CORPORATION FOR PUBLIC BROADCASTING
OFFICE OF INSPECTOR GENERAL

AUDIT OF PBS AND CPB GRANTS AWARDED
TO THE FRED ROGERS COMPANY
FOR THE PRODUCTION OF “ODD SQUAD”

FOR THE PERIOD JULY 1, 2012 THROUGH SEPTEMBER 30, 2015

REPORT NO. APT1702-1705

March 31, 2017
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Why We Did This Audit

We performed this examination based on our annual audit plan.

Our objectives were to determine whether the Fred Rogers Company (FRC):

a) financial report fairly presented total project grant expenditures;

b) costs were incurred in accordance with grant requirements; and

c) complied with grant requirements for the period July 1, 2012 through September 30, 2015.

This report contains the views of the Office of Inspector General (OIG). The Corporation for Public Broadcasting (CPB) will make the final decision on our findings and recommendations.

What We Found

We disclaimed an opinion on the $18.2 million FRC reported as costs for this production.

Our audit identified significant deficiencies in internal control to ensure compliance with various grant requirements for:

- CPB’s requirement that the final financial report be reconciled to grantee’s general ledger;
- CPB’s requirement to access subcontractor’s financial records to verify total project costs; and
- Ready to Learn’s (RTL) financial records requirement to identify the application (expenses) for federally sponsored activities.

FRC did not agree with our findings. CPB management will make the final determination on our findings and recommendations.

What We Recommend

CPB should:

- require FRC to obtain from its subcontractor a reconciliation of the final cost reports submitted to CPB to the subcontractor’s general ledger and a written certification of their accuracy;
- require that FRC’s final financial report for its current production disclose the basis for reporting project costs and the amount of its subcontractor’s reported costs that were not recorded in FRC’s accounting records;
- require FRC to comply with all CPB grant terms in its current production, including access; and
- ensure its oversight of grantees reinforces RTL requirements.

Audit of PBS and CPB Grants Awarded to The Fred Rogers Company for the Production of “Odd Squad” for the Period July 1, 2012 through September 30, 2015

The audit’s scope was limited when we were not given access to FRC’s subcontractor’s records to obtain sufficient audit evidence to opine on FRC’s final financial report.
Date: March 31, 2017

To: Jackie J. Livesay, Vice President, Compliance
Debra Sanchez, Senior Vice President, Education & Children’s Content Operations

From: Mary Mitchelson, Inspector General

Subject: Audit of PBS and CPB Grants Awarded to The Fred Rogers Company for the Production of “Odd Squad” for the Period July 1, 2012 through September 30, 2015, Report No. APT1702-1705

Enclosed please find our final report, which contains our findings and recommendations. CPB officials must make a final management decision on the findings and recommendations in accordance with established audit resolution procedures.

We request that you provide us with a draft written response to our findings and recommendations within 90 days of the final report. We will review your proposed actions and provide our feedback before you issue a final management decision to the grantee, which is due within 180 days of the final report. For corrective actions planned but not completed by the response date, please provide specific milestone dates so that we can track the implementation of corrective actions needed to close the audit recommendations.

We will post this report to the Office of Inspector General’s website as required by the Inspector General Act of 1978, as amended. Please refer any public inquiries about this report to our website or our office.

Enclosure

cc: Lori Gilbert, Chair, CPB Board of Directors
Bruce M. Ramer, Chair, CPB Audit and Finance Committee
U.S. Senate Committee on Homeland Security and Governmental Affairs
U.S. House of Representatives Committee on Oversight and Government Reform
U.S. Senate Committee on Commerce, Science and Transportation
U.S. House of Representatives Energy and Commerce Committee
U.S. Senate Committee on Appropriations
U.S. Senate Labor-HHS-Education Appropriations Subcommittee
U.S. House of Representatives Committee on Appropriations
U.S. House of Representatives Labor-HHS-Education Appropriations Subcommittee
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EXECUTIVE SUMMARY

We initiated an audit of the Corporation for Public Broadcasting (CPB) grant to the Fred Rogers Company (FRC) for the Odd Squad Season 1 production, including Department of Education Ready to Learn (RTL) pass through grant funds awarded through PBS. Our objectives were to determine whether FRC: a) financial report fairly presented total project grant expenditures; b) costs were incurred in accordance with grant requirements; and c) complied with grant requirements.

We have not been able to obtain sufficient audit evidence of FRC’s subcontractor’s Sinking Ship Entertainment (Sinking Ship) expenses to provide an audit opinion on the total reported project costs. Accordingly, we do not express an opinion on FRC and Odd Squad Season 1 final financial report in Exhibit A for the period July 1, 2012 through September 30, 2015.

Our audit identified significant deficiencies in internal control to ensure compliance with various grant requirements:

- CPB’s requirement that the final financial report be reconciled to grantee’s general ledger;
- CPB’s requirement to access subcontractor Sinking Ship’s financial records to verify total project costs; and
- RTL’s requirement to maintain financial records that identify the application (expenses) for federally sponsored activities.

We recommend that CPB:

1) require FRC to obtain from Sinking Ship for Odd Squad, Season 1 and the current Odd Squad, Season 2, projects:
   a) a reconciliation of the final cost reports submitted to CPB to Sinking Ship’s general ledger; and
   b) a written certification of the accuracy of the final cost reports;
2) require that FRC’s current Odd Squad, Season 2 final financial reports disclose:
   a) the basis for reporting project costs (i.e., based on actual costs incurred or on a percentage of completion basis for the fixed price contract); and
   b) the amount of Sinking Ship’s reported costs that were not recorded in FRC’s accounting records;
3) ensure FRC takes corrective actions regarding its current Odd Squad, Season 2 CPB grant to comply with all RTL and CPB grant terms for financial reporting, recordkeeping, and access to subcontractor financial records requirements; and
4) periodically monitor PBS’s oversight of its large RTL subrecipients to verify grant recipients are compliant with federal grant requirements to maintain financial records that identify the application of federal RTL activities including project budgets and financial reports.

In response to our draft report, FRC did not agree with our finding that it had significant deficiencies in internal control and compliance with RTL requirements. FRC said there were deficiencies in the structure of the agreement regarding financial reconciliations, and that the
project budget did not separately identify RTL costs to discretely account and report on the use of federal funds. FRC also stated it was not required to include access provisions in its vendor contract agreement. FRC’s written response to the draft report is presented in Exhibit C.

We performed this audit based on the Office of Inspector General’s (OIG) 2016 annual plan. We conducted our audit in accordance with Government Auditing Standards for financial audits. Our scope and methodology is discussed in Exhibit B.

This report presents the conclusions of the OIG and the findings do not necessarily represent CPB’s final position on the issues. While we have made recommendations we believe would be appropriate to resolve the findings, CPB officials will make final determinations on our findings and recommendations in accordance with established CPB audit resolution procedures. Based on FRC’s response to the draft report, we consider our recommendations unresolved pending CPB’s final determination.

