CORPORATION FOR PUBLIC BROADCASTING

OFFICE OF INSPECTOR GENERAL

AUDIT OF CPB GRANTS AWARDED TO INDEPENDENT TELEVISON SERVICE, INCORPORATED SAN FRANCISCO, CALIFORNIA FOR THE PERIOD OCTOBER 1, 2007 – SEPTEMBER 30, 2009

AUDIT REPORT NUMBER: APT1002-1103

March 29, 2011

Kenneth A. Konz

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Inspector General

Corporation for Public Broadcasting

Office of Inspector General

Date: March 29, 2011

To: Jennifer Lawson, Senior Vice President, Television and Digital Video Content
Steven Altman, Senior Vice President, Business Affairs

From: Kenneth A. Konz, Inspector General

Kenneth A Konz

Subject: Audit of Selected Grants Awarded to the Independent Television Service, Inc., San Francisco, California for the Period October 1, 2007 – September 30, 2009, Audit Report No. APT1002-1103

We have audited the accompanying financial grant reports (Exhibits B through N) of the Independent Television Service (ITVS) as of September 30, 2008 and September 30, 2009. The objectives of our audit were to determine whether: financial reports fairly presented the Corporation for Public Broadcasting (CPB) grant revenues and expenditures; costs were incurred in accordance with grant requirements; and ITVS complied with applicable provisions of the Public Broadcasting Act.

In our opinion, except for the following items of noncompliance, the financial grant reports referred to above present fairly, in all material respects, the CPB grant activities of ITVS as of September 30, 2008 and 2009 in compliance with grant agreement and statutory requirements.

- Questioned costs of $314,489, related to not returning funds de-obligated from CPB grants that had lapsed;
- Reporting interest income, totaling $594,000, earned on CPB funds held by ITVS;
- Reporting variances between operations grant budgets and actual expenditures; and
- Requiring producers to discretely account for CPB grant funds provided by ITVS.

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Additionally, we identified opportunities to restructure future ITVS grant agreements to facilitate better CPB oversight and provide more accountability over ITVS grant activities. Further, CPB grant requirements for cash reimbursement need to be clarified to more effectively manage CPB's cash payments to ITVS. These actions will allow CPB to provide better oversight of unused grant funds, as well as, improve CPB's cash management practices.

We performed this audit based on the Office of Inspector General's (OIG) annual audit plan objective to perform reviews of a cross-section of stations and organizations comprising the public broadcasting system. We performed our audit in accordance with *Government Auditing Standards* for financial audits. Our scope and methodology is discussed in Exhibit A.

In response to the draft report, ITVS management did not agree with our findings concerning the costs questioned related to de-obligated funds, reporting interest earned on ancillary income, reporting variances between budgeted and actual expenditures, requiring producers to discretely account for CPB grant funds, and portions of our analysis used in our finding regarding restructuring future grant agreements. However, ITVS did agree with our finding regarding the need to submit annual reports for interest earned on CPB cash-on-hand, and indicated a willingness to evaluate our recommendations regarding restructuring future grants agreements with CPB. ITVS' complete response to the draft report is attached in Exhibit Q.

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 ITVS' response to the draft report, we consider recommendations 1 through 9 unresolved, pending a final management decision by CPB on the findings and recommendations.

Please provide us a written response to our findings and recommendations within 180 days of this final report. For corrective actions planned, but not completed by the response date, please provide specific milestone dates when planned corrective actions will be completed.

BACKGROUND

In 1988, Congress mandated the creation of a service dedicated to independently produced programming that takes creative risks, sparks public dialogue, and gives voice to underserved communities. Since 1990, as required by its authorizing legislation, CPB has funded an independent television production service. ITVS is a separate entity from CPB and contracts with CPB to fund public television programs produced by independent producers and independent production entities. As required by law, these funds are to be used to expand diversity and promote innovation in programming available to public broadcasting.

ITVS was incorporated on September 22, 1989 and began operations in St. Paul, Minnesota in 1991. Now headquartered in San Francisco, California, ITVS is governed by a 13-member board of directors, which includes independent producers, media arts center executives and programmers, public television managers, academics and independent media experts. ITVS plays a major role in developing independent projects for public television, and currently delivers 50 to 60 hours of independently produced programs to public television each year, which is a significant percentage of the independent work supported by CPB. Station usage of ITVS programs has increased over the years, and in 2008 ITVS programming won 86 awards and honors, including an Academy Award nomination, four Emmy Awards, and three George Foster Peabody Awards, among others.

The primary work of ITVS is to provide financial support and services for independent programming that serves public broadcasting, while pursuing cultural, ethnic and geographic diversity in its allocation of resources. ITVS employs a wide range of solicitation strategies and partnerships to find programs that serve its mission. Through its Open Call and Linking Independents and Co-producing Stations (LINCS) initiatives, general solicitations are encouraged and accepted on a wide range of subjects or themes. While the Open Call and LINCS initiatives are limited to providing funds for programs already in progress to guarantee the completion and delivery of a finished program, ITVS also offers development support for projects in an early development phase. A separate yearly solicitation process—both general and by invitation—is used to bring in additional post-production phase programming for broadcast on PBS' *Independent Lens.*

Once approved, ITVS spends 12 to 24 months to prepare funded programs for public television broadcast. Each program enters the ITVS process at a unique phase in its production cycle, varying from early development to post-production. Once ITVS has funded a project its staff provides ongoing support services to producers, including: regular monitoring of production progress; technical and editorial assistance; as well as, promotion and outreach support for finished programs.

Since 1990 ITVS has received almost $200 million from CPB to fund independent productions. The most recent multi-year grant ITVS received from CPB was for a 3-year period (FYs 2008 - 2010) and included two components. The first was a grant for ITVS operations activities such as, salaries, equipment, insurance, and telephone, and a second grant for program production, production support, and service to independent producers. Details concerning these grants follow:

CPB Grants Awarded to ITVS for FY 2008-2010 Activities

Fiscal Year	***Operations Grant***	***Production Grant***	***Total***
2008	$967,784	$11,800,000	$12,767,784
2009	967,784	11,800,000	12,767,784
2010	1,016,173	12,390,000	13,406,173
Totals	***$2,951,741***	***$35,990,000***	***$38,941,741***

In FY 2008, ITVS budgeted $7,800,000 or 66 percent of the $11,800,000 of production grant funds it received from CPB for program licensing through production and development contracts. ITVS earmarked an additional 17 percent of the production grant funds for direct program support costs, such as production management, producer orientation, reader expenses, program, and production staff payroll, travel and consultants. The remaining 17 percent was allocated for outreach, station marketing, promotion, web support, communications staff, and other broadcast support costs. During our audit period, ITVS awarded 55 new commitments to independent producers for productions during FY 2008 and awarded another 58 new commitments during FY 2009.

The ITVS FY 2008 and 2009 financial statement audits reported total functional expenses of $19,256,559 and $19,906,197, respectively. Our audit tested CPB funds reported on Exhibits B – N totaling $13,921,881 in FY 2008 and $15,227,771 in FY 2009.

RESULTS OF REVIEW

We audited the accompanying ITVS financial grant reports (Exhibits B - N) as of September 30, 2008 and 2009. These financial reports are the responsibility of ITVS' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial reports presented are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts reported to CPB and compliance with grant agreement and statutory requirements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, except for the following items of noncompliance, the financial grant reports referred to above present fairly, in all material respects, the CPB grant activities of ITVS as of September 30, 2008 and 2009 in compliance with grant agreement and statutory requirements.

- Questioned costs of $314,489, related to not returning funds de-obligated from CPB grants that had lapsed;
- Reporting interest income, totaling $594,000, earned on CPB funds held by ITVS;
- Reporting variances between operations grant budgets and actual expenditures; and
- Requiring producers to discretely account for CPB grant funds provided by ITVS.

Additionally, we identified opportunities to restructure future ITVS grant agreements to facilitate better CPB oversight and provide more accountability over ITVS grant activities. Further, grant requirements for cash reimbursement need to be clarified to more effectively manage CPB's cash payments to ITVS. These actions will allow CPB to provide better oversight of unused grant funds, as well as, improve CPB's cash management practices.

In response to the draft report, ITVS management did not agree with our findings concerning the cost questioned related to de-obligated funds, reporting interest earned on ancillary income, reporting variances between budgeted and actual expenditures, requiring producers to discreetly account for CPB grant funds, and portions of our analysis used in our finding regarding restructuring future grant agreements. However, ITVS did agree with our finding regarding the need to submit annual reports for interest earned on CPB cash-on-hand, and indicated a willingness to evaluate our recommendations regarding restructuring future grants agreements with CPB. ITVS' complete response to the draft report is attached in Exhibit Q.

FINDINGS AND RECOMMENDATIONS

Returning De-obligated Grant Funds to CPB

ITVS needed to return production licensing funds de-obligated after the grant term had expired, and de-obligate unused funds from completed shows in a timelier manner. Instead of returning the expired funds to CPB as required by its grant agreement, ITVS spent these funds to complete other more recent productions. ITVS records for the past 19 years disclosed that about 111 shows were completed under budget and almost $1.9 million was de-obligated and then re-obligated to other productions. We estimate that $735,000 of this amount was from 50 productions, where unused funds were de-obligated and re-obligated after the CPB grant agreement period had expired. For our audit period, we questioned $314,489 of this amount that should have been returned to CPB. Not returning de-obligated funds provided additional funding to ITVS for productions without CPB's knowledge and approval. This did not provide CPB the opportunity to decide how to best utilize these funds to address current CPB priorities.

The current production grant agreement Section II paragraph 1 awarded grants for the period from October 1, 2007 through September 30, 2010. This paragraph states that . . . "no production funding shall be provided to ITVS hereunder that is not committed by ITVS to a third party within three years of the fiscal year of the CPB grant to which such funding relates." A subsequent grant amendment further explained that ITVS must commit FY 2008 grant funds by September 30, 2011, FY 2009 funds by September 30, 2012, and FY 2010 funds by September 30, 2013. The prior production agreement between CPB and ITVS, dated January 2005, contained similar requirements for grants awarded in FYs 2005 - 2007.

