was a period of time during the transition between accounting service providers (December 2008 – April 2009), where these funds were not accounted for in the official accounting records.

Related Party Charges Not Supported By Adequate Documentation

We found that KNON paid for administrative services provided by related parties totaling \$59,030 without adequate supporting documentation. We questioned CPB's portion of these costs totaling \$19,778, because without supporting documentation we could not properly evaluate the reasonableness of the costs. These costs were allocable to the CSG grant, because discrete accounting records were not maintained over the CSG funds. Discussions with CCI officials indicated that these charges were allocations of related party costs spread equitably among its clients based on their respective budgets.

CPB's General Provisions and Eligibility Criteria, Section 10, B. Record Keeping and Audit Requirements require:

... discrete accounting and proper documentation shall be maintained to support all FY 2007 CSG revenues and expenditures. All CSG expenditures must meet the test of allowability as stated throughout this document and as provided by all other CSG-related documents and policies. CSG funds which cannot be accounted for because of recipient's failure to comply with this requirement may be subject to repayment to CPB.

We are questioning CPB's portion of these charges totaling \$19,778 because there was no documentation (e.g., current agreements for services with explanation of rates charged) to support the validity of the services provided and the reasonableness of the amounts charged, per the following table.

Related Party Questioned Costs

	Related Party Costs	CPB Allocation Rate ⁴	Questioned Costs
Total FY 2008 Costs	\$59,030		
CPB Account Direct Charges	\$3,924	100%	\$3,924
Net Total	\$55,106	28.77%	\$15,854
Total Questioned Costs			\$19,778

KNON utilized the services of a number of different related parties for a variety of administrative services, e.g., accounting, legal, facilities, telephone, internet, human resources, FCC assistance, etc. These services were charged monthly to KNON's accounts by CCI. During FY 2008, KNON paid \$59,030 to related parties as shown in Exhibit E without adequate documentation or support.

The documentation provided to support these charges was not adequate to attest to its reasonableness, particularly when you consider the less than arm's length relationships inherent in related party transactions. KNON did not receive a monthly bill for the services provided; CCI just recorded the charges to KNON's accounting records. We could not verify what services were provided, how the charges were calculated, and whether the basis for calculating the charge was equitably distributed amongst the related party's clients.

To illustrate, the CCI agreement provided to support CCI charges was dated January 1, 1983 and specifically covered only accounting and bookkeeping services. The agreement did not address legal or other general services charged by CCI to KNON. KNON officials did not have copies of agreements with ACORN, AI Communications, or AM/FM for the services charged to KNON in the accounting records. Based on our work, we could not determine whether the 1983 fees were still in effect during our audit period. It is our understanding that KNON officials relied on CCI and the other related parties to provide various administrative services.

Questionable Internet Service Acquisition Grant Expenses

KNON reported expending \$19,318 on the ISA Grant even though this was only a \$15,000 grant. However, based on information provided by KNON officials and our review of the accounting records and invoices, we could only identify \$10,578 in expenditures. Our review of these expenditures identified \$9,249 in questionable costs. This total coupled with the undocumented expenditures reported (\$15,000 - \$10,578 = \$4,422) results in total questioned costs of \$13,671.

The terms of the ISA agreement require grantee's to acquire services from vendors not related to the station's licensee. Qualified services or service providers include: national

⁴ Related party costs paid from CPB bank account were questioned at a 100% rate, and the net total related party costs were questioned at a 28.77% rate (\$199,964 CPB CY 08 income/ \$694,938 total CY 2008 AFR revenues).

or regional website content providers, application service providers, website content management or design services and internet streaming providers. Further, the ISA Grant funds were not to be spent to reimburse the grantee or its licensee for station staff or internal expenses incurred in creating a standalone station website. In announcing this grant program to rural and minority radio stations, CPB said that the purpose of the ISA Grant program was designed to help stations use state-of-the-art web technology to “enhance service” to their listeners. CPB’s vision was to improve the stations’ web presence to enhance station outreach, deepen community relationships, improve public transparency and accountability; and offer listeners an easy and secure way to support stations financially.

Our audit of the recorded expenditures of \$10,578, determined that \$9,249 of these funds were used for services that did not meet the requirements of the grant program. They were either related third party administrative service charges (i.e., \$274 in services provided by the ACORN Institute) or were not related to enhancing existing internet services totaling \$8,975. The internet streaming service provider’s contract was initiated several years before KNON applied for the ISA grant and did not meet the purpose of the program to enhance internet services over previously existing station services. For some of the undocumented reported expenditures of \$4,422, KNON officials provided invoices for services provided by the ACORN Institute totaling \$1,519. However, these invoices did not agree with the \$274 in ACORN expenditures recorded in CCI’s accounting records.

Regarding the internet streaming expenses, KNON officials said they were ready to cancel the contractor’s service agreement because of the cost. However, upon receiving the grant they felt keeping the service was appropriate, since the streaming had enhanced the website, promoted the station, provided a service to listeners, and generated some donations. In our judgment, continuing this service did not increase the level of service already being provided to the station’s listeners.

Recommendations

- 2) We recommend that CPB:
 - a) evaluate whether the principal paid under the digital lease purchase agreement qualifies under the grant agreement (\$54,292 questioned as CPB’s portion of the grant);
 - b) require KNON to submit a revised final report to CPB reporting all eligible digital costs;
 - c) require KNON to evaluate the station’s contract engineer’s invoices to isolate his costs to install the digital equipment from routine station maintenance costs and include installation costs in the final revised digital cost report submitted to CPB;

- d) recover at least the \$3,005 overpayment made to KNON based on the net total eligible costs incurred by KNON to purchase the equipment; and
 - e) ensure future final payments only reimburse grantees for CPB's portion of agreed upon costs.
- 3) We recommend that CPB require KNON to:
- a) refund \$32,024 in questioned costs for related party costs (\$18,353) and ISA expenses (\$13,671).
 - b) institute controls to ensure CPB grant funds are expended on allowable activities;
 - c) ensure future CPB administrative service costs, supplied by related parties, are supported by current agreements that establish the methods used to determine the rates charged to KNON, specify the services provided, and the reasonableness of the costs billed (i.e., rates were consistently applied to all clients and can be verified to current market rates); and
 - d) formally request grant agreement periods be modified when grant performance cannot be accomplished within the specified grant agreement period.