**BACKGROUND**

The Corporation for Public Broadcasting (CPB) is authorized by the Communications Act of 1934, as amended, 47 U.S.C. § 396, to award grants to public telecommunications entities; national, regional, and other systems of public telecommunications entities, and independent producers and production entities. Specifically, CPB awards grants to fund projects for broadcast and other uses by public telecommunications and educational systems and had five active grants to The Fred Rogers Company (FRC) during our audit period. In addition, in 2010 CPB received a grant award from the Department of Education (DOE) Ready to Learn (RTL) program to fund CPB’s Expanded Learning Through Transmedia Content program. CPB was responsible for distributing the RTL grant funds to support the program and subgranted a portion of these RTL funds to PBS, which in turn made subawards to various independent producers, including FRC. Additionally, CPB partially funds PBS’s National Program Service (NPS) activities, including awards to FRC. CPB, RTL, and CPB’s NPS funding is shown in the table below:

<table>
<thead>
<tr>
<th>CPB Grant Number</th>
<th>Project</th>
<th>CPB Education Initiative Funds</th>
<th>RTL</th>
<th>CPB NPS</th>
<th>Total CPB and RTL Funding</th>
<th>Total Budget as Amended</th>
</tr>
</thead>
<tbody>
<tr>
<td>14816</td>
<td>Odd Squad Season 1</td>
<td>$3,000,000</td>
<td>$7,950,000</td>
<td>$10,950,000</td>
<td>$18,225,715</td>
<td></td>
</tr>
<tr>
<td>15436</td>
<td>Odd Squad Season 2</td>
<td>2,250,000</td>
<td>2,250,000</td>
<td>11,630,303</td>
<td>16,801,782</td>
<td></td>
</tr>
<tr>
<td>PBS/CPB/RTL³</td>
<td>Peg + Cat Season 1</td>
<td>3,000,000</td>
<td>7,990,845</td>
<td>10,990,845</td>
<td>16,801,782</td>
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</tr>
<tr>
<td>15322</td>
<td>Peg + Cat Season 2</td>
<td>2,250,000</td>
<td>2,250,000</td>
<td>13,029,049</td>
<td>16,801,782</td>
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</tr>
<tr>
<td>15059</td>
<td>Daniel Tiger's Neighborhood Season 2</td>
<td>1,708,772</td>
<td>1,600,000</td>
<td>3,308,772</td>
<td>14,732,918</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>$12,208,772</td>
<td>$15,940,845</td>
<td>$1,600,000</td>
<td>$29,749,617</td>
<td>$74,419,767</td>
</tr>
</tbody>
</table>

PBS is a nonprofit organization whose members are America’s public TV stations.

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¹ PR/Award Number U295A100025, CFDA No. 84.295A.
² CPB by statute awards national television programming grants to PBS, which include the NPS funding for Daniel Tiger’s Neighborhood Season 2.
³ PBS/CPB/RTL joint agreement funded Peg + Cat Season 1.
The PBS agreement with FRC states that, “...PBS is responsible for delivering to its public television stations a national program service (...) “NPS”) for home and educational use in various media.”

FRC is an independent producer and major supplier of children’s programming for PBS. It is a 501(c)(3) non-profit founded in 1971 to produce the television series Mister Roger’s Neighborhood. Its mission is: “The FRC strives to build on Fred Rogers’ legacy by creating quality children’s media that models an enthusiasm for learning and earns the trust of parents and caregivers.”

FRC, with its wholly owned subsidiary Odd Productions, LLC and its Canadian co-venture producer Sinking Ship, produces the Odd Squad half-hour live action comedy series and transmedia property to teach math concepts to early elementary school-aged children (5-8). The 40-episode series and transmedia suite launched in 2014 on PBS KIDS (on air and online). Funding was provided by the 2010-2015 RTL grant, PBS, CPB, and Sinking Ship.

The deal structure with Sinking Ship to take advantage of the Canadian tax credits was complicated. FRC created a related entity, Odd Productions, LLC (OP) and formed a co-venture with Sinking Ship, a Canadian corporation, to co-produce and co-finance the Odd Squad series in compliance with the Canadian Radio-television and Telecommunications Commission (The “CRTC”) in order to qualify for federal and provincial tax credits. This arrangement included the distribution and exploitation of the Initial Cycle Episodes (the PBS Production Series). The co-venture entered into a fixed price Production Services Agreement (PSA) with Sinking Ship (Odd Squad) Productions Inc., a wholly owned subsidiary of Sinking Ship, to produce the programs for the Initial Cycle Episodes.

FRC’s grant proposal for the Odd Squad production states that “Sinking Ship is an award-winning production and new media company that specializes in groundbreaking live-action programming and cross-platform content.” Sinking Ship acquired the rights to Odd Squad from the show’s creators, award-winning children’s television writers, Hundredth Town Productions, Inc.

FRC stated it is proud of its Emmy winning Odd Squad production, along with DOE’s annual Government Performance and Results Act review giving it the highest ratings for its transmedia curriculum execution.

This report discusses our audit of the Odd Squad Season 1 production with CPB and RTL funding as shown below:
### CPB Funding

<table>
<thead>
<tr>
<th>Grant Number</th>
<th>Project</th>
<th>CPB Education Initiative Funds</th>
<th>RTL(^4)</th>
<th>Total CPB and RTL Funding</th>
<th>Total Budget as Amended</th>
</tr>
</thead>
<tbody>
<tr>
<td>14816</td>
<td>Odd Squad Season 1</td>
<td>$3,000,000</td>
<td>$7,950,000</td>
<td>$10,950,000</td>
<td>$18,225,715</td>
</tr>
</tbody>
</table>

The final financial report for Odd Squad Season 1 is shown on Exhibit A.

### RESULTS OF AUDIT

We initiated an audit of FRC and Sinking Ship’s final financial report for the PBS RTL grant and CPB Grant No. 14816, Odd Squad, Season 1, (Exhibit A) submitted to CPB covering the activities through September 30, 2015. The financial report is the responsibility of FRC management. Our responsibility is to express an opinion on this report based on our audit.

Except as described in the basis for disclaimer of opinion paragraph, we conducted our audit in accordance with Government Auditing Standards for financial audits and auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial reports are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial reports to determine compliance with the grant agreement requirements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial reports. However, because of the matter described in the basis for disclaimer of opinion paragraph, we were not able to obtain sufficient appropriate evidence to provide a basis for an audit opinion. FRC prepared the accompanying final financial report to comply with the grant financial reporting requirements.