When productions are completed under budget, ITVS de-obligates (de-commits) the unused funds and, in almost all cases, re-obligates (re-commits) them in a subsequent fiscal year to fund another production. Since it takes on average almost three years to complete a show, and because ITVS generally did not de-obligate these funds in a timely manner, this de-obligation and re-obligation often took place after the 4-year grant term had expired. As a result, in many cases identified during our review, the original 4-year grant agreement used to fund the project had expired and, according to the grant agreement, the funds were no longer available to be committed for another production. Instead of returning these funds to CPB, ITVS used them for current production commitments under a subsequent grant agreement.

ITVS disagreed that funds de-obligated after the 4-year grant had to be returned to CPB. ITVS believed it met the grant requirement to commit grant funds within the grant term because the funds were originally committed within the grant term. We disagree with their interpretation of the grant agreement and the use of de-obligated funds after the expiration of the 4-year commitment period specified in the grant agreement.

ITVS explained that Section III paragraph 6 of the FY2009 production agreement states:

> . . . if any monies advanced for Production Licensing, or any other category in the Total Production Budget, are subsequently determined not required to be paid for a particular program, those monies must be subtracted from the next ITVS payment request.

ITVS personnel told us that quarterly payment requests submitted to CPB have always included adjustments for Production Licensing Contracts that have been written down to an amount less than the original contract. These adjustments are reported with each quarter's payment request on the *Production Licensing Fund Schedule of Commitments*. ITVS further explained that by showing a credit on the payment request it reduced the dollar amount of the payment requested for the current programs, and if it had returned these under budget amounts to CPB the payment request would have been increased by the same amount of the credit.

We analyzed ITVS' payment request and *Production Licensing Fund Schedule of Commitments* for the fourth quarter of FY 2009. Our analysis disclosed that ITVS did in fact provide a $175,230 credit for the amount it de-obligated when 11 production contracts were completed under budget or cancelled during the fourth quarter of FY 2009. However, $155,338[1] of this credit was for seven productions that were funded by prior production agreements with grant terms that had expired. When ITVS' reimbursement request deducted the $175,230 credit from the current production grant, it made these funds now available under the current grant, and allowed ITVS to keep $155,338 in expired grant funds. Details of the seven productions comprising the $155,338 that should have been returned to CPB follow:

[1] This total only represents fourth quarter de-obligations for expired grant agreements. Exhibit O provides a complete listing of FY 2009 de-obligations for expired grant agreements totaling $308,644.

FY 2009 Fourth Quarter Credits for Expired Grants

Productions	Production Grant Funds Originally Used	Amount	Year Funds Expired	Amount Re-Obligated in FY 2009
Absolutely Safe	2004	$196,000	2007	$110,000
Turned Out	2002	281,000	2005	11,484
Death of a Shaman	2001	74,000	2004	7,260
The Split Horn	1999	132,864	2002	3,364
Mai's America	1998	211,543	2001	2,254
Cushion the Fall	1997	15,000	2000	1,500
New Cop on the Beat	1996	226,404	1999	19,476
Total				**$155,338**

The chart above shows that ITVS originally funded *Absolutely Safe* with FY 2004 grant funds. ITVS cancelled this production in FY 2009 and credited $110,000 to the FY 2008-2010 production grant, even though the originating FY 2004 grant funds had expired in FY 2007.

Furthermore, ITVS needs to de-obligate unused funds for completed shows in a timelier manner. During FYs 2008 and 2009, ITVS de-obligated and re-obligated $436,450 of unused funds for 34 completed or cancelled productions; however, these funds remained obligated for an average of 4.2 years after the final payments were made to the producers. We questioned $314,489 in CPB costs applicable to 26 of the 34 productions, because the funds were de-obligated and re-obligated after the 4-year grant term had expired, instead of being returned to CPB. The seven productions that ITVS used to obtain the $155,338 credit on its September 30, 2009 payment request are included in the $314,489. Exhibit O provides details regarding the 26 productions with amounts de-obligated and re-obligated during FYs 2008 and 2009 after the 4-year grant term had expired.

ITVS personnel do not agree that unused funds transferred to a subsequent show after more than 4 years need to be returned to CPB because they believe the unused funds were not de-obligated, but only transferred to another production.

Recommendations

We recommend that CPB:

1) enforce existing grant agreement terms and require ITVS to return funds de-obligated after the 4-year term to CPB; and

2) recoup the $314,489 of questioned costs applicable to the unused funds de-obligated after the 4-year grant term had expired.

ITVS Response

ITVS believes that it complied with CPB requirements because any funds not spent by producers were credited against the next ITVS quarterly payment request to CPB as required by Section IV paragraph 7 of the production agreement. ITVS also indicated that nowhere in the production agreement is the term "de-obligation" used or is this concept addressed other than to credit the next quarterly payment request to CPB.

ITVS disagrees with the OIG characterization of "not returning de-obligated funds as providing additional funding" to ITVS as these funds were part of an annual contract to ITVS and not an amount in addition to the total ITVS contract amount, especially since these funds were again used for the intended purpose of funding independent film production.

Furthermore, ITVS explained that if it returned under budget amounts to CPB, the following quarter's payment request having been reduced by a credit would need to be increased by the same amount. Therefore, any monies returned to CPB would be offset by a subsequent increased payment request.

ITVS' response indicated that many shows are not identified and contracted for until the 2nd or 3rd year of the 4-year grant term and not the year the underlying grant originated. This leaves only 1 to 2 years to complete a new show without creating a re-obligation problem for under budget programs. Rather than asking ITVS to return the under budget funds which have already been committed to new programs ITVS believes it would make more sense to recommend that future ITVS/CPB contracts include a clear statement regarding a time limit on the use of funds related to programs completed under budget. ITVS would further recommend that such a time limit on the use of under budget contracted funds begin at the point when a contract is completed, not at the beginning of the fiscal year to which the underlying CPB contract relates.

OIG Review and Comment

Based on ITVS' management comments we consider recommendations 1 and 2 unresolved pending CPB's management decision. We do not agree that ITVS complied with the 4-year grant commitment period requirement when unspent funds from expired agreements were credited against the next ITVS payment request.

To illustrate, ITVS has until 2008 to commit 2005 funds. As a result, when producers returned unused 2005 funds to ITVS in 2009 or later, because the production was completed under budget or cancelled, the funds were no longer available to be committed and had expired per the grant agreement. When ITVS deducted the 2005 funds from a 2009 or later payment request, it reduced the amount of 2009 or subsequent year funds it required that quarter by using expired 2005 funds for the new commitments. By not returning the uncommitted and expired funds ITVS was providing additional funding to its current grant. For this reason, we questioned the $314,489 and recommended that ITVS return expired funds de-obligated (uncommitted) after the 4-year grant term.

We noted ITVS' assertion that it has only 1 to 2 years to complete a new show without creating a re-obligation problem for under budget programs. The primary reason this occurs is because ITVS cannot commit current year production funds in the year awarded, because as we reported ITVS carried over unused FY 2007 and 2008 production funds that were subsequently committed in FY 2009. We disagree with ITVS' suggestion that they should be given more time to re-commit these funds, in excess of the 4-year period that now exists. Alternatively, to eliminate this problem of having to increase the time available to commit and re-commit funds, we believe the more practical solution would be to only provide annual production funding to a level that covers projects that enter into a production agreement during the fiscal year the funds were made available.

Reporting Interest Earned From Cash-On-Hand and Ancillary Income

ITVS needs to report interest earned from investing the unspent CPB cash-on-hand held from production and operations grants, as well as, the interest earned on CPB's share of ancillary income. In total, ITVS did not report that it had earned $594,000 of interest income related to CPB funds[2] on hand, as required by its grant agreements with CPB.

[2] CPB operations and production grant agreements specify that these funds can be used to fund productions, but not administrative expenses.

According to ITVS, beginning in 2002 ITVS was required to report interest earned on CPB related funds. Section IV Paragraph 7 of both the current Production and the Operations grant agreements state:

> Interest on Funds Each year's Final Production [and Operations] Financial Reports shall set forth the precise amount of interest or other investment income earned on ***all CPB Funds*** (emphasis added) held by ITVS prior to the expenditure of such funds.

While ITVS maintained records of interest earned on operation and production grant funds, ITVS did not report this information to CPB as required by its grant agreements. As of September 2009, ITVS' records reflected $544,000 of interest income earned on unspent CPB production and operation grant fund balances. ITVS acknowledged that it did not submit this information to CPB. They further explained that the final production and operations reports submitted to date were accepted by CPB without a request by CPB for this information and if requested, ITVS would have submitted the interest reports.

Section V. Paragraph 10 of the current production agreement also requires that each agreement ITVS executed with independent producers establish that ITVS and CPB are entitled to a share in the net proceeds from the subsidiary or ancillary rights earned from the showings of completed programs ("the ITVS/CPB share"). This paragraph also provides several options for calculating the ITVS/CPB share of the ancillary income due each organization. Paragraph 10b of the same agreement established the maximum amount of time ITVS could hold CPB's share (retention period) by stating:

> ITVS shall not be required to make any payment to CPB of CPB's portion of the CPB/ITVS share . . . from the exercise of each Subsidiary or Ancillary Right . . . if within fifteen (15) years from the date . . . of this agreement (the "Retention Period") the Retained CPB Share has been contractually committed to or expended by ITVS for Direct Production Costs of programs to be initially distributed on public television. Any portion of the Retained CPB Share that ITVS has not contractually committed to or expended for Direct Production Costs by the end of the Retention Period shall be immediately paid to CPB with interest compounded annually . . . .

As of September 2009, the total ITVS/CPB ancillary income earned since 1994 was approximately $1,150,000. This amount was to be split equally between CPB and ITVS. We estimated that CPB's share was $574,000 plus interest income earned from 2002. Further, we found that ITVS did not calculate, maintain records, or report the interest earned on CPB's share of ancillary income. Using ITVS records of ancillary income earned each year since 2002, and the interest rates ITVS used during those years to calculate interest earned on production and operation funds, we estimate that ITVS has earned at about $100,000 of interest income on the ancillary income funds it held. CPB's share of this amount is $50,000.