Management Response

KNON officials provided the following responses to these recommendations.

Recommendation 2(a): While this recommendation was directed to CPB they reiterated that KNON was unable to obtain enough matching funds from other sources and had no choice but to finance the purchase of the equipment. They acknowledged that the grant indicated that they should have obtained written approval from CPB for the financing arrangement. Further, in the interest of fairness and CPB's desire to get community radio stations to convert to digital, the \$54,292 should qualify under the grant.

Recommendations 2(b) & (c): KNON's contract engineer revised his invoices to identify his costs to install the digital equipment. His revised costs are included in the revised final report submitted to CPB, dated September 24, 2010, for the Digital Conversion Grant.

Recommendation 2(d): KNON agreed that CPB overpaid KNON for the Digital Conversion Grant and based on the contract engineer's revised invoices agrees to repay CPB \$3,626.

Recommendation 2(e): KNON said this recommendation was directed to CPB and they could not address how CPB would ensure they only reimburse grantees for agreed upon costs.

Recommendation 3(a): KNON disagree with the related party questioned costs of \$18,353 based on their reconstruction of their FY 2008 CSG expenditures and the \$13,671 in questioned ISA costs. They acknowledged questionable ISA grant expenditures of \$4,696.

Regarding the questioned related party costs, they said that in reconstructing their FY 2008 accounting records for CSG expenditures they did not allocate any of the related party costs identified in the audit to the CSG grant. They said their reconstruction of CSG expenses was based on allocating expenses the station manager intended to pay with the CSG funds. Their response also challenged the 28.77 percent rate used in the audit report to calculate the questioned related party costs, citing the AFR only reported \$142,209 in funds received in CY 2008 and not the \$199,964 cited in the audit report. Their response went on to argue that at the most the report should have questioned \$8,592 based on KNON's calculation rate of 14.35 percent.

While their response acknowledged that KNON did not have current contracts specifying all the services received and fees paid to the related parties, they said the arrangement for the services had been in place for several years and complacency did become the norm. They said that at different times, KNON did consider changing to different service providers but did not take any action before 2009. They said they did generally evaluate the services received for the fees paid. They felt the fees charged were reasonable for the most part and presented their rationale for accepting these costs by service provider.

Regarding ISA questioned costs; they argued that the payments for streaming services were qualified expenditures of \$8,975 under the grant agreement. They said while CPB may have intended the Internet Service Acquisition Fund to make grants for the "Enhancement" of internet services, CPB's grant agreement did not mention enhancement. Therefore, it would be unfair for CPB to disallow their internet streaming costs, because KNON was paying for the service before the grant was received. Their response did acknowledge that they had reported \$4,696 in unqualified expenditures. They submitted a revised Internal Services Acquisition Fund Grant Report to CPB, dated September 24, 2010, identifying unspent funds of \$4,696.

Recommendation 3(b): On September 18, 2010, the KNON Board of Directors adopted a policy on cash controls, including CPB grant agreements and expenditures. This policy calls for grant agreements to be reviewed and approved by the Board of Directors before being signed by the station manager, expenses to be paid for by grants to be generally outlined in budgets approved by the board, monthly detailed reports on the status of each open grant will be presented to the Board at each monthly meeting, and KNON's accounting service provider will become familiar with grant requirements and question any expenditures they have doubts about. Finally, each Board member has been provided with a copy of CPB's FY 2010 CSG General Provisions and Eligibility Criteria.

Recommendation 3(c): KNON no longer has any related party service providers. All services for accounting, internet, telephone, website, legal, payroll, health insurance, and human resource assistance are now provided by unrelated parties.

Recommendation 3(d): KNON said the most important lesson learned from this audit was to understand the grant requirements and adhere to each and every requirement. They will never again rely on any oral communication with CPB and will formally request in writing that the grant agreement period be modified when grant performance cannot be accomplished within the specified grant agreement period.

A more detailed discussion of KNON's disagreements with the findings in this report is presented in their written response to the draft report in Exhibit G. The documentation accompanying KNON's written response was too voluminous to attach to this report, but is available upon request from the Office of Inspector General.

OIG Review and Comment

Based on KNON's response, we consider recommendations 3(b), 3(c), and 3(d) resolved but open pending CPB's final management decision on KNON's corrective actions. We consider recommendations 2(a) - 2(e), and 3(a) unresolved, as explained by recommendation.

Recommendation 2(a): This recommendation addressed the \$54,292 questioned because KNON did not obtain CPB's written consent to assign or transfer the rights to the digital equipment purchased under this agreement to a third party. This recommendation remains unresolved until CPB officials make a management decision on the allowability of the costs associated with the lease purchase agreement entered into by KNON.

Recommendation 2(b): While KNON submitted a revised final report for the Digital Conversion Grant reporting total eligible costs of \$159,686 versus the previously reported \$152,731, we could not trace the reported additional costs to an itemized accounting of digital expenses provided to us by KNON prior to issuance of the draft report. As a result, this recommendation remains unresolved until CPB officials make a management decision on the allowability of the lease purchase agreement and CPB obtains an accounting for the additional eligible costs reported by KNON.

Recommendation 2(c): Previously, KNON reported contract engineer costs of \$12,845; the revised digital report only identified \$11,587 in costs, a \$1,258 difference. The revised invoices submitted by the contractor only identified a difference of \$1,058. Further, it appears that the contractor's monthly retainer fee of \$200 was not adjusted from the digital grant billings for August and September of 2008. As a result, this recommendation remains unresolved until the inconsistencies are resolved by KNON to CPB's satisfaction.

Recommendation 2(d): While KNON agreed to refund \$3,626 in overpaid CPB funds under the Digital Conversion Grant; based on the response we could not verify that this is the correct overpayment amount. As a result, this recommendation remains unresolved until CPB makes a management decision on the allowability of reported costs under this grant.

Recommendation 2(e): This recommendation was addressed to CPB management and remains unresolved until CPB makes a management decision.