#### Basis for Disclaimer of Opinion

FRC did not provide access to Sinking Ship’s financial records. FRC reported $18,232,555 in project costs for Odd Squad on its final financial report to CPB for Grant No. 14816. FRC did not provide us access to documentation supporting $5,282,555 of that amount, all Sinking Ship costs, which were not recorded on FRC’s books. FRC claimed Sinking Ship is a vendor and not subject to audit. FRC further contended that it had a fixed price contract with Sinking Ship and the costs Sinking Ship incurred in excess of FRC’s financing obligation were not FRC’s responsibility. FRC also asserted it was responsible for reporting only up to the fixed price contract amount. However, FRC acknowledged that the PBS and CPB agreements required that all project costs be reported in accordance with the project budget, and therefore FRC reported all costs, including the $5,282,555 in Sinking Ship’s costs that were not recorded on FRC’s books and were not paid by FRC.

We were not provided access to Sinking Ship’s financial records, therefore we were unable to complete certain tests of transactions and balances or perform other procedures necessary to

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\(^4\) RTL Funding provided under PBS NPS agreement dated October 1, 2012.
opine on the final financial report presented in Exhibit A. As the $5,282,555 million in Sinking Ship’s costs represents 29 percent of the total amount reported, the lack of access to Sinking Ship’s records is a material scope limitation. The accuracy of the total costs reported impacts the calculation of a production surplus or deficit and the future reporting of ancillary revenues.

Because of the significance of the matter described in the above paragraphs, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on FRC and Sinking Ship Odd Squad Season 1 final financial report in Exhibit A for the period July 1, 2012 through September 30, 2015.

In accordance with Government Auditing Standards, we considered FRC’s internal control over financial reporting and its compliance with provisions of law and grant agreement requirements. The purpose of the following explanations are to describe the scope of our testing of internal control over financial reporting and compliance, and the results of that testing, and not to provide an opinion of the effectiveness of internal control over financial reporting or on compliance. Accordingly, this information is not suitable for any other purpose.

**Internal Control over Financial Reporting**

In planning and performing our audit of the final financial report submitted to CPB, we considered FRC’s internal control over financial reporting to design audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial reports provided to CPB but not for the purpose of expressing an opinion on the effectiveness of internal control. Accordingly, we do not express an opinion on the effectiveness of FRC’s internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. Our audit identified significant deficiencies in internal control to ensure compliance with various CPB and RTL grant requirements for:

- CPB’s requirement that the final financial report be reconciled to grantee’s general ledger; and
- CPB’s requirement to access subcontractor Sinking Ship’s financial records to verify total project costs incurred.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement on the entity’s financial reports will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency or a
combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether FRC’s financial reports are free from material misstatements, we performed tests of its compliance with certain provision of law and grant agreement requirements, noncompliance with which could have a direct and material effect on the determination of financial report amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed noncompliance with federal RTL and CPB grant requirements as discussed further in the Findings and Recommendations section of the report.

**FINDINGS AND RECOMMENDATIONS**

**Financial Reporting, Recordkeeping, and Access to Subcontractor Records**

FRC and Sinking Ship’s Odd Squad Season 1 financial report could not be reconciled to underlying accounting records because access to Sinking Ship’s books and records was not provided, nor were CPB audit access provisions incorporated into FRC’s PSA with Sinking Ship. Further, FRC also did not adequately track federal RTL expenses.

**Financial Reporting**

FRC’s final financial report was not reconcilable to FRC’s general ledger, because FRC did not record in its general ledger the full $18.2 million amount of the project’s costs incurred by its subcontractor Sinking Ship. As illustrated in the following table, FRC reported $5,282,555 in costs that were not recorded on FRC’s general ledger. Included in this amount were $1,305,614 in additional costs over Sinking Ship’s fixed price PSA contract with FRC. CPB amended its grant budget to cover these additional costs; PBS did not revise its total budget but accepted the budget variances.

**CPB Agreement Total Budget for Odd Squad, Season 1**

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<tbody>
<tr>
<td>$18,225,715</td>
<td>$18,232,555</td>
<td>$16,926,941</td>
<td>$1,305,614</td>
<td>$12,950,000</td>
<td>$5,282,555</td>
</tr>
</tbody>
</table>

FRC through its co-venture subcontracted 100 percent of the Odd Squad series production budget of $16,926,941 to Sinking Ship, a Canadian producer, for a fixed price payment obligation of $12,950,000. FRC contends that the difference between the project budget and its financing obligation was the anticipated Canadian tax credits and license fees Sinking Ship expected to receive to cover these costs and was not FRC’s responsibility. According to FRC, Sinking Ship planned to finance any deficit and eventually recover its costs with the tax credits and licensing fees, while fulfilling its contractual obligations. However, under the PBS
agreement, FRC was the fiduciary agency responsible for all legal and financial aspects of the agreement, including providing access to support for all costs reported to PBS and CPB.

FRC did not record the total project costs of $18,232,555, which included the $1.3 million in costs above the original budget. Instead, FRC recorded on its books only the $12,950,000 fixed price obligation funded by PBS, RTL, and CPB. FRC explained that the remainder of the project’s costs totaling $5,282,555 were on Sinking Ship’s books, which were not made available to OIG to audit. While FRC certified to CPB that the final financial report reconciled to its general ledger, FRC subsequently informed us it did not, because the costs incurred by Sinking Ship were not recorded on FRC’s general ledger.

Recordkeeping

FRC did not separately account for costs covered by its federal RTL funds within its project expenditure general ledgers, as required by RTL grant regulations. FRC was not consistent in how it accounted for federal funds received from RTL versus other federally funded grants. We found FRC commingled RTL, CPB, and PBS funded expenses on a total project basis for the Odd Squad production. In contrast in a grant project funded with NSF federal funds for the Peg + Cat project, FRC discretely accounted for the NSF funds within the project’s accounting classification system. FRC did separately identify RTL revenues for the Odd Squad project in a subsidiary receipts schedule, although the funds were commingled in its general ledger account for revenues, but it did not separately account for detailed RTL expenses. RTL expenses were commingled with PBS and CPB expenses.

The PBS/RTL agreement states FRC’s role in the production agreement as:

The Fred Rogers Company…will be the contracting Producer for the Series and will serve as the fiduciary agency throughout the production. It will be ultimately responsible for all legal and financial aspects of the relationship with PBS and CPB (and thus, indirectly, RTL).

PBS National Program Service Production and Distribution Agreement, Exhibit A, VIII Key Personnel.

Access to Subcontractor Records

In addition, the CPB grant agreement incorporated CPB’s 2013 terms and conditions for budget and financial reporting and subcontracts and required the grantee to maintain adequate records and permit access to them for audits.