By combining the $50,000 in interest earned on CPB's share of ancillary income with the $544,000 of interest earned on CPB production and operation funds ITVS held, we calculated that ITVS earned a total of $594,000 in CPB interest. ITVS was required to report these interest earnings to CPB.

ITVS officials believe they were not required to calculate and report interest earned on CPB's share of ancillary income until after the 15-year retention period had lapsed. They contend these funds did not belong to CPB until after the retention period had lapsed. As a result, they believed no interest was due, or needed to be calculated on CPB's share of ancillary income, unless the income earned by a production was not spent within 15 years of the program's completion.

ITVS further explained that the grant agreements, from FY 2002 through 2010, did define ***CPB Funding*** as the Total Production grant or the Total Operation grant, and that these terms were defined in another section of the agreement as the annual grant amounts. Based on these definitions ITVS personnel believed it was reasonable for them to interpret ***all CPB Funds*** as not all the money received or held for CPB, including ancillary income and the interest on these funds, but instead the meaning was constrained to the narrower category of ***CPB Funding***, i.e., monies given by CPB under the production and operation grants and not the ancillary income subsequently earned through the distribution of programs.

We disagree with ITVS' rationale for not reporting interest earned on production funds, operations funds, and ancillary income. The grant agreements clearly state that ITVS ". . . shall set forth the precise amount of interest or other investment income earned on ***all CPB Funds*** (emphasis added). . . ." Additionally, ITVS is not relieved of its responsibility to report complete and accurate financial information as required by its grant agreements because CPB did not request the information.

The production grant agreement required program producers to pay “the ITVS/CPB share” during the fifteen year retention period. Because the grant agreement identified a “CPB share” to be paid during the retention period, we disagree with ITVS’ contention that the ancillary income and related interest does not belong to CPB until after the retention period. By not reporting interest, ITVS understated its cash-on-hand balances and CPB was unaware of the total CPB cash balance available to fund current payments to producers.

Recommendation

3) We recommend that CPB require ITVS to report interest earned on production and operations grant funds it holds, as well as, the interest earned on CPB’s share of ancillary income as required by the production and operations agreements.

ITVS Response

ITVS acknowledged that it did not submit annual reports summarizing interest earned on CPB funds and explained that the failure to submit these reports did not result in the misuse of funds or cause any underpayments to CPB or overpayments to ITVS. Additionally ITVS’ response indicated that, as of September 30, 2010, ITVS has now spent $565,000 of CPB's share of Ancillary Income and $514,781 of the $544,000 of interest earned on CPB funds. In both cases, the ancillary income and interest income amounts were spent on new production licensing agreements to create new programming for public television.

ITVS believes the correct interpretation of the grant agreement is that no interest is due or calculated on CPB's share of Ancillary Income unless that income is not spent on program production within 15 years. If this condition occurs, then ITVS must pay the income plus interest earned from the time the ancillary income was received. Furthermore, ITVS contends that the grant agreement specifies that the amount required to be spent within the 15 year period on Direct Production Costs is the "Retained CPB Share" of ancillary income, not the Retained CPB Share plus interest accrued. For these reasons, ITVS believes the OIG has misinterpreted the ITVS/CPB grant agreement language and all references to interest due on ancillary income should be removed from the OIG report.

ITVS also indicated that it respects the OIG's concern regarding interest calculated on all CPB funds, and believes it would be valid to make a recommendation for future versions of the ITVS/CPB Production agreement that interest be calculated on CPB's share of ancillary income.

OIG Review and Comment

Based on ITVS' management comments we consider recommendation 3 unresolved pending CPB's management decision. While ITVS acknowledged that it should have reported interest on CPB cash on hand, ITVS still maintained that CPB is not entitled to interest on its share of ancillary income until after the 15-year retention period. We disagree and believe it should have been reported until spent within the 15 year period.

Reporting Grant Variances

Our comparison of the actual expenses for the operations grant shown in ITVS' general ledger with grant budgets disclosed variances that ITVS should have reported to CPB. Moreover, ITVS did not request CPB's prior approval for budget reallocations in excess of $5,000 in accordance with grant requirements.

Section III, paragraph 3 of the operations agreement specifies that, "ITVS may make discretionary budget reallocations within the Expense line items up to 10% or $5,000 of each item of the Total Operations Budget without prior CPB approval; however, explanation of material variances must be provided." Section IV, paragraph 4 of the operations agreement also specifies that, "All financial reports and accountings must include all expenditures incurred in the performance of the Project, regardless of whether CPB funds were applied to these expenditures."

While ITVS' total fiscal year grant expenses for both operations grants exceeded the grant budget, the final financial reports that ITVS submitted to CPB for FY 2008 and 2009 operations grants did not meaningfully report actual expenses to CPB or report budget variances in accordance with grant requirements. Instead, ITVS reduced some reported expenses, principally payroll, so that financial reports submitted to CPB disclosed expenses that agreed with approved grant budgets. Our comparison of the FY 2008 operations grant expenses on the final financial report to actual expenses reported in the financial statements disclosed the following variances:

FY 2008 Operations Grant

Expense Category	Budget	Expenses Reported to CPB	Actual Expenses (General Ledger)	Variances	
				Budget vs. Actual	Percent
Salaries, Taxes, and Benefits	$675,000	$681,601	$732,454	$57,454	9
Accounting & Audit Fees	23,000	23,086	23,086	86	0
Conferences & Special Events	53,500	57,889	62,496	8,996	17
Equipment	16,000	16,657	16,657	657	4
Insurance	10,500	12,993	12,993	2,493	24
Office	29,784	27,497	12,687	(17,097)	(57)
Office Lease	82,000	70,253	70,253	(11,747)	(14)
Online Services	21,000	14,810	14,810	(6,190)	(71)
Outreach Activities	4,000	6,415	8,740	4,740	119
Postage/FedEx/UPS	4,000	4,808	4,808	808	20
Printing	1,000	1,521	1,521	521	52
Professional Services	21,000	23,569	23,569	2,569	12
Telephone/Fax	11,000	9,713	9,713	(1,287)	(12)
Travel	16,000	16,972	36,183	20,183	126
Totals	**$967,784**	**$967,784**	**$1,029,970**	**$62,186**	**6**

Because ITVS did not report actual expenses, the variances between budget and actual shown above are different from the variances reported to CPB on Exhibits B and C. The variances between budgeted and actual expenses for the FY 2009 operations grant are shown in Exhibit P.

ITVS does not agree that it was required to report all operation grant expenditures because the operations grant states:

> ITVS agrees that all funds provided by CPB to ITVS under this Agreement are provided on a cost-reimbursement basis only, and that ITVS shall charge CPB only actual costs incurred in performance of this Agreement, up to the amounts reflected in the Total . . . Budget. . . .

Because the Total Operations Budget equals the total amount of CPB funding specified in the grant, ITVS contends that actual expenses compared to this budget in a financial report should consist only of CPB funded expenses. Moreover, ITVS personnel explained that the expenses exceeding the CPB Operations Budget were paid for by ITVS with its own funds or from other sources. As a result, ITVS personnel believed these non-CPB funded costs would not be meaningful to CPB and were outside of the Total Operations Grant or the "Project" as defined in the contract. ITVS explained that it has consistently reported in this manner for the past 15 years without CPB requesting otherwise or expressing any difference in interpretation. ITVS personnel also disclosed that over the years they have provided their audited financial statements to CPB which reported their total costs of operations from all sources; hence ITVS has always reported its full cost of operations and productions to CPB. We disagree and believe it is necessary for ITVS to report all variances as required by the operations grant agreement.

Our discussions with CPB management disclosed that the amount budgeted for each line item reflected CPB grant priorities. Additionally, the grant required ITVS to report all expenditures regardless of whether CPB funds were applied. As a result, we believe that ITVS needed to report budget line item variances for the operation grant on the financial reports submitted to close out each grant year, and request budget reallocations when there were material variances from budget line item expenses, as required by the grant. Without reporting ITVS' actual costs for the operations grants, CPB did not have a complete picture of the investment required to effectively oversee and use the funds awarded to ITVS.

Recommendations

We recommend that CPB require ITVS to comply with grant requirements to report:

4) actual expenditures for the operations grant.

5) all variances between each fiscal year's operations grant actual expenses and budgeted amounts for all line items that exceed 10% or $5,000, and obtain CPB's prior approval for significant variances from the budgeted amounts.

ITVS Response

ITVS strongly disagreed with the following OIG statements:

- There were variances that ITVS did not report.
- There were budget reallocations that required approval.
- ITVS financial reports did not meaningfully report actual expenses to CPB.

ITVS' response explained that if the intent of both parties was to report all operations costs regardless of funding source, this would have required a different budget which included not only CPB funded operations expenditures but all operations costs regardless of funding source.

ITVS' further explained that the FY 2008 – 2010 operations and production agreements had a typographical error regarding the discretionary budget reallocation threshold, and it should have been written as "10% and $5,000" of each budget line item, instead of "10% or $5,000". The correction of this language was discussed in an e-mail to CPB dated January 22, 2009. Unfortunately an amendment to the contract was discussed but not deemed necessary by CPB. The understanding that the language should read "10% and $5,000" was agreed upon by both ITVS and CPB and that the grant would be administered as if it was written as such.

The closing FY 2008 and FY 2009 Operations reports were prepared with this understanding which resulted in none of the variances requiring explanations. The fact that CPB did not ask for any explanations in the acceptance of these reports indicates there was agreement on the treatment of the error in the contract.

Several line items on the FY 2008 Operations budget presented in the OIG report ranged from $1,000 to $4,000. With the typographical error, ITVS would have been required to request budget reallocations for $100 to $400 variances from the budget which would not have been reasonable given $100 equals 100th of 1% of the Operation grant funds. With the corrected language, ITVS did not have to request a budget reallocation unless the variance was greater than $5,000. The final sentence in the above quoted paragraph indicates the intent of budget reallocation requirements was to capture "material" or significant variances. Certainly, variances of less than $5,000 cannot be considered material when $5,000 equals less than half of 1% of the $967,000 Operations grant.