Recommendation 3(a): Regarding the related party questioned costs of \$18,353, KNON stated that they reconstructed their CSG expenditures for FY 2008 and did not include any related party costs in their reconstruction. Regarding KNON's reconstructed costs, during our initial fieldwork we tested selected charges for national programming that were included in their reconstructed costs. We also tested nine transactions totaling \$16,265 in unrestricted expenditures that were also included in their reconstructed CSG costs.

Regarding KNON's challenge of the calculation of related party questioned costs using a 28.77 percent rate; KNON argued that this rate was inaccurate because they only reported \$142,209 in CPB income during CY 2008 on its AFR. However, our audit of CPB's records showed that CPB paid KNON a total of \$199,964 during CY 2008. These payments included a \$5,000 ISA payment in October 2008 and \$48,625 FY 2009 CSG payment in November 2008. Further, our audit of KNON's AFR showed they under reported FY 2008 CSG revenues by \$4,130. As a result, we do not believe the reported 28.77 percent rate was inaccurate.

Regarding the reasonableness of related party costs questioned, aside from the accounting services provided to KNON, we have no documentation of what services were provided by the related parties to begin to assess their reasonableness. Regarding the accounting service charges, we could not verify how CCI billed for their accounting services and whether that billing was consistent with the charges made to other clients. Since we were dealing with related party transactions, the equitable distribution of the accounting service provider's costs among its clients was critical in our assessment of the reasonableness of these charges.

Regarding the ISA payments made for internet streaming totaling \$8,975, CPB's correspondence to the stations announcing the ISA grants program explained the intent of the program, which was to use state-of-the-art web technology to increase service to their listeners. They also explained that improving station's web presence would also enhance station outreach, deepen community relationships, improve public transparency and accountability; and offer listeners an easy and secure way to support stations financially. Since a continuation of KNON's existing internet services agreement did not improve or enhance existing services at the time of the grant award, we consider this recommendation unresolved pending CPB's management decision on the allowability of these charges.

Lack of Documentation or Procedures Showing Compliance with Communications Act Requirements

KNON was in compliance with various statutory provisions of the Act. These provisions included conducting open meetings of its Board of Directors (BOD); establishing an active CAB; making open financial records available to the public; making EEO information available to the public; and maintaining and securing donor lists. While we found KNON in compliance with the specific requirements, KNON officials had not prepared documentation or implementing procedures explaining how they complied with the requirements of the Act.

CPB's Certification Requirements for Station Grant Recipients provides the following requirements on documentation and written procedures for Open Meetings, Open Financial Records, CAB, EEO and Donor List and Political Activities. Each recipient of a CPB station grant shall develop documentation explaining how the station complies with these requirements. This documentation should address the procedures for conducting open meetings and the methods used to give reasonable notice to the public; the types of financial and EEO information to be made available to the public, including the mechanisms used to give the public access to this information; the establishment, composition, role, and position of the community advisory board relative to the organization of the station; and how the station complies with donor list and political activity restriction requirements. This documentation shall be kept by each station at a reasonable location and made available to CPB, upon request, to determine the fact and extent of compliance with these requirements.

These procedures should specify how the station actually goes about complying with each of the five sections of the certification requirements. These procedures are necessary to provide the public with information they can use to understand how the station complies with these grant responsibilities.

In response to this finding KNON officials said they were aware of the various statutory requirements of the Act, but did miss the requirement to prepare documentation to explain how they complied. KNON officials acknowledged the need to comply with these requirements.

Recommendation

- 4) We recommend that CPB require KNON management to establish written implementing policies on the station's practices for all of the Act's requirements, including open meetings, maintaining open financial records, maintaining a functioning CAB, making EEO information available to the public, and maintaining and securing donor lists.

Management Response

In response to Recommendation 4, KNON officials said that they were unaware of CPB's documentation and written procedures requirements for Open Meetings, Open Financial Records, CAB, EEO and Donor list and Political Activities. Responding to this recommendation KNON's Board adopted written policies at their September 18, 2010 Board meeting to address:

- Open Meetings;
- Open Financial Records;
- Community Advisory Board;
- Equal Employment Opportunity;
- Donor Information, Security, Privacy, and Political Lists; and
- Document Retention.

They said the approved policies and procedures have been placed in the KNON public file for public viewing.

OIG Review and Comment

Based on KNON's response, we consider Recommendation 4 resolved but open pending CPB final management decision on KNON's corrective actions.

Need for Further Governance Improvements

Our review identified that station officials had limited knowledge of CCI's accounting practices and that CCI relied upon its independent public accountant (IPA) to prepare the Annual Financial Report submitted to CPB. Further, station officials had not established the necessary oversight controls to ensure that the work performed by its accounting service CCI adequately met CPB's General Provisions and Eligibility Criteria for Radio CSGs. Further, KNON management officials did not provide adequate oversight of its performance under the Digital and ISA grants and to ensure these grants were fully accounted for in the accounting records.

Review of Board meeting minutes for June of 2008 identified concerns about the financial services provided by CCI. These concerns surfaced during the meeting following the disclosure by CCI that \$22,857 in KNON funds had been embezzled by a former CCI official in 2000. Arrangements were made to restore these funds to KNON and were subsequently repaid by CCI in October 2008. While CCI did not respond to KNON's inquiries about interest being paid on the embezzled funds, KNON booked \$9,998 as an interest receivable. This total was subsequently netted against funds due ACORN of \$5,963, for a net interest receivable of \$4,035. This amount was subsequently booked to the Reserve for Doubtful Accounts in December 2009 when recovery appeared unlikely with the closure of CCI.

In response to the reported embezzlement, KNON officials passed a Board Resolution in June of 2008 requiring CCI to provide KNON with monthly copies of bank statements and their reconciliations, a summary trial balance, and a detailed general ledger report. While CCI did improve somewhat in providing the information requested, the information was not provided timely and the Board decided to find a new accountant in February of 2009. They subsequently hired a local accounting service that began work in April 2009.