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5 As of the 9/30/15 final financial report date, FRC had booked only $12,150,000 of obligated expenses for its contract obligation with Sinking Ship. FRC booked the expense when it was reimbursed from PBS/RTL and CPB, the difference of $800,000 was reimbursed in October and December 2015. FRC stated that it used Sinking Ship’s reported final financial report as of 7/31/15 to prepare the final financial report to CPB. Since we did not have access to Sinking Ship’s general ledger, we could not verify these amounts.
4G. Records – A Grantee must keep books, records and accounts relating to the Grant and the Grant Project sufficient to:

ii) Allow CPB, by examination of Grantee’s general ledger and other records, to account for the Grant Project Level of activities in sufficient detail to enable an audit to verify the investment of the CPB funds in the approved expenses of the Grant Project;

iii) disclose fully the amount and use of the proceeds of the Grant, the Total Project Cost, and amount and nature of any portion of the Total Project Costs supplied by other than CPB…

4H. Audit. Each Grantee and its subcontractors, if any, are required to allow CPB and the Comptroller General of the United States or their representatives access, for the purpose of audit and examination, to any books, documents, papers, and records that relate to a Grant or any other funds received from CPB.

4K. All Financial reports shall, … be reconcilable to Grantee’s General ledger.

CPB Terms and Conditions, Section 4 – Budget and Financial Reporting.

These obligations are to flow down to grantee’s subcontractors, as well.

Section 8 –Delegation and Subcontracts 8B –Subcontracts. A Grantee must include in any and all subcontracts or other delegation contracts a provision that will effectuate the Grantee’s obligations to CPB. Any subcontracts or other delegation contracts must also allow CPB and the Comptroller General of the United States or their representative’s access to and the right to examine and audit pertinent books, documents, papers and records of such subcontractor or assignee involved the Grant Projects for three (3) years following the final disbursements by CPB under the Grant Agreement.

8C – Conditions Attached to CPB Funds. As a condition of the distribution of funds by CPB and to Grantee hereunder (“CPB Funds”), including funds distributed by Grantee to a delegee or subcontractor (individually, a “Subgrantee”; collectively, (“Subgrantees”), Grantee shall include in any production agreement funded by Grantee with CPB funds: …

iv) a provision requiring that Subgrantees provide for CPB audit rights, as well as requirement that sub-grantees to maintain their general ledger and other records in detail sufficient to account for project level activities and which will provide an audit trail enabling CPB to verify the investment of CPB funds in the approved expenses of the funded projects; …

CPB Terms and Conditions, Section 8 - Delegation and Subcontracts.

Further, the RTL program is governed by the Education Department General Administrative Regulations (EDGAR) that also require documentation of expenses. They provided that a grante must maintain:
(b)(2) Records that identify adequately the source and application of funds for federally-sponsored activities.

EDGAR Title 34 CFR Subtitle A Part 74-Administration of Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations, Subpart C-Post-Award Requirements, Financial and Program Management § 74.21 Standards for financial management systems.

FRC’s agreement with PBS specifically required compliance with the RTL regulations:

(e)(ii) “[… ] Subcontractor must comply with the applicable administrative requirements of OMB Circular A-110 (2 CFR Part 215) / 34 CFR Part 74 and OMB Circular A-133. Subcontractor’s financial management system must provide records that identify adequately the source and application of funds of federally-sponsored activities […]”

Public Broadcasting Service National Program Service Production and Distribution Agreement: Odd Squad Season 1, Exhibit D-1, Section 4-Payments.

In response to our findings FRC, said it does not believe that it is required to provide CPB or OIG access to Sinking Ship’s accounting records for audit purposes and stated its method of project accounting adequately tracked the RTL funds. FRC’s position is that Sinking Ship was a vendor and therefore any provisions for subcontracts were not applicable to its agreement with Sinking Ship. Further, as this was a fixed price PSA contract, FRC’s funding obligation was limited to the $12,950,000 reimbursement amount recorded in its books, and it provided OIG access to its books.

FRC said PBS choose Sinking Ship to be the production company for the Odd Squad series production and asked FRC to perform as fiduciary agent for the production. FRC asserts that its subcontract with Sinking Ship is a vendor contract that provided services to FRC as the pass-through recipient of the federal funds, and that FRC has the federal compliance responsibilities, not its subcontractor. We discussed this relationship with PBS officials. They stated that FRC was PBS’s subrecipient for the RTL funding and monitoring since FRC had the final editorial control. Further, FRC advisors and digital producer made the decisions to meet the RTL curriculum and PBS editorial standards for PBS Kids, not Sinking Ship officials. These FRC advisors and digital producer were funded through the subcontract with Sinking Ship.

FRC monitored Sinking Ship’s performance, communicated with PBS and CPB via its grant reporting narrative and financial reports, and kept PBS and CPB informed of variances and budgetary changes and project deliverables throughout the project. FRC said Sinking Ship provided it with the cost reporting and variance explanations, which FRC then provided to PBS and CPB. FRC did not audit Sinking Ship’s reported project costs. CPB amended its grant budget based on FRC’s reporting of the project costs and explanation of variances. PBS did not amend its budget but did approve the reported variances.

CPB officials confirmed that under the CPB grant, any subcontracted or delegated work required the inclusion of CPB’s delegation and subcontract provisions that provide CPB access to the
subcontractor’s records. CPB further stated that the vendor classification had no bearing on CPB’s access to subcontractor records, particularly when the full costs of the subcontractor were included in the project’s final financial report and represented 100 percent of the total project costs.

Finally, FRC’s own Financial Policy, Appendix D: Grantor-Imposed Accounting requirements state that FRC will follow grantors’ requirements and also apply the federal guidance to federal funded grants, which includes RTL.

Where, in the view of management, there is a conflict between the grantor’s requirements and these policies and procedures, the grantor’s requirements will prevail… Examples of grantors with special accounting requirements include the Corporation for Public Broadcasting and National Science Foundation. Such grants are reviewed by Chief Operating Officer and the Director of Finance to ensure compliance with provisions which may not otherwise be detailed in these policies and procedures. Often, such grants refer to federal regulations, and even where they do not FRC observes the following procedures containing federal funds: Federal Cost Principles OMB Circular A-122; Federal Management Standards OMB Circular A-110; Federal Audit Requirements OMB Circular A-133…

FRC did not comply with CPB financial reporting and access to records requirements, the federal requirement to adequately identify the use of federal RTL funds in the project’s accounting records, and FRC’s own policies and procedures.

Because FRC did not provide us access to verify the total $18.2 million in costs it reported to CPB, we have not been able to obtain sufficient evidence to form an opinion and must therefore disclaim an opinion on the accuracy of the final report. The ability to audit total reported costs is important to provide funders with accountability over the project’s total costs. Further, as FRC officials have acknowledged, the accuracy of total project costs is critical to calculating production surpluses or deficits and the future reporting and distribution of ancillary revenues.