OIG Review and Comment

Based on ITVS' management comments we consider recommendations 4 and 5 unresolved pending CPB's management decision. We agree that only "material" or significant variances need reporting. However, with or without the typographical error, with or without a budget that shows only CPB funded operations expenditures or all operations costs, regardless of funding source, we found that 6 of the 14 expense categories had variances of ***more*** than $5,000. Three of these were negative variances for which ITVS did not expend the amount CPB budgeted. For these six, explanations should have been provided.

Discrete Accounting Needed for Producers

ITVS Production Sub-recipient Grant Agreements did not require producers to separately account for CPB grant funds used for productions, i.e., effectively track and report on the use of CPB funds. ITVS' sub-recipient agreements only required producers to report total funds expended on their production project from inception of the project until completion. In many cases the production had been in progress for several years before ITVS became a funding partner. Without discrete accounting neither ITVS nor CPB can be assured that CPB grant funds were expended on items eligible and allowable as required by the ITVS/CPB grant agreement, or that an effective audit of CPB funds could be performed.

Discrete accounting is essential to fully account and report on CPB receipts and disbursements and is required by Section VII, paragraph 1 of the CPB Production grant which provides that ITVS:

> "…shall require each program producer to keep . . . records as may be necessary to disclose fully the amount and disposition of the proceeds of this Agreement, and to fully disclose: (i) the total cost of the program funded and/or acquired pursuant to this Agreement; (ii) the CPB funding; (iii) the amount and nature of that portion of Program costs supplied by other sources, if any; and (iv) such other records as will facilitate an effective audit."

ITVS personnel believe its reporting requirements for producers, as well as, its review procedures provided reasonable assurance that grant funds were spent in accordance with the production agreement and CPB requirements. ITVS personnel explained when ITVS contracts with a producer for $200,000 on a project with an $800,000 budget; ITVS reviews all $800,000 of its costs, and ensures there is at least $200,000 of valid and allowable costs incurred from the date of the ITVS agreement until the project is completed. ITVS contends it is in compliance with Section VII, because the amount and nature of that portion of Program costs supplied by other sources is quantified and clearly defined in the producers' reports to ITVS. ITVS personnel contend the grant agreement does not require ITVS to ask producers to code individual transactions in their accounting systems to individual income sources. We disagree and believe the producer should provide sufficient accounting information to identify CPB receipts and expenditures to facilitate an effective audit of CPB funds.

Recommendation

6) We recommend that CPB enforce grant terms and require ITVS to ensure production licensees provide discrete accounting for CPB grant funds and separately report CPB expenditures by including these requirements in sub-recipient grant agreements.

ITVS Response

ITVS believes its reporting requirements for producers and its review procedures provide reasonable assurance that ITVS monies are spent in accordance to the ITVS/CPB requirements. ITVS also asserts that Section VII of the ITVS/CPB agreement does not require producers to code individual transactions to individual income sources.

ITVS explained that it requires that producers have segregated accounting systems and bank accounts for each production. Periodic financial reports are submitted at each stage of delivery itemizing individual transaction details which add up to the total project funding, costs, and budget. All individual production costs are reviewed from the ITVS/producer contract date to ensure all ITVS funding is spent on valid costs. ITVS has been able to conduct successful and effective audits of its producers with the records required and believes other auditing entities could as well.

ITVS disagrees with the OIG interpretation of the ITVS Production Contract and believes the contract does not include language that requires ITVS to have its producers maintain their project accounting records at the individual transaction level by each funding source. Although ITVS can respect the OIG making a recommendation in regards to this issue for future contracts, ITVS believes this should not be noted as an area of non-compliance to the ITVS Production contract and should be removed as a finding from the report.

OIG Review and Comment

Based on ITVS' management comments we consider recommendation 6 unresolved pending CPB's management decision. Contrary to the ITVS response, the grant agreement does require producers to discretely account for CPB funds when it specified that producers' records must facilitate an effective audit. We do not agree that an effective audit can be performed unless producers segregate the expenses paid for with CPB grant funds. As a result, our position concerning this issue remains unchanged. However, we do agree that resolution of this issue can be applied to future producer contracts.

Restructuring Future Grant Agreements and Clarifying Terms

Based on our audit, we believe there are opportunities to streamline the ITVS grant agreements to facilitate better CPB oversight and provide more accountability over ITVS grant activities. Further, grant requirements need to be clarified so that CPB can more effectively manage its cash payments to ITVS. These actions will allow CPB to provide better oversight of unused grant funds, as well as, improve CPB's cash management practices.

More specifically, we found that separate annual operating and multi-year production grant agreements were difficult to oversee because of the complexities of tracking several active production grants over multiple fiscal years. To illustrate, in FY 2009 ITVS incurred $13.4 million in production expenses. A total of $11 million of this amount was expensed against the FY 2007 and 2008 CPB production grants; only $2.4 million was expensed against the $11.8 million CPB 2009 production grant. Further, the tracking of de-obligated funds from individual projects for expired production grant periods was not highlighted in the information reported to CPB to identify funds that should be returned to CPB because the originating grant had expired.

Additionally, we found that ITVS maintained CPB cash balances in excess of its need to make quarterly production disbursements. While ITVS complied with grant requirements for requesting cash reimbursements, we estimated that ITVS held an average CPB quarterly cash balance of almost $5.7 million during FY 2009 and only made estimated quarterly payments to producers of $3.2 million, resulting in an estimated excess cash balance of $2.5 million over quarterly needs. In discussing this matter with CPB officials, we learned they had a different understanding of the grant cash reimbursement requirements than ITVS. CPB expected ITVS' reimbursement requests to more closely match its quarterly payments to production producers.

Finally, we identified that the grant agreement did not specify a timeframe for utilizing the interest ITVS earned on operations and production funds it received. The agreement did provide guidance for utilizing the interest earned on ancillary income.

Consolidating Operations and Production Grant Agreements

Based on our review the operations grants were easier to oversee than the production grants because they were one year grants and were closed annually. The multi-year production grants were more difficult to oversee, particularly to account for unused grant funds at the end of the 4-year production grant period, as well as, to ensure compliance with cash management requirements. Details concerning the Fiscal Year 2008 and 2009

Operations grants are shown on Exhibits B and C. Details for the Fiscal Year 2008 and 2009 Production grants are shown on Exhibits I and J.

Similar to other years, the CPB FY 2009 production grant had two major components; $7.5 million budgeted for production licensing to fund the contracts ITVS awarded to independent producers, and $4.3 million to fund production support and other associated support costs incurred by ITVS. To illustrate, the FY 2009 detailed budget follows:

FY 2009 Production Grant

Expense Categories	Budget
Production Licensing	$ 7,500,000
Production Support*	742,000
Business Affairs*	310,000
Programming Development*	918,000
Broadcast*	694,000
Outreach*	531,000
Promotion*	878,000
Web/New Media*	227,000
Total	***$11,800,000***

** ITVS internal Other Production Support costs totaling $4.3 million.*

The production grant terms allow ITVS up to four years to commit funds to third parties. Section II paragraph 1 of the current production grant states that, “No production funding will be provided to ITVS hereunder that is not committed by ITVS to a third party within three years of the fiscal year of the CPB grant to which such funding relates.” This provision provides ITVS four years to use a particular year’s funds, i.e., execute a contract with a producer or incur other expenses.

Managing and accounting for ITVS production grant activities requires significant project accounting beyond *generally accepted accounting principles* to address quarterly cash requests, project cost accounting needs, and overall accountability for the commitment of production grant funds over the 4-year grant term. With 91 active production agreements with independent producers at September 30, 2009, spanning 10 grant agreements dating back to 2000, the grant requirement to draw down funds based on new project commitments, track available funds from multiple active CPB production grants, and de-obligate unused funds from completed projects for expired grants requires extensive recordkeeping. This extensive grant accounting by grant year is required in addition to the sub-recipient accounting for budgetary compliance with their sub-agreement requirements.

Our analysis of FY 2009 activities found that ITVS expended $5.7 million for other production support activities, but only $2.4 million was expensed against the FY 2009 production grant. The balance of $3.3 million was expended against the unused funds remaining under the FY 2007 and 2008 production grants. Since other production support primarily covers expenses incurred by ITVS for such things as Business Affairs, Programming Development, Communications (Broadcast Outreach, Promotion, and Web), in our judgment these line items could be more effectively managed on an annual basis, as opposed to managing them over the 4-year production grant period. This would reduce the recordkeeping now required under the production grant.

Further analysis of the FY 2009 production grant found that none of the $7.5 million budgeted for production licensing was used during FY 2009 and $1.9 million in other production support funds also remained available to be used in future fiscal years. Additionally, on September 30, 2009, ITVS still had not spent $1.6 million of its FY 2008 production grant funds.

Aside from tracking the use of grant funds, our finding on *Returning De-Obligated Grant Funds* to CPB, further illustrates the need for better accountability over the commitment and de-obligation of funds over the four year life of production grants.

Clarifying Cash-on-Hand Requirements

Our review found that ITVS' average quarterly production cash-on-hand balance ($5.7 million) exceeded quarterly cash disbursements ($3.2 million) to independent producers in FY 2009. Specifically, we found ITVS' quarterly reported cash balances ranged from $1.7 to $5.6 million, for an average quarterly balance of $4.5 million. However, we also found that ITVS did not report $544,000 of interest earned on CPB grant funds, as well as, an estimated $50,000 of interest earned on CPB's share of $574,000 ancillary income received from completed productions. While ITVS requested cash reimbursement from CPB in accordance with the grant agreement language (generally accepted accounting practices and contract commitment language), CPB officials had a different understanding of these requirements and expected cash reimbursement requests to more closely align with quarterly cash disbursements made to independent producers.

ITVS Production Agreement – FYs 2008, 2009, 2010, Attachment C, Section 1b, states:

> Payment Request forms shall include ITVS' estimate of its cash flow needs to cover Production Licensing funding of independently produced programs based on actual projected contractual commitments for the last and next calendar quarters.