KNON officials explained that the new accounting provider records all deposits, reconciles the bank statements, and prepares monthly detailed financial statements for the Board and station management. The accounting service also processes all payables and issues checks for approval to station management and the Board's Treasurer. KNON officials handle all funds received and make deposits to the local bank account, records pledge receipts in the pledge database, receives invoices and forwards them to the accounting service for processing, and approves all payments made by the station. Because the new accounting services were implemented after our audit period, we did not evaluate whether they fully met CPB requirements for discrete accounting.

The station also adopted several governance policies following the new IRS Form 990 requirements in February 2009. These included a Conflicts of Interest Policy, Whistleblower Policy, and Document Retention and Destruction Policy.

During our audit period, station management prepared weekly "allocations" forms to document local revenues and invoices received at the station. This information was transmitted to CCI in New Orleans for further processing. However, CCI did not always use the KNON prepared allocations forms to record costs against funding sources, as instructed by KNON. KNON officials were not aware that this information was not always being used by CCI to record station activities.

In addition to the local revenues and invoices received from KNON; CCI also received revenues for the station directly from grantees and invoices from various vendors that were not processed by KNON officials. As a result, KNON officials were not fully aware of how this information was being recorded to ensure accountability by funding source and how this information may have been reported to granting agencies, e.g., CPB. As previously discussed, we could not identify CSG, Digital, and ISA grant expenditures in the CCI accounting records and we had to rely on KNON officials to identify expenditures under the Digital and ISA grants.

The Board is ultimately responsible for ensuring that CPB grant requirements are complied with; however, we observed that the station relied on CCI to account for its CPB activities and report financial information to CPB on the AFR. While the AFR information was finalized by CCI for input to CPB, the financial information reported was prepared by the IPA. Both CCI and KNON officials accepted the AFR schedules prepared by the IPA without revision. We were advised by the IPA that KNON Board never requested to be briefed on his audit work during our audit period.

The AFR information should be prepared by KNON officials using financial information obtained from its accounting system. The IPA cannot be involved in the preparation of the AFR because such actions would compromise the IPA's independence to opine on the AFR attestation provided to CPB.

In addition to its financial responsibilities, the Board is also responsible for overseeing compliance with CPB grant requirements under the Act. As discussed in our Act findings, neither the Board or station officials had established operating policies for ensuring compliance with the Open Meeting, Open Financial Records, CAB, EEO, and Donor Lists requirements under the Act. While the Board had no formal mechanism to oversee how the station complied with these requirements, it annually certified to CPB that it had complied with the Act's and CPB requirements.

While KNON has now changed accounting service providers and is receiving better financial information, we are not clear how these new practices will ensure CPB funds are; (1) properly accounted for using discrete accounting; (2) used for only allowable purposes; and (3) properly documented in accordance with CPB grant requirements. Further, controls have to be implemented to ensure future CPB payments are recorded timely in the accounting records to avoid repeating what happened when the December 2008 \$42,500 Digital grant payment was received. This deposit was not immediately recorded in the official accounting records maintained by CCI. It was not recorded in the accounting records until the new accountant took over the recordkeeping in April 2009.

In response to our finding that the IPA prepared the station's AFR during our audit period, KNON officials disagreed. KNON officials said that it was their belief that CCI had prepared the AFRs during prior periods. However, our work identified that the IPA prepared the schedules presented on the AFR.

Recommendations

- 5) We recommend that CPB determine whether the current governance mechanisms are adequate and the licensee has instituted sufficient corrective actions to continue as a CPB grant recipient.
- 6) We recommend that CPB require the KNON Board and station officials to:
 - a) Establish controls to ensure CPB funds are only expended on allowable activities.
 - b) Discontinue the practice of having its IPA prepare its AFR. The IPA is responsible for independently attesting to its accuracy.
 - c) Establish controls over the AFR preparation to ensure KNON officials prepare the AFR in accordance with CPB financial guidelines.

Management Response

KNON's officials provided the following responses to these recommendations.

Recommendation 5: While this recommendation was directed to CPB, KNON officials said that it had in the past relied too heavily on its outside contractors. That reliance began to change before the audit was started and they have taken corrective actions to address each recommendation in this report.

Recommendation 6 (a): KNON officials stated that at the September 18, 2010 Board meeting, the Board adopted a policy outlining cash controls, including CPB grant agreements and expenditures. Among other things, the policy calls for:

- all grant agreements to be reviewed and approved by the Board before being signed by the station manager;
- all expenses paid for by grants to be at a minimum generally outlined in budgets approved by the Board;
- Monthly detailed reports on the status of each open CPB grant will be presented to the Board;
- the accounting company to be familiar with the CPB grant requirements and to question any expenditures they have doubts about.

Recommendations 6 (b) and 6 (c): KNON officials stated that the Board understood the need for independence and will make it clear that the independent auditor is not to prepare the AFR. The station manager will prepare the AFR from the audited financial statements with assistance, as needed, from accounting service provider and the KNON Treasurer. The KNON Treasurer is qualified to prepare the report correctly.

OIG Review and Comment

Based on KNON's response, we consider recommendation 5 unresolved and recommendations 6 (a) - 6 (c) are resolved but open pending CPB's management decision on KNON's corrective actions.

Exhibit A

**Schedule of CPB Payments to KNON
For Internet Service Acquisition Grant, Digital Conversion Grant and
FY 2008 Radio Community Service Grant
(October 1, 2007 – September 30, 2008)**

Payment Date	Grant Type	Unrestricted	Restricted	Total
2/1/05	Internet Service Acquisition Grant	\$0	\$10,000	\$10,000
10/2/08	ISA		5,000	5,000
	ISA Total		\$15,000	\$15,000
5/3/06	Digital Conversion		\$37,500	\$37,500
11/6/08	Digital Conversion		42,500	42,500
	Digital Total		\$80,000	\$80,000
1/14/08	FY 2008 CSG	\$38,067	\$14,688	\$52,755
8/4/08	FY 2008 CSG	36,862	14,222	51,084
	FY 2007 Total	\$74,929	\$28,910	\$103,839
	Total Grants	\$74,929	\$123,910	\$198,839