**Recommendations**

We recommend that CPB:

1) require FRC to obtain from Sinking Ship for Odd Squad, Season 1 and the current Odd Squad, Season 2, projects:
   a) a reconciliation of the final cost reports submitted to CPB to Sinking Ship’s general ledger; and
   b) a written certification of the accuracy of the final cost reports;
2) require that FRC’s current Odd Squad, Season 2 final financial reports disclose:
   a) the basis for reporting project costs (i.e., based on actual costs incurred or on a percentage of completion basis for the fixed price contract); and
   b) the amount of Sinking Ship’s reported costs that were not recorded in FRC’s accounting records;
3) ensure FRC takes corrective actions regarding its current Odd Squad, Season 2 CPB grant to comply with all RTL and CPB grant terms for financial reporting, recordkeeping, and access to subcontractor financial records requirements; and

4) periodically monitor PBS’s oversight of its large RTL subrecipients to verify grant recipients are compliant with federal grant requirements to maintain financial records that identify the application of federal RTL activities including project budgets and financial reports.

**FRC Response**

FRC did not agree with our findings that it had deficiencies in its internal controls because it could neither reconcile the final financial reports submitted to CPB to its general ledger nor provide access to its subcontractor Sinking Ship’s financial records to verify total project costs incurred and reported. FRC also did not agree that it did not comply with Federal award requirements to track RTL disbursements.

**Reconciliation**

FRC’s stated what it had previously explained to OIG that due to the nature of the agreements with its Canadian co-producers, it could reconcile only the costs that it had disbursed for the project to its general ledger and not the actual costs reported to PBS/CPB. FRC said the difference was the cost of work performed and financed in Canada, which were not recorded on FRC’s books. FRC said the agreements required that all costs be reported, even the costs FRC was not obligated to pay. FRC “believes this is a deficiency in the structure of CPB’s agreement rather than internal control.” FRC said it was never going to be possible to reconcile the project’s total costs to its general ledger.

**Access to Sinking Ship’s Records**

FRC disagreed with our finding that the CPB grant agreement required that its subcontract with Sinking Ship include access provisions to enable CPB to verify the total project costs reported. FRC reiterated that Sinking Ship was a vendor and because of FRC’s fixed price contract with Sinking Ship, the vendor’s actual costs were irrelevant. Only the costs that FRC was required to pay Sinking Ship were relevant to CPB’s audit access. FRC also explained that since there was RTL funding in the PBS agreement it followed OMB A-133 rules, which excluded both commercial and non-U.S. based vendors from such provisions.

FRC explained that its contracts with its Canadian partners had to satisfy requirements of the Canadian government to receive the Canadian tax credits. FRC said these requirements required they enter into several complex agreements, the most significant being the PSA that engaged a Canadian contractor (an affiliate of Sinking Ship) to provide many of the services in the approved $17 million PBS budget, for a fixed price of only $13 million. The balance of $4 million was the anticipated Canadian tax credit.

FRC said it is assumed that the Canadian vendor would finance the deficit and eventually recover it through the tax credit, but regardless the Canadian partner was obliged to provide the contracted services. FRC further stated that it was of no consequence to FRC, PBS, or CPB what
the actual costs incurred by the Canadian vendor might be, because FRC was obligated to pay only the fixed contract fee of $13 million. FRC went on to say that the Canadian vendor was reluctant to undertake the burden of OIG’s request to review its records given that it had a fixed fee contract with FRC.

FRC contended that the access provisions for vendor costs is a technical disagreement based on how the PSA agreement was classified and noted that Sinking Ship did incur additional costs over the fixed price amount that were reported. The PBS agreement provided that PBS at its discretion could approve the additional costs and permitted the producer to recoup them before beginning to share its profits. FRC stated that had PBS and CPB needed support for these additional costs, they should have requested documentation at the time they approved them.

**Tracking Disbursements**

FRC did not agree with our finding that it was noncompliant with federal award requirements to adequately track RTL funded costs, because the agreement’s budget did not separately identify RTL budgeted costs. Further, FRC did not agree that the NSF cost reimbursable grant funds for the Peg+ Cat production project was comparable to the Odd Squad PBS RTL agreement.

FRC stated that all funds from PBS, RTL, and CPB were applied to the Odd Squad production and each one of these component amounts could be easily derived from FRC’s books.

**OIG Review and Comment**

Based on FRC’s response to our draft report’s recommendations one through four remain unresolved, pending CPB’s final management decision.

**Reconciliation**

We disagree with FRC’s assertion that, pursuant to the PBS and CPB agreement terms, it had to provide us access to only its records supporting the amount it paid, $12.9 million, and not the $18.2 million amount FRC reported as total project costs. According to the agreement, FRC was the fiduciary agent responsible for all legal and financial aspects of the agreements. Therefore, it had an obligation to ensure that grant compliance requirements were met and total cost reporting was verifiable. Without access to Sinking Ship’s records we could not independently verify that Sinking Ship had incurred the total $18.2 million in costs reported to CPB and PBS. As a result, our scope was limited.

It is noteworthy that in our audit of another production contract where the producer had subcontracted work with a Canadian partner, we found that all project costs and funding, whether fixed or actual, were recorded on the producer’s financial books and could be audited. FRC could have done the same and thus met the terms of the agreement.
**Access to Sinking Ship’s Records**

We disagree with FRC’s assertion that we should not have access to Sinking Ship’s records because of the fixed price contract with Sinking Ship, its classification as a vendor, or that OMB A-133 guidelines did not apply to commercial and non-U.S. based vendors.

While FRC’s PSA with Sinking Ship was fixed price, FRC was nonetheless required to report all costs to PBS/CPB. The nature of the PSA was irrelevant. Similarly irrelevant is Sinking Ship’s classification as a commercial contractor or a vendor under OMB A-133 guidelines, because FRC was required to report all costs to PBS/CPB. FRC provided no support for $5.3 million in Sinking Ship costs reported because they were not on FRC’s books, and FRC as fiduciary agent for the total project did not provide us access to Sinking Ship’s books to audit these costs.

Further, FRC as the subrecipient of federal funds was required to comply with procurement regulations under EDGAR Title 34 CFR Subtitle A Part 74-Administration of Grants, Subpart C-Post Award Requirements, Procurement Standards, § 74.43-46 and § 74.48. Specifically, § 74.48 requires that negotiated contracts include audit access provisions for the federal awarding agency, the Comptroller General of the United States, or any of their duly authorized representatives. The Sinking Ship agreement was a negotiated fixed price contract. FRC as the pass-through entity, was responsible for ensuring for-profit contractor compliance with grant requirements and in this case providing access to Sinking Ship’s financial records to audit total reported costs.

Finally, regardless of the federal provisions, CPB’s grant terms required that CPB have access to FRC’s subcontractor’s records. Such access would have enabled us to verify the accuracy of the total costs reported for this project.