Section IV. Paragraph 6, <u>Actual Costs</u>, states:

> ITVS agrees that all funds provided by CPB to ITVS under this Agreement are provided on a cost-reimbursement basis only, and that ITVS shall charge CPB only actual costs incurred in performance of this Agreement . . . For purposes of clarification, CPB agrees that, in accordance with generally accepted accounting practices, ITVS may request reimbursement for one hundred percent (100%) of the cost associated with fully executed grants for Production Licensing (as defined in the total Production Budget) so long as ITVS' current assets exceed their current liabilities at the time of payment request; <u>provided however</u>, if any monies advanced for Production Licensing, or any other category in the Total Production Budget, are subsequently determined not required to be paid for a particular program, those monies must be subtracted from the next ITVS payment request.

It appears that the language in these requirements caused confusion between CPB and ITVS. CPB personnel told us they believed ITVS was requesting reimbursements based on projected quarterly cash disbursements to producers, because the production grant required ITVS to *"true up"* each quarter to bring CPB grant payments to ITVS in line with ITVS payments to producers. While CPB agreed that some cash float was needed, they believed that ITVS was performing the *"true up",* i.e., reducing subsequent grant payment requests when payments to producers were less than the amount requested in the previous quarter. They further explained that this process was intended to bring CPB grant payments to ITVS in line with amounts ITVS paid to producers.

ITVS personnel explained that their payment requests reported accurate cash-on-hand balances. We found that except for not reporting interest earned on CPB funds, the balances ITVS reported were reasonably correct. ITVS also believed that its average cash balance of $4.5 million was reasonable given that ITVS receives quarterly payments from CPB. ITVS personnel also believe they complied with Paragraph 6. Section IV of the CPB ITVS Production Agreement provision which states: "For purposes of clarification, CPB agrees that, in accordance with generally accepted accounting practices, ITVS may request reimbursement for one hundred percent (100%) of the cost associated with fully executed grants for Production Licensing." ITVS personnel further explained that there is no indication in the grant agreement that there are "grant agreement terms to *"true up"* requests for reimbursement to match actual cash disbursements to producers" on a quarterly basis. For these reasons, ITVS personnel believed they complied with the grant agreement terms and that the unused funds and cash-on-hand balances were reasonable, as well as, allowable by its grant agreement with CPB.

The divergent viewpoints of CPB and ITVS personnel concerning: whether ITVS complied with existing grant agreement terms; what is a reasonable amount of cash-on-hand; and whether a *"true up"* was required demonstrates the ambiguities in the current grant agreement. Additionally, the amount of cash-on-hand and length of time that these funds were held before being disbursed to independent producers show that the current reimbursement mechanism was not effective when CPB's goal was to pay ITVS in alignment with projected quarterly ITVS cash disbursements to independent producers.

We found based on the productions completed over the past two fiscal years, productions can take an average of almost 3 years to complete. During FY 2009, ITVS executed contracts or contract amendments with producers, valued at $7.7 million, and ITVS requested reimbursement for these funds. ITVS will hold these funds until they are paid to independent producers in installments over the multiple year life of their sub-recipient agreements. ITVS records show that commitments made to producers as far back as 2003 still have not been fully paid. Clarifying the CPB reimbursement requirements will allow CPB to better manage its own cash and invest it for CPB purposes, as opposed to allowing ITVS to invest it.

Establishing a Timeframe for Using Interest Income

The FY 2008-2010 operations and production grant agreements did not specify a timeframe for using interest income earned by ITVS on the CPB grant funds it held as cash-on-hand. As of September 30, 2009, ITVS had earned $544,000 of interest from CPB operations and production grant funds and about $50,000 of interest earned by investing CPB's share of ancillary income.[3] In total, ITVS had earned $594,000 in interest income on CPB funds. ITVS had not expended any of this interest that it had been accumulating since 2002.

[3] CPB's share of ancillary income totaled about $574,000.

The production grant agreement Section IV, paragraph 7 establishes that interest or investment income earned on all CPB funds held by ITVS may be utilized for program production, but not for administration. While Section V, paragraph 10b of the production grant agreement provides that CPB's share of ancillary income must be utilized within 15 years, neither the production nor the operations grants specify a timeframe for using the interest earned on CPB grant funds held by ITVS. ITVS personnel were aware of the requirement for expending the interest earned on ancillary income, and had plans for doing so in order to comply with the grant agreement terms. However, because there is no current requirement for using interest earned on grant funds, ITVS had not formulated plans for using this income. Without a specified timeframe for using these funds, ITVS has held the interest earned, instead of using it to fund new productions.

Recommendations

We recommend that CPB management:

7) Revise future grants to require production support budget line items, Production Support, Business Affairs, Programming, and Communications (Broadcast, Outreach, Promotion, and Web) to be funded on an annual basis, similar to the operations grant. Payments for production support activities can also be reimbursed similar to the operations grant in 3 to 4 payments based on the yearly budget and actual expenditures incurred for that grant year.

8) Clarify production grant reimbursement language to require ITVS to only request CPB reimbursements to meet quarterly cash disbursement needs to pay production licensees and not base reimbursement requests on contractual commitments.

9) Ensure future production and operation agreements specify a time period for using interest earned on CPB operations and production grant funds held by ITVS.

ITVS Response

ITVS' response separately addressed cash balances and interest income, as follows:

<u>CPB Cash Balances</u>

The OIG reports states in several areas that for FY 2009 the average CPB cash balance ITVS held is $5.7 million. This average is based on four month end of quarter cash balances for the year. An average cash balance calculated using 12 month end cash balances is more accurate and equals $3.45 million. If the balance of CPB's share of

Ancillary Income ($574,000) and Interest on CPB funds ($544,000) is added to the average CPB cash on hand, the average cash balance would be equal to $4.6 million, which is a full $1.1 million below the OIG reported average cash balance used in several comments. This is an overstatement of the average cash balance by 24%.

ITVS spent on average $1.1 million of cash per month during the past three years. $4.6 million would equal four months and one week of CPB cash on hand. This amount appears to be a reasonable average cash balance given that ITVS receives payments from CPB on a quarterly basis.

Interest on CPB Funds

As of September 30, 2009, interest on CPB funds amounted to $543,911. As noted earlier, ITVS strongly disagrees that the ITVS/CPB Contract requires ITVS to accrue interest on CPB's share of Ancillary Income. For the sake of discussion, if interest earned on Ancillary Income since 2002 were to be calculated, interest on Ancillary Income would equal $7,076 as of 9/30/09 and not $70,000 as reported by the OIG.

The related calculation, if it were required, would relate only to interest earned on CPB's share of Ancillary Income generated by programs funded by the FY2002 to FY2009 contracts (and not the entire CPB share of Ancillary Income earned in those related fiscal years). Ancillary Income earned from programs funded by ITVS/CPB Production Agreements prior to FY2002 would not be subject to the "Interest on Funds" clause since no such clause existed in contracts prior to FY2002. No amendments relating to interest due on CPB funds have been made to earlier contracts between ITVS and CPB.

In regard to recommendations regarding restructuring future grant agreements with CPB, ITVS looks forward to evaluating these recommendations and other ideas with CPB's contracting team to determine what would be the most mutually beneficial and practical agreements for both ITVS and CPB.

OIG Review and Comment

Based on ITVS' response we consider recommendations 7, 8, and 9 unresolved pending CPB's management decision.

We calculated the $5.7 million average quarterly balance in our report using the cash-on-hand balances ITVS reported to CPB with its quarterly payment requests. This is the amount CPB requested that ITVS report. ITVS' calculation of an average yearly amount is noted, as is its assertion that a $4.6 million cash on hand balance is reasonable. We do not agree that our report overstated ITVS' cash on hand balance or that a $4.6 million average balance is reasonable as ITVS indicated, given that the new production agreement will provide average cash balances of far less than either $5.7 million or $4.6 million.

ITVS' response correctly indicated that interest should be calculated starting in 2002 and not 1994. As a result, we revised our report to show that CPB's share of ancillary income was $50,000 versus $70,000. Additionally, we disagree with ITVS' contention that ancillary income should be calculated only for shows funded from 2002 forward. The CPB/ITVS agreement states that CPB is entitled to a share of ancillary income and that interest shall be reported on ***all CPB Funds.***

Recommendation 9 is the responsibility of CPB management to address during audit resolution.

Exhibit A

SCOPE AND METHODOLOGY

We conducted our audit of ITVS in accordance with *Government Auditing Standards* (GAS) for financial audits to determine the accuracy of costs reported to CPB, and to assess whether ITVS spent grant funds in accordance with CPB grant agreement terms, as well as, complied with applicable provisions of the Public Broadcasting Act. We performed our audit field work during the period July through November 2010.

The scope of the audit included tests of the costs claimed by ITVS on active CPB grants during the period October 1, 2007 – September 30, 2009. The grants audited included the production and operations grants, the Securing Digital Rights and Readying ITVS Programs for Multiplatform Distribution grant, the Securing Digital Rights II grant, My Source (PAI) Training and Marketing Services grant, and the My Source (PAI) Community Impact Demo Testimonials Using Independent Producers grant. Final and interim reports submitted to CPB as of September 30, 2008 and September 30, 2009 are provided in Exhibits B through N.

In conducting our audit, we reviewed CPB's grant files and discussed the award and administration of the grants with CPB officials from the Office of Business Affairs and the Office of Television Content. At ITVS, we discussed the agreements with financial, production, and management officials. We also reconciled the financial data maintained by ITVS in its accounting records for each project to the expenses it reported to CPB. We tested the accuracy of grant expenditures that ITVS claimed by performing financial reconciliations and comparisons to underlying accounting records and the audited financial statements to verify transactions recorded in the general ledger and reported to CPB on payment requests. We also evaluated compliance with the grant agreement terms, in part, by testing a judgmental sample of 105 expenditures for the grants reviewed, valued at almost $2,275,033, against supporting documentation maintained by ITVS. The transactions tested included a variety of expenditure types such as, payroll, travel, producer contracts, and consulting fees made during FYs 2008 through 2009.

We also reviewed documentation of ITVS' compliance with the applicable provisions of the Public Broadcasting Act. Specifically, we reviewed ITVS' public inspection files to verify that it contained all the information required by the Act.

To assist in our audit planning and assure ourselves that we could rely on the work performed by ITVS' independent public accountant (IPA), we met with representatives of the firm that conducted ITVS' financial statement audit. We reviewed their tests of internal controls and their fraud risk assessment analysis. We also reviewed their test work on the accuracy of ITVS' audited financial statements.