**KNON Annual Financial Report
Year Ending December 31, 2008**

Line	Description	2008
	<i>Schedule A, Source of Income:</i>	
1.	Amounts provided directly by federal government	\$ 0
2.A.	CPB-CSG	72,791
2.B.	CPB-digital Project Grants	42,500
2.C.	CPB-Restricted CSG	26,918
2.I.	Other PBE funds	14,400
8.	Foundation and nonprofit associations	500
9.	Business and Industry	127,611
10.	Memberships and subscriptions	232,525
14.A.	Gross special fundraising activities	129,935
15.	Passive Income	3,520
18.	Capital fund contributions	43,931
20.	Other Direct Revenue	307
21.	Total Revenue	\$694,938
	<i>Adjustments to Revenue</i>	
22.	Federal revenue	\$ 0
23.	Public broadcasting revenue	156,609
26.B	Special fundraising event expenses	93,063
27.	Total Direct Nonfederal Financial Support	\$445,266
	<i>Schedule E, Expenses:</i>	
	Program Services	
1	Programming and production	\$293,039
2	Broadcasting and engineering	131,271
3	Program information and promotion	7,973
	Support Services	
4	Management and general	75,506
5	Fund raising and membership development	93,063
6	Underwriting and grant solicitation	114,954
7	Depreciation and amortization	0
	Total Expenses	\$745,806
	<i>Investment in Capital Assets</i>	
	Total capital assets purchased or donated	\$182,930
	Total expenses & investment in capital assets	\$928,736

Exhibit C

KNON Summary of Non-Federal Financial Support 2008
Certification by Head of Grantee and Independent Accountant's Report

Line	Description	2007
	Summary of Non-Federal Financial Support:	
1	Direct Revenue (Schedule A)	\$445,266
2	Indirect Administrative (Schedule B)	0
3	In-Kind Contributions (Schedule C)	
3a	Services and Other Assets (Schedule C)	0
3b	Property and Equipment (Schedule D)	0
4	Total Non-Federal Financial Support	\$445,266

Analysis of Questioned Costs

CPB Grant Type	Total Questioned Costs
<i>Digital Conversion Grant</i>	
Unallowable Costs	\$54,292
<i>CSG - Unrestricted</i>	
Lack of Documentation	\$19,778
<i>Internet Service Acquisition</i>	
Unallowable Costs	\$9,249
Lack of Documentation	\$4,422
Total	\$87,741

Exhibit E

Related Party Expenses (Oct. 1, 2007 – Sept. 30, 2008)

Related Party	FY 2008	Administrative Activities
ACORN	\$1,337	Campaign & program services
AI Communications (ACORN Institute)	986	Telephone, internet & website
Network Council Fees (AM/FM)	28,756	Networking services to corporation
CCI Accounting	18,332	Accounting services
CCI Legal	2,934	Legal services
CCI General	6,685	Other administrative services
Total	\$59,030	

Scope and Methodology

We performed an examination to determine KNON's adherence to the requirements of the CPB Financial Reporting Guidelines, Generally Accepted Accounting Principles, provisions of the Act, and CPB grant provisions and certification requirements. The scope of the examination included reviews and tests of the data reported by the station on the 2008 AFR and audited financial statements. We examined KNON's compliance with the Act and Certification Requirements for CPB station grant recipients. We examined expenses for the Community Service Grant, Digital Conversion Grant and Internet Service Acquisition Grant to determine if expenses incurred were allowable in accordance with the terms and conditions of the grants. Our examination of expenditures was limited by the lack of discrete accounting for CSG revenues and expenditures by grant. This limited our ability to verify that CSG funds were fully expended within the two year grant period or identify expenditures incurred under the Digital and ISA grants.

We conducted a risk assessment using the information presented on KNON's FY 2008 AFR and audited financial statements. As part of our risk assessment, we gained an understanding of internal controls established by KNON for preparation of the AFR, recording revenue, and approving expenditures. We met with CCI's IPA and reviewed copies of the IPA's working trial balance and certain supporting schedules used to prepare the audited financial statements. Our risk assessment was used to plan our detailed testing.

Specifically, we tested the accuracy of the AFRs by comparing the report to KNON's underlying accounting records and audited financial statements. We evaluated compliance with CPB's Financial Reporting Guidelines, in part, by reviewing KNON's determination of revenue when computing its NFFS. We reviewed documentation supporting revenue reported on the FY 2008 AFR, for pledge contributions and underwriting. We tested nine underwriting agreements totaling \$4,475. Without discrete accounting of CSG expenditures, we had to sample from all KNON expense transactions to verify they were used for public broadcasting purposes. We judgmentally reviewed 95 invoices totaling \$102,717 supporting KNON's allocation worksheets submitted to CCI of local station expenditures to determine whether the expenses were appropriate and allowable. CCI presented us with a listing of Digital Conversion Grant and Internet Service Acquisition grant expenditures. We also reviewed the trial balances and supporting detailed transactions provided by CCI.

Our examination was performed in accordance with *Government Auditing Standards*, for attestation engagements. We conducted our examination fieldwork during May 2009 and obtained additional information, as needed, through August 2010 to prepare our report.

KNON

89.3 FM Community Radio

Exhibit G

September 24, 2010

William J. Richardson III
Deputy Inspector General
Corporation for Public Broadcasting
401 Ninth Street, NW
Washington, DC 20004-2129

RE: Response to Audit Report No. ESR909-XXX

Mr. Richardson:

The purpose of this letter is to provide our response to the findings and recommendations set forth in the draft audit report on the Examination of Agape Broadcasting Foundation, Inc., Licensee of KNON-FM, Dallas, Texas for Selected Grant Periods and Fiscal Year 2008. We appreciate the fact that the audit has been helpful in clarifying CPB requirements. Each and every recommendation listed in the draft audit report, whether it applies to KNON or only to CPB is addressed or has a comment in this letter. We hope to demonstrate in this letter and the attachments that we have complied with all recommendations that apply to KNON.