**Tracking Disbursements**

We disagree with FRC’s response that because the PBS budget did not separately identify RTL funds, it could not separately identify the use and application of RTL funds. FRC did separately identify RTL revenues within its accounting system. FRC could have decided what cost categories to spend the RTL funds on and establish a separate code to track the federal RTL expenses. We are aware of another PBS/CPB/RTL production agreement that the independent producer’s budget and financial reports separately identified RTL costs from other funding sources. We did not change our finding but, based on FRC’s response, we modified recommendation four to include in future RTL agreements the requirement that independent producers identify RTL costs in their detailed budgets and separately report RTL costs in their financial reports to ensure full accountability over RTL funds.
Exhibit A

Odd Squad Season 1
The Fred Rogers and Sinking Ship Entertainment
Final Financial Report as of September 30, 2015

<table>
<thead>
<tr>
<th>Budget Category</th>
<th>Budget</th>
<th>Actual Reported</th>
<th>Variance (under)/over</th>
<th>% Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PBS/RTL</td>
<td>$7,950,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CPB</td>
<td>3,000,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PBS</td>
<td>2,002,540</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Production Deficit</td>
<td>1,298,774</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canadian Tax Credit</td>
<td>3,599,401</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canadian License Fee</td>
<td>375,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Project Funds</strong></td>
<td>$18,225,715</td>
<td>$0</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Canadian co-venture partner

| Scenario                  | $2,248,000 | $2,251,530 | $3,530 | 0.2% |
| Producer                  | 824,815    | 824,815    | -      | 0.0% |
| Director                  | 380,000    | 379,068    | (932)  | (0.2%) |
| Cast                      | 1,640,000  | 1,635,250  | (4,750) | (0.3%) |
| Extras                    | 428,500    | 427,158    | (1,342) | (0.3%) |
| Production Staff          | 1,466,500  | 1,465,972  | (528)  | 0.0% |
| Design Labor              | 350,000    | 358,112    | 8,112  | 2.3% |
| Construction Labor        | 450,000    | 448,624    | (1,376) | (0.3%) |
| Set Dressing Labor        | 230,000    | 229,289    | (711)  | (0.3%) |
| Property Labor            | 415,000    | 413,958    | (1,042) | (0.3%) |
| Special Effects Labor     | 7,500      | 7,243      | (257)  | (3.4%) |
| Wardrobe Labor            | 320,000    | 324,605    | 4,605  | 1.4% |
| Makeup/Hair Labor         | 115,000    | 118,299    | 3,299  | 2.9% |
| Camera Labor              | 560,000    | 556,872    | (3,128) | (0.6%) |
| Electrical Labor          | 228,000    | 227,669    | (331)  | (0.1%) |
| Grip Labor                | 130,000    | 129,590    | (410)  | (0.3%) |
| Production Sound Labor    | 85,000     | 84,827     | (173)  | (0.2%) |
| Transportation Labor      | 78,000     | 78,003     | 3      | 0.0% |
| Fringe Benefits           | 317,000    | 317,010    | 10     | 0.0% |
| Production Office Expenses| 494,000    | 494,208    | 208    | 0.0% |

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6 FRC did not report funding sources on this report but asserts it provided this information to CPB and PBS in accordance with PBS agreement Exhibit C requirements.

7 PBS actual funding is $2,000,000 per agreement narrative, but the budget exhibit showed it as $2,002,540. The $2,540 difference should be included as part of the production deficit or funding from the Canadian tax credits and license fees.

8 For report presentation purposes, we summarized FRC’s final detailed budget line item expense report into these line item categories.
### Odd Squad Season 1
#### The Fred Rogers and Sinking Ship Entertainment
#### Final Financial Report as of September 30, 2015

<table>
<thead>
<tr>
<th>Budget Category</th>
<th>Budget</th>
<th>Actual Reported</th>
<th>Variance (under)/over</th>
<th>% Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Studio/Backlot Expenses</td>
<td>-</td>
<td>2,825</td>
<td>2,825</td>
<td>NA</td>
</tr>
<tr>
<td>Site Expenses</td>
<td>150,000</td>
<td>151,589</td>
<td>1,589</td>
<td>1.1%</td>
</tr>
<tr>
<td>Unit Expenses</td>
<td>383,500</td>
<td>382,122</td>
<td>(1,378)</td>
<td>(0.4%)</td>
</tr>
<tr>
<td>Travel and Living Expenses</td>
<td>135,500</td>
<td>140,054</td>
<td>4,554</td>
<td>3.4%</td>
</tr>
<tr>
<td>Transportation</td>
<td>217,000</td>
<td>219,523</td>
<td>2,523</td>
<td>1.2%</td>
</tr>
<tr>
<td>Set Dressing</td>
<td>137,000</td>
<td>137,624</td>
<td>624</td>
<td>0.5%</td>
</tr>
<tr>
<td>Props</td>
<td>121,000</td>
<td>121,136</td>
<td>136</td>
<td>0.1%</td>
</tr>
<tr>
<td>Special Effects</td>
<td>12,000</td>
<td>11,776</td>
<td>(224)</td>
<td>(1.9%)</td>
</tr>
<tr>
<td>Animals</td>
<td>14,000</td>
<td>14,030</td>
<td>30</td>
<td>0.2%</td>
</tr>
<tr>
<td>Wardrobe Supplies</td>
<td>118,000</td>
<td>116,791</td>
<td>(1,209)</td>
<td>(1.0%)</td>
</tr>
<tr>
<td>Makeup/Hair Supplies</td>
<td>23,500</td>
<td>23,644</td>
<td>144</td>
<td>0.6%</td>
</tr>
<tr>
<td>Studio</td>
<td>1,050,000</td>
<td>1,032,805</td>
<td>(17,195)</td>
<td>(1.6%)</td>
</tr>
<tr>
<td>Camera Equipment</td>
<td>165,000</td>
<td>167,051</td>
<td>2,051</td>
<td>1.2%</td>
</tr>
<tr>
<td>Electrical Equipment</td>
<td>241,000</td>
<td>241,807</td>
<td>807</td>
<td>0.3%</td>
</tr>
<tr>
<td>Grip Equipment</td>
<td>87,650</td>
<td>87,650</td>
<td>-</td>
<td>0.0%</td>
</tr>
<tr>
<td>Sound Equipment</td>
<td>61,000</td>
<td>61,041</td>
<td>41</td>
<td>0.1%</td>
</tr>
<tr>
<td>Videotape Stock</td>
<td>17,000</td>
<td>17,523</td>
<td>523</td>
<td>3.1%</td>
</tr>
<tr>
<td>Editorial Labor</td>
<td>642,000</td>
<td>638,945</td>
<td>(3,055)</td>
<td>(0.5%)</td>
</tr>
<tr>
<td>Editorial Equipment</td>
<td>82,000</td>
<td>82,357</td>
<td>357</td>
<td>0.4%</td>
</tr>
<tr>
<td>Video Post Production (Picture)</td>
<td>957,000</td>
<td>958,057</td>
<td>1,057</td>
<td>0.1%</td>
</tr>
<tr>
<td>Video Post Production (Sound)</td>
<td>439,000</td>
<td>436,809</td>
<td>(2,191)</td>
<td>(0.5%)</td>
</tr>
<tr>
<td>Film Post Production Sound</td>
<td>500</td>
<td>649</td>
<td>149</td>
<td>NA</td>
</tr>
<tr>
<td>Music</td>
<td>185,000</td>
<td>188,926</td>
<td>3,926</td>
<td>2.1%</td>
</tr>
<tr>
<td>Versioning</td>
<td>140,000</td>
<td>141,721</td>
<td>1,721</td>
<td>NA</td>
</tr>
<tr>
<td>Additional Project Components</td>
<td>118,000</td>
<td>119,069</td>
<td>1,069</td>
<td>0.9%</td>
</tr>
<tr>
<td>General Expenses</td>
<td>460,500</td>
<td>460,740</td>
<td>240</td>
<td>0.1%</td>
</tr>
<tr>
<td>Indirect Costs</td>
<td>945,750</td>
<td>949,387</td>
<td>3,637</td>
<td>0.4%</td>
</tr>
<tr>
<td>Miscellaneous 3.2%</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Transmedia Production</td>
<td>$555,500</td>
<td>$554,802</td>
<td>($698)</td>
<td>(0.1%)</td>
</tr>
<tr>
<td><strong>Total Project Expenses</strong></td>
<td><strong>$18,225,715</strong></td>
<td><strong>$18,232,555</strong></td>
<td><strong>$6,840</strong></td>
<td><strong>0.04%</strong></td>
</tr>
</tbody>
</table>
SCOPE AND METHODOLOGY