In accordance with *Government Auditing Standards* we gained an understanding of internal controls over the presentation of the grant reports, cash receipts, and payments authorizations to plan our substantive testing. Further, to obtain reasonable assurance that financial reports submitted to CPB were free of material misstatement, we performed tests of compliance with certain provisions of laws and grant agreement requirements, when noncompliance could have a direct and material effect on the grant report amounts.

Exhibit B

INDEPENDENT TELEVISION SERVICE, INC.
Report to the Corporation for Public Broadcasting
Operations FY 2008 Final Financial Report
For the 12 Months Ending 9/30/2008

	CPB FY 2008 Budget	Operations Actual	Budget Difference	Percentage Difference
Revenue:				
CPB Operations Grant	$967,784	$967,784	0	0
Total Revenue	**$967,784**	**$967,784**	**0**	**0**
Expenses:				
Salaries, Taxes & Benefits	$675,000	$681,601	($6,601)	(1.0)
Accounting & Audit Fees	23,000	23,086	(86)	(0.4)
Conferences, Meetings & Special Events	53,500	57,889	(4,389)	(8.2)
Equipment Costs	16,000	16,657	(657)	(4.1)
Insurance – General, D&O, E&O	10,500	12,993	(2,493)	(23.7)
Office	29,784	27,497	2,287	7.7
Office Lease & Other Space Costs	82,000	70,253	11,747	14.3
Online Services	21,000	14,810	6,190	29.5
Outreach Activities	4,000	6,415	(2,415)	(60.4)
Postage/FedEx/UPS	4,000	4,808	(808)	(20.2)
Printing	1,000	1,521	(521)	(52.1)
Professional Services	21,000	23,569	(2,569)	(12.2)
Telephone/Fax	11,000	9,713	1,287	11.7
Travel	16,000	16,972	(972)	(6.1)
Total Expenses	**$967,784**	**$967,784**	**$0**	**0%**

Exhibit C

INDEPENDENT TELEVISION SERVICE, INC.
Report to the Corporation for Public Broadcasting
Operations FY 2009 Final Financial Report
For the 12 Months Ending 9/30/2009

	CPB FY 2009 Budget	Operations Actual	Budget Difference	Percentage Difference
Revenue:				
CPB Operations Grant	$967,784	$967,784	0	0
Total Revenue	**$967,784**	**$967,784**	**0**	**0**
Expenses:				
Salaries, Taxes & Benefits	$664,000	$667,107	($3,107)	(0.5)
Accounting & Audit Fees	23,000	21,426	1,574	6.8
Conferences, Meetings & Special Events	61,000	56,495	4,505	7.4
Equipment Costs	16,000	16,632	(632)	(4.0)
Insurance – General, D&O, E&O	11,000	8,018	2,982	27.1
Office	21,684	22,665	(981)	(4.5)
Office Lease & Other Space Costs	94,000	95,845	(1,845)	(2.0)
Outreach Activities	8,500	7,696	804	9.5
Postage/FedEx/UPS	4,500	5,285	(785)	(17.4)
Printing	500	2,111	(1,611)	(322.2)
Professional Services	19,100	18,532	568	3.0
Telephone/Fax	9,000	9,812	(812)	(9.0)
Travel	35,500	36,160	(660)	(1.9)
Total Expenses	**$967,784**	**$967,784**	**$0**	**0%**

Exhibit D

INDEPENDENT TELEVISION SERVICE, INC
Annual Fiscal Year Report for the 12 Month Period Ending 9/30/2008
FY 2006 Production

FY 2006 Production Funds	Budget	CPB Amount Disbursed in Prior Years	CPB Amount Disbursed in Current Year	CPB Total Disbursed to Date	ITVS Amount Committed in Prior Years	Correction to Prior Year Ending Balance	ITVS Amount Committed in Current Year	ITVS Total Committed to Date
Production Licensing	$7,200,000	$3,602,564	$3,371,436	$6,974,000	$5,143,456	$0	$2,056,544	$7,200,000
Production Support	967,000	743,002	223,998	967,000	830,328		136,672	967,000
Business Affairs	860,000	660,825	199,175	860,000	932,692	(72,692)	0	860,000
Broadcast and Communications	2,000,000	2,000,000	0	2,000,000	2,000,000		0	2,000,000
Programming Development	273,000	231,000	42,000	273,000	273,000		0	273,000
Total:	**$11,300,000**	**$7,237,391**	**$3,836,609**	**$11,074,000**	**$9,179,476**	**($72,692)**	**$2,193,216**	**$11,300,000**

Budget Funds Remaining to be Spent as of 9/30/2008 (Budget less ITVS Total Committed to Date) $0

Budget Funds Remaining to be Disbursed by CPB as of 9/30/2008 (Budget less CPB Total Disbursed to Date) $226,000

* Expenses shown in prior year report should have been capped at $860,000. Amount spent in excess of the budget, $72,692, represents expenditures of FY 2007 Programming Funds and are shown there in the FY 2007 Fund report.

Exhibit E

INDEPENDENT TELEVISION SERVICE, INC
Annual Fiscal Year Report for the 12 Month Period Ending 9/30/2008
FY 2007 Production

FY 2007 Production Funds	Budget	CPB Amount Disbursed in Prior Years	CPB Amount Disbursed in Current Year	CPB Total Disbursed to Date	ITVS Amount Committed in Prior Years	Correction to Prior Year Ending Balance	ITVS Amount Committed in Current Year	ITVS Total Committed to Date
Production Licensing	$7,500,000	$1,180,000	$2,229,564	$3,409,564	$0	$0	$5,717,269	$5,717,269
Production Support	968,000	0	572,002	572,002	0		813,602	813,602
Business Affairs	883,000	0	666,825	666,825	0	72,692	810,308	883,000
Broadcast and Communications	2,289,000	780,831	1,508,169	2,289,000	1,021,789		1,267,211	2,289,000
Programming Development	160,000	0	160,000	160,000	26,615		133,385	160,000
Total	**$11,800,000**	**$1,960,831**	**$5,136,560**	**$7,097,391**	**$1,048,404**	**$72,692**	**$8,741,775**	**$9,862,871**

Budget Funds Remaining to be Spent as of 9/30/2008 (Budget less ITVS Total Committed to Date) $1,937,129

Budget Funds Remaining to be Disbursed by CPB as of 9/30/2008 (Budget less CPB Total Disbursed to Date) $4,702,609

* Expenses shown in prior year report should have been capped at $860,000. Amount spent in excess of the budget, $72,692, represents expenditures of FY 2007 Programming Funds and are shown there in the FY 2007 Fund report.

Exhibit F

INDEPENDENT TELEVISION SERVICE, INC
Annual Fiscal Year Report for the 12 Month Period Ending 9/30/2008
FY 2008 Production

FY 2008 Production Funds	Budget	CPB Amount Disbursed in Prior Years	CPB Amount Disbursed in Current Year	CPB Total Disbursed to Date	ITVS Amount Committed in Prior Years	ITVS Amount Committed in Current Year	ITVS Total Committed to Date
Production Licensing	$7,500,000	$0	$1,180,000	$1,180,000	$0	$0	$0
Production Support	827,000	0	0	0	0	0	0
Business Affairs	310,000	0	28,000	28,000	0	74,687	74,687
Programming Development	905,000	0	0	0	0	67,417	67,417
Broadcast	623,000	0	160,000	160,000	0	321,089	321,089
Outreach	717,000	0	155,000	155,000	0	322,781	322,781
Promotion	524,000	0	167,831	167,831	0	254,608	254,608
Web/New Media	394,000	0	150,000	150,000	0	140,368	140,368
Total:	**$11,800,000**	**$0**	**$1,840,831**	**$1,840,831**	**$0**	**$1,180,950**	**$1,180,950**

Budget Funds Remaining to be Spent as of 9/30/2008 (Budget less ITVS Total Committed to Date) $10,619,050

Budget Funds Remaining to be Disbursed by CPB as of 9/30/2008 (Budget less CPB Total Disbursed to Date) $9,959,169

Exhibit G

INDEPENDENT TELEVISION SERVICE, INC
Annual Fiscal Year Report for the 12 Month Period Ending 9/30/2009
FY 2006 Production

FY 2006 Production Funds	Budget	CPB Amount Disbursed in Prior Years	CPB Amount Disbursed in Current Year	CPB Total Disbursed to Date	ITVS Amount Committed in Prior Years	ITVS Amount Committed in Current Year	ITVS Total Committed to Date
Production Licensing	$7,200,000	$6,974,000	$226,000	$7,200,000	$7,200,000	$0	$7,200,000
Production Support	967,000	967,000	0	967,000	967,000	0	967,000
Business Affairs	860,000	860,000	0	860,000	860,000	0	860,000
Broadcast and Communications	2,000,000	2,000,000	0	2,000,000	2,000,000	0	2,000,000
Programming Development	273,000	273,000	0	273,000	273,000	0	273,000
Total:	**$11,300,000**	**$11,074,000**	**$226,000**	**$11,300,000**	**$11,300,000**	**$0**	**$11,300,000**

Budget Funds Remaining to be Spent as of 9/30/2009 (Budget less ITVS Total Committed to Date) $0

Budget Funds Remaining to be Disbursed by CPB as of 9/30/2009 (Budget less CPB Total Disbursed to Date) $0

Exhibit H

INDEPENDENT TELEVISION SERVICE, INC
Annual Fiscal Year Report for the 12 Month Period Ending 9/30/2009
FY 2007 Production

FY 2007 Production Funds	Budget	CPB Amount Disbursed in Prior Years	CPB Amount Disbursed in Current Year	CPB Total Disbursed to Date	ITVS Amount Committed in Prior Years	ITVS Amount Committed in Current Year	ITVS Total Committed to Date
Production Licensing	$7,500,000	$3,409,564	$3,854,436	$7,264,000	$5,717,269	$1,782,731	$7,500,000
Production Support	968,000	572,002	395,998	968,000	813,602	154,398	968,000
Business Affairs	883,000	666,825	216,175	883,000	883,000	0	883,000
Broadcast and Communications	2,289,000	2,289,000	0	2,289,000	2,289,000	0	2,289,000
Programming Development	160,000	160,000	0	160,000	160,000	0	160,000
Total:	**$11,800,000**	**$7,097,391**	**$4,466,609**	**$11,564,000**	**$9,862,871**	**$1,937,129**	**$11,800,000**