Recommendation 1 (a):

KNON understands the need to have accounting records that facilitate an audit of the revenue and expenditures of the Corporation for Public Broadcasting grants. Since changing to our new accounting company in April 2009, all CPB grant funds (and only CPB grant funds) received have been deposited into separate bank accounts, one for restricted funds and one for unrestricted funds. **(Attached are partial copies of the bank statements showing they were open in July 2009; no receipts or expenditures of CPB funds were made between March and June of 2009. Exhibit A)** Since opening the accounts all expenditures for these CPB grants have been paid directly from these two accounts and no other expenditures have been made from these accounts. Beginning with July 31, 2010, the accounting company gives KNON a report each month that shows a summary and details of revenues and expenditures to date for each grant by fiscal year and includes the name of the bank accounts for each and every transaction.

Recommendation 1 (b):

KNON has reconstructed its accounting records for FY2008 and FY 2009. FY2010 did not need to be reconstructed because all revenues and expenditures for FY2010 were already accounted for as described in Recommendation (1) (a) and it provides for not

only separate reports but totally discrete / separate accounting. Of course, the FY2008 and FY2009 revenues and expenditures were commingled with general funds and that commingling of bank accounts cannot be altered. However, KNON has asked the accounting company to retroactively add class codes to each revenue and expenditure (as identified in the reconstructed reports) in the general ledger to identify it as Restricted or Unrestricted and by the Fiscal Year of the Grant to which it relates. With these class codes, any future audit of these past fiscal years will be easily facilitated even though the money was not kept in separate accounts.

The final reports for FY2008 and FY2009 and the grant period to date report as of August 31, 2010 for FY 2010 are all attached. (Exhibits B-1, B-2, & B-3) Because of volume, we did not even attempt to attach copies of all the invoices or other supporting documentation. However, if you want them, we can and will make every effort to get them to you.

Recommendation 1 (c):

KNON will report to CPB in October of each year the revenues received by grant (CSG unrestricted, CSG restricted, and any special grants), opening cash balances, expenditures, and ending cash balances as of September 30th of each year.

Again, the final reports for FY2008 and FY2009 are attached and they have been sent to CPB today, September 24, 2010. We have also included the interim FY2010 report as of August 31, 2010. The FY2010 report as of September 30, 2010 will be sent to CPB in October as soon as the books for the month of September are closed.

Recommendation 2 (a):

While this recommendation is for CPB to evaluate whether the principal portion of the capital lease qualifies under the grant agreement, KNON wants to assert its position again: KNON was unable to obtain enough matching funds from other sources and had no choice but to finance the equipment the best way that it could. We relied on Section 3 of the Digital agreement that states "Matching funds shall only be provided by funds obtained from non-federal sources." KNON's interpretation of Section 7 leads us to believe borrowed money is still an acceptable source of matching funds. We agree that Section 19 does seem to indicate that KNON should have obtained written approval/permission from CPB for the financing arrangement. Hindsight does show that we should have read more closely and then reread the grant agreement before completing this project. Without CPB's encouragement and grant dollars, KNON would not have been able to convert to Digital. In the interest of fairness and CPB's own desire to get as many community radio stations as possible to convert to digital, we believe the \$54.262 should qualify.

Recommendation 2 (b) & (c):

KNON's contract engineer has evaluated his invoices and isolated his costs to install the digital equipment. His memo to KNON and his corrected invoices showing Digital and Non-digital hours and costs are attached. **(Exhibit C)** Those costs are included in the revised final report for the Digital Conversion Grant. The Revised Final Digital Conversion Grant has been sent to CPB today, September 24, 2010 and a copy is attached. **(Exhibit D)**

Recommendation 2 (d):

KNON agrees that CPB did overpay KNON for the Digital Conversion Grant. However, the verification of the installation costs by KNON's contract engineer discussed at Recommendation 2 (b) & (c) has corrected the overpayment to \$3,626. KNON agrees to repay CPB for the \$3,626 overpayment.

Recommendation 2 (e):

KNON cannot address how CPB will ensure they reimburse grantees only for agreed upon costs.

Recommendation 3 (a):

Related Party Costs:

KNON disagrees that the related party costs must be allocated to the CSG Grant simply because funds were not kept in separate bank accounts or separate expense accounts titled "CPB". KNON reconstructed its accounting records for FY2008 and FY 2009 (as discussed in Recommendation 1 (b) above) and did not allocate any of the related party costs to the CSG Grant. The reconstruction of those CSG expenses was based on allocating expenses the station manager intended to pay with CSG funds. Those same categories of expenses are the ones actually spent from the separate bank accounts for the FY2010 CSG Grant.

Even if CPB should insist that the related party costs are allocable to the CSG Grant, the calculated percentages on page 13 of the Draft Audit Report is not accurate and does not compare apples to apples. KNON's CPB CY 08 income per Exhibit B of the Draft Audit Report:

CPB-CSG	72,791	
CPB-Restricted CSG	<u>26,918:</u>	
Subtotal CSG	99,709	14.35%
CPB-Digital Project	<u>42,500</u>	
Total CPB income	<u>142,209</u>	20.46% (not \$199,964 & 28.77%)
Total Revenue	<u>694,938</u>	100.00%

In this case, the related party expenses themselves should also be based on the CY 2008 because the CSG grant money was not received nor spent until 2008. Even though the FY2008 grant starts in 2007, KNON had no receipts or expenditures for FY2008 in CY2007. Corrected CY2008 related party expenses are:

ACORN	1,522
AI Communications	584
AMFM	25,415
CCI Accounting	22,886
CCI Legal	2,901
CCI General	<u>6,569</u>
Total	<u>59,877</u>

Even if you apply the percentage to the Digital Grant (which we disagree with), it only adds to ineligible costs on the Final Grant Report and does not give rise to any possible refund of CPB Digital Grant funds.