We planned our audit in accordance with Government Auditing Standards for financial audits to determine whether The Fred Rogers Company (FRC): a) submitted a financial report that fairly presented total project grant expenditures; b) incurred costs in accordance with grant requirements; and c) complied with grant requirements including federal Ready to Learn (RTL) terms. We performed our audit field work during the period May 2016 through November 2016.

The scope of the audit included reviews and tests of the costs reported by FRC on CPB Grant Number 14816, Odd Squad Season 1 during the period July 1, 2012 through September 30, 2015. The financial report is provided in Exhibit A.

In conducting our audit, we reviewed CPB’s grant files and discussed the award and administration of the grant with CPB officials from the Office of Business Affairs, Office of the Chief Financial Officer, Education and Children’s Content Operations, as well as PBS officials. We also reviewed the PBS distribution agreement with RTL funding and RTL grant awards. We also discussed with various FRC officials, including its Chief Operating officer, VP of Broadcast and Digital Media and Director of Finance, the grant agreements and related co-venture, production services and distribution agreements, as well as management’s policies and procedures.

We reconciled the financial data maintained by FRC in its accounting records to its audited financial statements but could not reconcile the total costs FRC reported to CPB to FRC’s accounting records, because it did not record all of Sinking Ship’s costs through its subcontracted production services agreement contract.

We tested the accuracy of grant expenditures that FRC claimed for payments to Sinking Ship based on its contractual payment obligations, as well as payments FRC made to some U.S. contractors as fiscal payment agent for Sinking Ship. We were not provided access to all the contracts and records for these contractors as they were not FRC’s agreements. We also evaluated compliance with the grant agreement terms, in part, by testing 42 or $3,688,197 judgmentally selected expenditure payments from the universe of $18,232,555 in expenses reported under the grant to supporting documentation maintained by FRC. We did not have access to the Canadian co-venture production services agreement expenses reported totaling $5,282,555 that were not recorded on FRC’s books. This lack of access represents a material scope limitation, representing 29 percent of the total reported costs.

We gained an understanding of the internal controls over the preparation of the grant financial reports, cash receipts, and payment authorizations. We also gained an understanding of FRC’s policies and procedures for compliance with CPB and RTL grant agreement terms for allowable costs. We used this information to assess risks and plan the nature and extent of our testing to conclude on our objectives. We also performed tests of compliance with certain provisions of law and grant agreement requirements, when noncompliance could have a direct and material effect on the grant report amounts.
William J. Richardson III  
Deputy Inspector General  
Corporation for Public Broadcasting  
401 Ninth Street, NW  
Washington, DC 20004

March 10, 2017

Dear Mr. Richardson:

Thank you for providing us with a copy of the OIG draft report No. APT1702-XXXX dated February 8th, 2017 concerning “Odd Squad”. We have considered the report’s findings, and welcome this opportunity to respond.

In the interests of brevity, we have used the following terms:

"CPB" means the Corporation for Public Broadcasting;  
"DED" means the Department of Education;  
"FRC" means The Fred Rogers Company;  
"PBS" means the Public Broadcasting Service;  
"PTV Entity" means PBS and CPB;  
"RTL" means the DED 'Ready to Learn' pass-through grant funds;  
"SS" means Sinking Ship Entertainment.

In addition, we have used the PBS NOLA code and a number representing the season when referring to the programs. Thus, for example, "ODDS1" means the first season of "Odd Squad " (episodes 1-40).

I Deficiencies in internal control

(a) Reconciliation

OIG noted that it was not possible to reconcile the final financial report to FRC's books.

A key feature of this production was that certain work was performed in Canada and financed in Canada. By definition, costs being incurred in Canada, and separately funded there, do not show as costs or revenues on FRC's books.

---

1 The report concludes that OIG is unable to express an opinion, and so the issues discussed here may not technically be 'findings'. We have nevertheless tried to respond as fully as possible.
As OIG notes, it was a requirement in the CPB agreement that the final financial report could be reconciled to FRC's general ledger. However, the format of that report is not specified in detail, other than that it should be presented "in the form of the Detailed Budget".

Of course, if the budget for the series had only included Canadian costs which were U.S.-funded, and if FRC's cost reports only showed what it actually disbursed, then it would easily have been possible to reconcile such cost reports to FRC's books. Unfortunately, CPB did not wish to see either the budget or the cost reports presented in this way, and asked that they show all costs on the production, including those not on FRC's books. It was therefore always going to be impossible to reconcile the cost reports to the general ledger. We believe that this is a deficiency in the structure of the agreement rather than in internal control.

(b) Access to Sinking Ship’s Financial Records

Its inability to express an opinion on the Final Financial Report for ODDS1 is principally attributed by OIG to the fact that it did not have access to the books of an affiliate of The Fred Rogers Company’s production partner, Sinking Ship. There was a lengthy discussion of this issue between the parties during the audit.

There are two separate program agreements governing ODDS1 — one with CPB and one with PBS. The latter agreement contained provisions for DED RTL pass-through funding and was administered by PBS, although it was part of this audit exercise. The CPB agreement specified 30 episodes, and was subsequently amended to 40 episodes. The PBS agreement contained provisions for three separate budgets with varying numbers of episodes, the last of which was for 40 episodes. The 40-episode budgets in both agreements were the same, and came to $16,926,941.