Budget Funds Remaining to be Spent as of 9/30/2009 (Budget less ITVS Total Committed to Date) $0

Budget Funds Remaining to be Disbursed by CPB as of 9/30/2009 (Budget less CPB Total Disbursed to Date) $236,000

Exhibit I

INDEPENDENT TELEVISION SERVICE, INC
Annual Fiscal Year Report for the 12 Month Period Ending 9/30/2009
FY 2008 Production Funds

FY 2008 Production Funds	Budget	CPB Amount Disbursed in Prior Years	CPB Amount Disbursed in Current Year	CPB Total Disbursed to Date	ITVS Amount Committed in Prior Years	ITVS Amount Committed in Current Year	ITVS Total Committed to Date
Production Licensing	$7,500,000	$1,180,000	$2,596,564	$3,776,564	$0	$5,922,543	$5,922,543
Production Support	827,000	0	827,000	827,000	0	827,000	827,000
Business Affairs	310,000	28,000	282,000	310,000	74,687	235,313	310,000
Programming Development	905,000	0	905,000	905,000	67,417	837,583	905,000
Broadcast	623,000	160,000	463,000	623,000	321,089	301,911	623,000
Outreach	717,000	155,000	562,000	717,000	322,781	394,219	717,000
Promotion	524,000	167,831	356,169	524,000	254,608	269,392	524,000
Web/New Media	394,000	150,000	244,000	394,000	140,368	253,632	394,000
Total:	**$11,800,000**	**$1,840,831**	**$6,235,733**	**$8,076,564**	**$1,180,950**	**$9,041,593**	**$10,222,543**

Budget Funds Remaining to be Spent as of 9/30/2009 (Budget less ITVS Total Committed to Date) $1,577,457

Budget Funds Remaining to be Disbursed by CPB as of 9/30/2009 (Budget less CPB Total Disbursed to Date) $3,723,436

Exhibit J

INDEPENDENT TELEVISION SERVICE, INC
Annual Fiscal Year Report for the 12 Month Period Ending 9/30/2009
FY 2009 Production

FY 2009 Production Funds	Budget	CPB Amount Disbursed in Prior Years	CPB Amount Disbursed in Current Year	CPB Total Disbursed to Date	ITVS Amount Committed in Prior Years	ITVS Amount Committed in Current Year	ITVS Total Committed to Date
Production Licensing	$7,500,000	$0	$1,180,000	$1,180,000	$0	$0	$0
Production Support	742,000	0	157,002	157,002	0	124,119	124,119
Business Affairs	310,000	0	99,000	99,000	0	148,319	148,319
Programming Development	918,000	0	318,825	318,825	0	503,566	503,566
Broadcast	694,000	0	582,000	582,000	0	560,338	560,338
Outreach	531,000	0	307,000	307,000	0	517,340	517,340
Promotion	878,000	0	278,831	278,831	0	416,826	416,826
Web/New Media	227,000	0	54,000	54,000	0	163,849	163,849
Total:	**$11,800,000**	**$0**	**$2,976,658**	**$2,976,658**	**$0**	**$2,434,357**	**$2,434,357**

Budget Funds Remaining to be Spent as of 9/30/2009 (Budget less ITVS Total Committed to Date) $9,365,643

Budget Funds Remaining to be Disbursed by CPB as of 9/30/2009 (Budget less CPB Total Disbursed to Date) $8,823,342

Exhibit K

INDEPENDENT TELEVISION SERVICE, INC.
Report to the Corporation for Public Broadcasting
Securing Digital Rights and Readying ITVS Programs for Multiplatform Distribution
For the Period 6/1/07 – 9/30/08

	Original Budget	Actual to Date
Rights Acquisition:		
Personnel:		
Director of Digital Initiatives	$90,000	$36,885
Technical Coordinator	70,000	86,723
Benefits	30,000	27,322
	$190,000	*$150,930*
Program Fees:		
Producer License Fees and Clearances	*$320,000*	*$338,333*
Production, Post Production:		
Producer	$50,000	$73,361
Technical Consultants, Contractors	80,000	80,241
Compression and Output:		
Tape Stock	20,000	16,310
Offline Edit Suite	30,000	31,527
Digitization of Media	40,000	43,228
Technical Evaluation	20,000	16,070
	$240,000	*$260,737*
Total	***$750,000***	***$750,000***

Exhibit L

INDEPENDENT TELEVISION SERVICE, INC.
Budget Phase II
Securing Digital Rights and Readying Programs for Multiplatform Distribution
Final Report for the Period
10/1/08 – 9/30/09

	Budget	Previously Reported Expenses	Current Period Expenses	Total Grant Expenses
Digital Assets Management & Rights Acquisition:				
Personnel:				
Director of Digital Initiatives	$71,000	$39,808	$0	$39,808
Digital Producer	62,000	41,076	30,450	71,526
Digital Coordinator	40,000	16,829	22,115	38,944
	$173,000	*$97,713*	*$52,565*	*$150,278*
Benefits	38,000	20,583	11,565	32,148
Total Personnel	*$211,000*	*$118,296*	*$64,130*	*$182,426*
Producer License Fees:	$340,000	$294,582	$9,973	$304,555
Technical Consultants/Contractors:				
Digitization, Digital Asset Management and Business Rights Management Activities	100,000	165,510	5,579	171,089
Digital Assets Management & Rights Acquisition	**$651,000**	**$578,388**	**$79,682**	**$658,070**
Production & Post Production:				
Production Elements:				
Editing, Reversioning, Tape Stock, Dubbing, Close Captioning, Packaging	$99,000	$76,909	$15,021	$91,930
Production & Post Production	**99,000**	**76,909**	**15,021**	**91,930**
Total	***$750,000***	***$655,297***	***$94,703***	***$750,000***
Total Funds Remaining:				$0

Exhibit M

INDEPENDENT TELEVISION SERVICE, INC.
My Source (PAI) Training & Marketing
Report as of 9/30/2008

	Original Budget	Actual to Date
Revenues:		
CPB Grant	$64,775	$64,775
Expenses:		
Salaries:		
Project Director	$12,000	
Outreach and Publicity Staff	9,000	
Production Staff	5,000	
Executive Administration	5,000	
Benefits (at 20%)	6,200	
Total Salaries and Benefits	*$37,200*	*$52,395*
Contractor Services	$13,000	$1,525
Travel:		
Round Trip Airfare	$3,900	
Ground Transportation	1,200	
Hotel	3,575	
Per Diem	900	
Total Travel	*$9,575*	*$2,832*
Administrative Expenses and Tech Support	5,000	8,118
Total Project Costs	**$64,775**	**$64,870**

** The OIG prepared this schedule using the ITVS FY 2008 trial balance because this was a fixed fee grant agreement and CPB did not require ITVS to submit a final financial report.*

Exhibit N

INDEPENDENT TELEVISION SERVICE, INC.
My Source (PAI) Community Impact Demo
Report as of 9/30/2009

	Original Budget	Actual to Date
Revenues:		
CPB Grant	$120,000	$120,000
Expenses:		
ITVS Salaries:		
Production Staff	$35,000	
Benefits (at 20%)	7,000	
Total Salaries and Benefits	*$42,000*	*$31,681*
Travel:		
Round Trip Airfare	$4,800	
Ground Transportation	1,200	
Hotel	2,000	
Per Diem	480	
Total Travel	*$8,480*	*$8,565*
Production:		
Independent Producer Stipends	$10,000	
Camera Package and Shooter	10,400	
Sound Person	4,000	
Location Costs	600	
Tapes and Materials	2,500	
Total Production	*$27,500*	*$38,798*
Post Production:		
Editor	$10,500	
Graphics	13,520	
Sound Mix	5,000	
Edit Suite	9,000	
Tape Stock	2,500	
Music	1,500	
Total Post Production	*$42,020*	*$41,150*
Total Project Costs	***$120,000***	***$120,194***

** The OIG prepared this schedule using the ITVS FY 2008-2009 trial balances because this was a fixed fee grant agreement and CPB did not require ITVS to submit a final financial report.*

Exhibit O

INDEPENDENT TELEVISION SERVICE, INC
Productions with De-obligations and Re-obligations
During FYs 2008 and 2009 after the 4-year Grant Term Expired

Productions	Production Grant Funds Originally Used	Amount	Year Funds Expired	Amount Re-obligated
1 Absolutely Safe*	2004	$196,000	2007	$110,000
2 Cushion the Fall*	1997	15,000	2000	1,500
3 Death of a Shaman*	2001	74,000	2004	7,260
4 Mai's America*	1998	211,543	2001	2,254
5 New Cop on the Beat*	1996	226,404	1999	19,476
6 The Split Horn*	1999	132,864	2002	3,364
7 Turned Out*	2002	281,000	2005	11,484
8 Chisholm for President '72	2002	290,800	2005	5,938
9 Country Boys	2004	746,908	2007	47,865
10 Every Mother's Son	2000	253,921	2003	10,229
11 Flag Wars	2001	295,121	2004	3,554
12 Foto-Novelas: Season II	2001	817,461	2004	40,876
13 Freedom Machines	2002	200,000	2005	8,377
14 Get the Fire! Young Mormon	2000	262,547	2003	11,128
15 King Kamehameha I: A Legacy	2000	75,000	2003	6,609
16 Mirror Dance	2003	235,000	2006	10,947
17 This Far by Faith	2002	250,000	2005	7,783
Total FY 2009 Re-obligations				***$308,644***
1 Alcatraz is Not an Island	2000	97,855	2003	$22
2 Hiding and Seeking	2000	267,344	2003	443
3 Na Kamalei: The Men of Hula	2003	202,000	2006	1,039
4 One Night at the Grand Star	2000	128,987	2003	1,665
5 A Panther in Africa	2002	86,000	2005	771
6 Recalling Orange County	2003	192,975	2006	566
7 Sun River Homestead	1998	24,629	2001	20
8 Taking the Heat	2001	237,571	2004	1,120
9 A Wok-in-Progress	1997	$215,220	2000	199
Total FY 2008 Re-obligations				***$5,845***
Total FY 2008 and 2009				**$314,489**