We disagree with the \$3,924 in CPB Account Direct Charges because the accounts were so commingled that it makes no sense. Our own reconstructed accounting records for FY2008 CSG grants considers any miscellaneous overhead charges (related party or otherwise) to have been reimbursed from the general operating fund back to the CSG Grant because KNON did not intend and did not consider those general overhead expenses as a part of the budget for the CSG Grants. That means shared overhead costs of 14.35% to apply to the total related party costs of:

- a) if you ignore the direct charges, $\$59,877 \times 14.35\% = \$8,592$
- b) if you insist on the direct charges, $\$3,924 + \$55,953 \times 14.38\% = \$11,953$

KNON did not have a current contract specifying all the services received and fees paid to the related parties. The arrangement for the services had been in place for several years and complacency did become the norm. At different times, KNON did consider changing to different service providers. While KNON never put out requests for qualifications or proposals before 2009, we did generally evaluate the services received for the fees paid. KNON felt the fees charged were reasonable for the most part and also felt that they were helping to support fellow non-profit organizations doing good work in the community. While there are no invoices with specific descriptions or a contract with details of services and fees, KNON feels a review of most of the services and amounts on the list of Exhibit E will actually determine them to be reasonable. KNON's rationale for a reasonableness test is:

- a) ACORN provided copy and creative voice talent for public service announcements related to other non-profit organizations. They also provided consulting advice on possible topics for some community affairs talk shows. An annual charge of \$1,300 to \$1,500 is not an unreasonable amount for such services.
- b) AI Communications provided website hosting, email service setup, domain name registration services and technical support services. The fee for CY 2008 was \$584. Anyone in business, profit or non-profit, will agree that this is not an unreasonable fee for such services. It could have cost less or more but it is reasonable.

c) CCI Accounting & CCI General charged \$22,886 for accounting services and \$6,569 for accounting related (but not day to day) services, respectively. The General services included coordinating the audit with the independent auditor and assisting with human resources issues. This is a total of \$29,455 in CY2008 (only \$25,017 for the CPB FY2008). The audit plainly showed that CCI did provide these services. KNON presently pays unrelated parties, Venturity and Paychoice, \$26,500 in base fees for the same services. As discussed in Recommendation 3 (c) below, these two vendors were KNON's least expensive options when we went out for proposals for services. Therefore, CCI annual charges of \$25,017 to 29,455 per year can certainly not be considered as unreasonable.

d) CCI Legal charged \$2,901 for legal services in CY2008. CCI paid three attorneys and one paralegal to be sure that KNON and the other organizations in its client base remained properly registered in the proper states and reviewed all leases and any significant contracts. To retain legal advice for these things at \$2,901 for a year should not be considered unreasonable. Again, it could have cost less or more but given the extremely high hourly rate of most attorneys, this was reasonable.

e) AMFM signed a contract in February 1986 with KNON to provide a variety of consulting services. A copy of that contract is attached. **(Exhibit E)** The main services are listed in the contract and they are:

1. Advice and assistance in establishing and maintaining management systems
 2. Recruitment and training of managers, staff and volunteers
 3. Advise and assistance regarding licensee responsibilities regarding FCC laws, rules and regulations
 4. Assistance arranging loans and financing for the purchase of broadcast equipment
 5. Advice and assistance relating to the technical operation of the station and any necessary changes requiring FCC approval
- Over time, additional services received included:
6. Fundraising assistance including writing of grant applications, and grant management
 7. Providing advice on staff management
 8. Assisting in resolving issues with CCI
 9. Corresponding with legal counsel about organizational policies

Based on the services received, the fees of \$25,415 paid to AMFM in CY2008 do appear to be reasonable. KNON understands that documenting these services is difficult without time sheets and/or invoices from those providing the service and we do not have those things. The amount of time required for KNON to attempt to document in other ways all the specific instances of service received, is the thing that is not reasonable. While we might be able to do this, we are unable to do it in time to include such documentation in this response. In November 2009, the KNON Board did determine the services received from AMFM had not been high-quality services and terminated the contract and relationship with AMFM. Copy of memo of cancellation is attached.

To summarize KNON's position on the related party costs:

KNON does not believe that the related party costs should give cause for a refund of those costs to CPB because:

1. KNON disagrees with the allocation of the related party overhead costs to the CSG grant and the Digital grant for reasons outlined above.
2. If CPB is insistent on allocating related party overhead costs to the CSG Grant, it should be the correct amount, \$8,592 and
3. The related party overhead costs are reasonable as discussed above and therefore qualified expenses..

Recommendation 3 (a):

Internet Service Grant:

KNON agrees that, unfortunately, a portion of the expenditures from the Internet Services Acquisitions Grant do not qualify. However, KNON's position is that the payments to WARP for streaming services were qualified expenditures under the grant agreement. Therefore, the amount of unqualified expenditures is only \$4,696.

While CPB may have intended the Internet Services Acquisitions Fund to make grants for the "Enhancement" of internet services at community radio stations, CPB's own grant agreement with KNON never mentions "Enhancement". And paragraph 14 on page 4 of the grant agreement states:

"This agreement constitutes the parties' complete understanding with respect to its subject matter and supersedes and replaces any previous or contemporaneous agreements or understandings, whether written or oral, related to the subject matter of this Agreement."

Therefore, it would be wholly unfair for CPB to disallow the WARP steaming costs just because KNON was paying for the service before the grant was received.

On the other hand, the grant agreement is very clear on the requirement that vendors used for the qualified services cannot be related parties and must be national or regional suppliers. Even KNON cannot document any costs other than AT&T and WARP as being paid to unrelated parties. Therefore, KNON believes that we do have unqualified expenditures of \$4,696:

Total Internet Services Acquisition Grant received		\$ 15,000
Less Qualified Expenditures:		
WARP	8,975	
AT&T	<u>1,329</u>	<u>10,304</u>
Net KNON		<u>\$ 4,696</u>

KNON has sent a Revised Internet Services Acquisition Fund Grant Report to CPB today, September 24, 2010 stating that unspent funds are \$4,696. A copy of that report is attached. (Exhibit F)

Recommendation 3 (b):

At the September 18, 2010 meeting, the KNON Board of Directors (Board) adopted a policy outlining cash controls, including CPB grant agreements and expenditures. A copy of the Policy is attached. **(Exhibit G)** Among other things, the policy calls for

- (1) All grant agreements to be reviewed and approved by the Board before being signed by the station manager (Page 10 of the Policy)
- (2) All expenses paid for by grants to be at a minimum generally outlined in budgets approved by the Board (page 4 of Policy)
- (3) Monthly detailed reports on the status of each open grant presented to the Board at each monthly meeting (reports described in Recommendation 1 (a) above (Page 9 & 10-11 of Policy)
- (4) The accounting company to be familiar with the grant requirements and to question any expenditures they have doubts about. (Page 10 of Policy) **(Exhibit H)**

All of the above procedures together will ensure that the grant expenditures and the accounting for them are proper. KNON will attempt to make even more improvements to the controls as time, money and staff will allow. Each Board member now has their own personal copy of Cooperation for Public Broadcasting FY2010 Radio Community Service Grant General Provisions and Eligibility Criteria and will become familiar with it.