The total PBS/CPB funding provided by their respective agreements for these 40 episodes is shown as $12,952,540, and so the PBS agreement places an obligation on The Fred Rogers Company to fund the approximately $4 million shortfall. It notes that the deficit will likely be met by Canadian tax credits.

Canadian contributions to the funding of the series are therefore significant, and exceed PBS's or CPB's own individual contributions. In order to benefit from the Canadian tax credits, The Fred Rogers Company has to satisfy the requirements of the Canadian government, which call for a number of complex agreements. Only one needs to concern us here: the Production Services Agreement, or PSA. That agreement engages a Canadian contractor (an affiliate of Sinking Ship) to provide many of the services detailed in the PBS Approved Budget (coming to approximately $17 million in value) but at a fixed price of only $13 million. The differential is the anticipated Canadian tax credit. It is assumed that the Canadian vendor will finance the deficit in some manner and eventually recover it from tax credits, but he is obliged to deliver the specified services regardless of whether he ultimately obtains those credits. It should be noted that the PSA requires FRC to pay only the specified (fixed price, $13 million) fee,
regardless of any cost under- or over-runs. This fixed price fee was paid and can be reconciled easily to FRC's books.

OIG nevertheless asked to audit the Canadian production company which was a party to this agreement. We were unclear as to the rationale for this request since

1. OIG, in its opinion, cites references in its Terms and Conditions governing flow-down access. These references variously use the terms ‘subcontractor’, ‘delegee’ and ‘subgrantee’ but do not define these terms. By all generally-accepted and customary tests, the Canadian company was performing services as a vendor, and vendors are not typically subject to such flow-down provisions.

   In discussions with OIG, FRC used the analogy of a cost on its books for sending a FedEx envelope to Los Angeles: if it appeared in the ledger as $40, it would have been reasonable to ask for the invoice for this amount, and evidence of payment. It would not have been reasonable or relevant to expect to have the right to audit FedEx and see what its costs actually were — whatever they were, FRC's cost was $40. FedEx would, of course, be unlikely to consent to such a request.

2. Only with FRC's written permission could there have been an increase in the fixed contract fee (and none was requested), nor as part of the arrangement was there any provision for any cost saving to be passed back to FRC, PBS or CPB. It is therefore of no consequence to either FRC or the PTV Entity what the actual costs incurred by the vendor might be.

   We understand that OIG has the right to inquire into our costs, but take the position that the costs of our vendors are beyond the purview of the audit. This particular vendor was rightly reluctant to undertake the burden of this request given that it had a fixed fee contract with us that was not in any way dependent on the costs. We also valued the significant financial contribution made by the government of Canada to this series, which could not have been made without that contribution, and were concerned about possible repercussions from this exercise.

   It therefore remains the position of the Fred Rogers Company that we provided all relevant supporting information, and the position of OIG that FRC should have provided CPB with access to the vendor's books in the Production Services Agreement. In that respect, when drafting this agreement we followed OMB A-133 rules, which exclude both commercial and non-U.S. based vendors from such provisions. We disagree with this noncompliance finding.

   So far, this concern relating to post hoc access to the vendor's books is a technical or theoretical disagreement about the correct interpretation of federal provisions and whether the company performing the services was a subrecipient, a subcontractor, a delegee, a subgrantee, or a vendor. It is also a straightforward dispute about the relevance of any cost overages in the context of a fixed-price arrangement.
There is, however, a practical aspect to this issue which is mentioned in passing in OIG’s report, and that is the fact that the Canadian work did cost the vendor more than the fixed price contract (by approximately $1.3 million). The PBS agreement provided that in this event PBS could, in its sole discretion, approve the additional cost and permit the producer to recoup it before beginning to share profits (if any) from the series. Any approval by PBS of the overage would therefore have had an effect on net revenues.

The CPB agreement contains no specific language concerning overages or changes to the budget, but says that net revenue shall be calculated in accordance with the PBS agreement.

This would have been the logical point at which either or both parties to the PTV Entity could have requested complete documentation for all these costs. Even in the absence of any access provisions in the vendor’s contract, such a request would have carried great weight simply because of the power of the purse. Without supporting vouchers, the PTV Entity could have disallowed all these additional costs.

In the event, PBS approved the overage, and so did CPB, which amended the agreement accordingly.

II Federal Award Noncompliance

(a) Tracking disbursements by projects

OIG finds that

“... FRC did not separately account for federal RTL funds within its project expenditure general ledgers, as required by RTL grant regulations. FRC was not consistent in how it accounted for federal funds received from RTL versus other federally funded grants. We found FRC comingled RTL, CPB, and PBS funded expenses on a total project basis for the Odd Squad production. In contrast in a grant project funded with NSF federal funds for the Peg + Cat project, FRC discretely accounted for the NSF funds within the project’s accounting classification system. FRC did separately identify RTL revenues for the Odd Squad project in a subsidiary receipts schedule, although the funds were comingled in its general ledger account for revenues, but it did not separately account for detailed RTL expenses. RTL expenses were comingled with PBS and CPB expenses.”

Since the budgets in both the relevant agreements did not distinguish between RTL expenses, PBS expenses, CPB expenses, or any other kind of expenses, it is difficult to see how FRC could possibly have satisfied this requirement. In the absence of any detail in the agreement specifying which part of the budget an RTL dollar might be spent on, we took the view that it was fungible and could be spent on anything, as long as it was part of the grant project. Nevertheless, the general requirement that records ‘identify the source and application of funds for federally-sponsored activities’ was met: the source of the funds was RTL, CPB and PBS, and the application of the funds was exclusively
ODDS1. The precise amount of each one of these component figures is easily derived from FRC's books.

OIG notes that, on the other hand, FRC was not consistent when it did discretely account for NSF funds and costs. But consistency needs to be assessed by comparing apples to apples: the NSF grant, unlike the PTV Entity funding of ODDS1, was awarded on a straightforward cost-reimbursement basis, and included a budget specifically identifying costs matching the grant. Because of this, we were able to properly account to NSF.

We disagree that this is a noncompliance issue. If this level of financial reporting was required, the necessary and sufficient precondition would have been a budget showing line-item detail allocations to RTL, CPB and PBS. We would be happy to operate in this way in the future.

All are agreed that these agreements are complex. We believe that the OIG report provides helpful observations for all parties on a number of issues, and look forward to working with PBS and CPB in the future to address them.

Sincerely,

Kevin Morrison,
Chief Operating Officer

cc: Paul Siefken, President and CEO
cc: Debra Sanchez, SVP, Education and Children's Content Operations, CPB
cc : Jackie J. Livesay, Vice-President, Compliance, CPB