Recommendation 3 (c):

KNON no longer has any related parties. See the attached discussion of the disposition of all related party relationships and the attached documents supporting the discussion. **Exhibit I)** All services for accounting, internet, telephone, website, legal, payroll, providing health insurance and other human resource assistance are all now provided by unrelated parties. The Board has been using the accounting services of Venturity Financial Partners since April 2009 and on September 18, 2010 voted to continue using them for the next year as their fixed monthly fee. They also voted to continue the contract with PayChoice for preparing the weekly payrolls and all payroll reports. Bids were obtained from other vendors back in early 2009 and both Venturity and PayChoice were both well qualified and the least expensive. The contract for each is attached. **(Exhibits J & K)** As you can see on the Venturity contract, it does spell out the fees per month and a detailed list of the services they provide; any extra services not listed are billed at an hourly rate.

Recommendation 3 (d):

KNON has learned a lot from this audit and perhaps the most important lesson is to read, reread and commit to memory all the grant requirements - then read again on a regular basis. And most importantly, adhere to each and every requirement exactly as written. KNON will never again rely on any verbal communication with CPB.

KNON will formally request in writing that the grant agreement period be modified when grant performance cannot be accomplished within the specified grant agreement period.

Recommendation 4:

KNON has always complied with the practices of open meetings, maintaining open financial records, maintaining a functioning Community Advisory Board (CAB), making EEO information available to the public and maintaining and securing donor lists. KNON did not realize that the ACT also required us to written policies describing how we were implementing these policies.

On September 18, 2010 KNON's Board did adopt written policies on the following:

- Open Meetings
- Open Financial Records
- Policies & Procedures for the Community Advisory Board
- Equal Employment Opportunity
- Donor Information, Security, Privacy & Political Lists
- Document Retention

The approved policies have been placed in the KNON public file and copies of the policies and the Board minutes adopting them are attached. **(Exhibit L)**
M)

Recommendation 5:

While this recommendation is for CPB to determine whether KNON's current governance mechanisms are adequate, KNON would like to comment. KNON's Board and management have in the past relied much too heavily on the outside contractors. That reliance began changing even before this audit was started. This audit has helped KNON to realize how bad it was before and we will work very hard to be sure KNON is never in a situation like this again. We feel that we have complied with every recommendation in the audit report. We have not just said we will comply but have already complied. We welcome any future audits with open arms.

KNON also requests the statement at the bottom of page 18 be removed from the report because it is an incorrect statement. The night before KNON's telephone discussion with the auditor regarding the initial draft findings, KNON's very fatigued Treasurer did email comments on that report to the auditor and included was an erroneous comment that the CPB unrestricted funds were not currently held in separate bank accounts. However, in the telephone discussion the very next day, the station manager and the Treasurer both notified the auditor of the error and asked that he correct it. As discussed in Recommendation 1 (a) & (b) above, since KNON hired its new accounting company in April, 2009, all CPB grant funds have been deposited in separate accounts and qualified expenses paid directly from those accounts without exception. Attached is the August 31, 2010 bank statements for the CPB fund accounts and bank reconciliations for same showing that the balances match the remaining balances shown on the CSG Grant Reports referred to in Recommendation 1 (b) and Exhibits B-1, 2 & 3. **(Exhibit M)**

Recommendation 6 (a):

This recommendation is exactly the same as Recommendation 3 (b) and is addressed there.

Recommendation 6 (b):

On September 18, 2010, the KNON Board adopted Policies on Cash Controls (also discussed an reference to Recommendation 3 (b)) that included the following: "There has been some concern that KNON's past auditor was preparing the Annual Financial Report (AFR) required by CPB each year. The Board understands the need for independence and makes it clear that the independent auditor is not to prepare the AFR. The station manager will prepare the AFR from the audited financial statements with assistance, as needed, from Venturity and the KNON Treasurer." Because any independent auditor will be given a copy of these policies on cash controls, they will be on notice that they are not to assist with the preparation of the AFR.

Recommendation 6 (c):

KNON does not believe that it has ever had a problem getting its AFR filed correctly. The KNON Treasurer is qualified to prepare the report correctly, was at one time very familiar with the instructions for preparing the report and will become so again. Therefore, the station manager, with assistance from the Treasurer and with Venturity available for any needed details in the general ledger, will have no problem with preparing an accurate report.

Recommendation for CPB:

While scanning the audits of other CPB Grantees, there appears to be a regular pattern of the same errors, mainly lack of discrete accounting and lack of written policies required under the ACT. The stations that made these errors did not seem to have a blatant disregard for the rules but rather appeared to have a lack of knowledge. KNON would like to make a recommendation to CPB:

CPB management should be required to take a more active role in educating the Grantees on the grant requirements and STRESSING the importance of adhering to those requirements. It is much too easy for community radio stations with small staffs and little time and money to read the Grant Agreements, put them away and forget half of the requirements. KNON realizes the fiscal responsibility belongs with the station management and the governing board. However, one of CPB's goals listed on their website is under Leadership and states: "Foster the continuous improvement of leadership in public service media." Educating the Grantees in the area of grant requirements is one way of fostering a continuous improvement.

Conclusion:

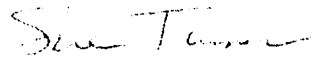
KNON has attempted to address every single recommendation contained in the draft audit report. KNON believes that each and every recommendation that it has enough control to resolve has been resolved and so documented in this letter and attachments. If we have failed to include some documentation, please let us know and we will be glad to promptly provide it.

If you have any other questions, please let us know.

Sincerely,



David Walkington
Station Manager



Sue Turner
Treasurer