**Re-obligations total $155,338 for these 7 productions, which were used as an example on page 9 .*

Exhibit P

INDEPENDENT TELEVISION SERVICE, INC
FY 2009 Operations Grant
Comparison of Budget to Actual

Expense Category	Budget	Expenses Reported to CPB	Actual Expenses (General Ledger)	Variances: Budget vs. Actual	Variances: Percent
Salaries, Taxes, and Benefits	$664,000	$667,107	$668,671	$4,671	1
Accounting & Audit Fees	23,000	21,426	21,426	(1,574)	(7)
Conferences & Special Events	61,000	56,495	56,495	(4,505)	(7)
Equipment	16,000	16,632	24,132	8,132	51
Insurance	11,000	8,018	8,010	(2,990)	(27)
Office	21,684	22,665	23,765	2,081	10
Office Lease	94,000	95,845	108,845	14,845	16
Outreach Activities	8,500	7,696	7,696	(804)	(9)
Postage/FedEx/UPS	4,500	5,285	8,285	3,785	84
Printing	500	2,111	3,737	3,237	647
Professional Services	19,100	18,532	39,814	20,714	108
Telephone/Fax	9,000	9,812	9,812	812	9
Travel	35,500	36,160	55,660	20,160	57
Totals	**$967,784**	**$967,784**	**$1,036,349**	**$68,565**	7

Exhibit Q

March 16, 2011

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

Re: Audit of CPB Grants Awarded to Independent Television Service, Inc. for the Period October 1, 2007–September 30, 2009, Audit Report No. APT1002

Dear Mr. Richardson,

I have enclosed ITVS's response to the draft audit report referenced above.

Of the four findings of non-compliance to contract requirements in your report, ITVS agrees with one finding. We believe the remaining three findings originate from fundamental differences in the interpretation of the ITVS/CPB contract. Indeed, several of these findings run counter to interpretations, and therefore practices, which have been agreed upon by ITVS and CPB through multiple administrations at both organizations.

Therefore, ITVS believes that, rather than citing non-compliance and recommending the return of approximately $314,000—an amount already spent on independent documentary production licensing agreements—the report should instead recommend changes and/or greater clarity in the language of future agreements.

ITVS greatly appreciates the funding it receives from CPB. Thank you for the consideration you and your team have extended to ITVS during the audit.

Sincerely,

Michael Shiro
Controller

Enclosure

cc: Sally Jo Fifer, President and CEO
Judy Tam, Executive Vice President and CFO

Exhibit Q

Date: March 14, 2011

To: Kenneth A. Konz, Inspector General
William J. Richardson III, Deputy Inspector General

From: Michael Shiro, Controller, ITVS

cc: Sally Jo Fifer, President, ITVS
Judy Tam, Executive Vice President, CFO, ITVS

As with any written agreement between two parties, the ITVS/CPB Production and Operations contracts are subject to interpretation. ITVS believes that it has correctly interpreted the contract between itself and CPB in the most accurate and reasonable way possible based on the contract language, actual communications between CPB and ITVS, and generally accepted accounting principles. ITVS has confirmed these interpretations over an extended period of time when necessary with appropriate CPB staff.

In regard to the four items of noncompliance listed in the OIG's opinion, ITVS disagrees with the following:

- Questioned costs of $314,489 related to not returning funds de-obligated from CPB grants that had lapsed.
- The amount of unreported interest income totaling $614,000.
- Reporting variances between operations grant budgets and actual expenditures.
- Requiring producers to discretely account for CPB grant funds.

In regard to the OIG'S recommendations on restructuring of future grant agreements, ITVS would like to correct certain analyses presented by the OIG in their report so that readers have the most accurate information when considering the recommendations put forth.

De-obligated Funds

ITVS believes that it was in compliance with its agreement with CPB concerning under budget independently produced television programming contracts. When a program is completed by a third party producer below budget, any funds not spent or returned by producers to ITVS are credited against the next ITVS quarterly payment request to CPB. At the same time the amount of Production Licensing expenses in ITVS' accounting records is reduced as was understood by ITVS and CPB staff and as defined in Section IV paragraph 7 of the "ITVS Production Agreement:"

"...if any monies advanced for Production Licensing, or any other category in the Total Production Budget, are subsequently determined not required to be paid for a particular program, those monies must be subtracted from the next ITVS payment request."

Nowhere in the "ITVS Production Agreement:" is the term "de-obligation" used or is this concept addressed in other than the above paragraph. Being that ITVS complied with this paragraph ITVS feels that the OIG recommendation goes too far in calling for ITVS to return these funds, especially since these funds were again used for the intended purpose of funding independent film production.

ITVS disagrees with the OIG characterization of "not returning de-obligated funds as providing additional funding" to ITVS as these funds were part of an annual contract to ITVS and not an amount in addition to the total ITVS contract amount.

Furthermore, if ITVS were to have returned these under budget amounts to CPB as suggested, the following quarter's payment request having been reduced by a credit for these under budget shows would now be increased by the same amount since the credit would no longer exist. Therefore, any monies returned to CPB would be offset by a subsequent payment request of increased amount due to the absence of these under budget credits.

Also in regard to the OIG's comment that "ITVS did not de-obligate these funds in a timely manner" the OIG makes no mention of the fact that many of the related shows are not identified and contracted until the 2nd or 3rd year of the four year grant term and not the year the underlying grant originated as listed in the table on page 8 of the OIG Report titled, "FY2009 Fourth Quarter Credits for Expired Grants." This would leave only one to two years to complete a new show without creating a re-obligation problem for under budget programs.

Rather than ask ITVS to return the under budget funds which have already been committed to new programs and which would compel ITVS to respond by increasing their next payment request to cover the productions that would thereby not have been paid for by CPB because of the corresponding elimination of credits which reduced the previous payment requests, the OIG might recommend that future ITVS/CPB contracts include a clear statement regarding a time limit on the use of funds related to programs completed under budget.

ITVS would further recommend that such a time limit on the use of under budget contracted funds begin at the point when a contract is completed, not at the beginning of the fiscal year to which the underlying CPB contract relates.

For example, when a show is completed under budget, upon the date of final acceptance and closing of the show, ITVS would have one year, to re-obligate the under budget funds to a new production contract. When this show is completed, if under budget, there will be another one year period available to commit this new under budget amount to a new production contract.

This allows the under budget money to be spent for its intended purpose within a reasonable time period from when the under budget production is closed rather than within the four year CPB contract period.

Reporting Interest Earned from Cash on Hand

Although ITVS maintained proper accounting records for this requirement, ITVS acknowledges it did not submit an annual report summarizing interest earned on CPB funds.

All ITVS Production and Operations Funding final reports submitted to date were accepted and final payments were made to ITVS indicating acceptance of the closing of the related contracts without a request by CPB for an interest report.

The submission of the reports or lack thereof did not relate to any interest payments being due or payable to CPB. Therefore, the failure to submit these reports did not result in the misuse or underpayment to CPB of any funds due or the overpayment of funds to ITVS.

Reporting Interest Earned from Ancillary Income

ITVS believes the correct interpretation of the CPB/ITVS Production Agreements in regard to interest on ancillary income (income from the distribution of ITVS-funded programs) is as follows:

Section V. Rights, paragraph 10.b. of the ITVS Production Agreement 2008-2010 states:

"Each Program Producer shall pay the ITVS/CPB Share to ITVS on an annual basis not later than November 15 of each year, covering the previous twelve-month period and such subsequent years as necessary until ITVS and CPB have received all sums to which they are due; provided, however, that ITVS shall not be required to make any payment to CPB of CPB's portion of the ITVS/CPB Share derived from the first $250,000 of Shared Net Proceeds from the exercise of each Subsidiary or Ancillary Right if within fifteen years from the date of execution of this agreement (the Retention Period) the Retained CPB Share has been contractually committed to or expended for Direct Production Costs of Programs to be initially distributed on public television. Any portion of the Retained CPB Share that ITVS has not contractually committed to or expended for Direct Production Costs by the end of the Retention Period (15 years from the date of the ITVS/CPB contract execution date) shall be immediately paid to CPB with interest compounded annually at the Retention Rate from the first day of the next calendar quarter following the date of receipt by ITVS to the date of payment to CPB."

ITVS believes the correct interpretation of the above paragraph is that no interest is due or calculated on CPB's share of Ancillary Income unless that income is not spent within 15 years on program production. If this condition occurs, then ITVS must pay the income plus interest calculated from the time the ancillary income was received. Furthermore, the above paragraph 10.b. specifies that the amount required to be spent within the 15-year period on Direct Production Costs is the "Retained CPB Share" of ancillary income, not the Retained CPB Share plus interest accrued.

Beginning in the "ITVS Funding Agreement FYs 2002, 2003, 2004" a new clause, "Interest on Funds," at Section IV, Payments Reports, and Records, paragraph 11 (and in Section, IV, paragraph 7 of the ITVS Production Agreement – FY 2008, 2009, 20010) requires interest to be calculated "on all CPB Funds" held by ITVS.

The use of the wording in the above referenced paragraph "on all CPB Funds" is a critical distinction in regard to the issue of whether interest on CPB's share of ancillary income need be calculated and reported prior to holding this income for 15 years as noted above.

"CPB Funds," is capitalized in this section IV, paragraph 7, which indicates by legal convention that this term is defined elsewhere in the contract. Although, no definition is found for "CPB Funds," in the Appendix under "Definitions," ITVS believes the intent of the meaning exists in a definition for the term "CPB Funding" which reads, "CPB Funding" means all or any part of the Total Production Grant or the Total Operations Grant which is applied by ITVS to the Project or any Program pursuant to this Agreement."

Section III, paragraph 2(a) defines the "Total Production Grant" as the amount of the production expenses set forth in the annual total production budget (the annual grant amount). The same definition exists for the "Total Operations Grant" in Section III, paragraph 1 of the ITVS Operations Agreement – FYs 2008, 2009, 2010.

These definitions had remained consistent in each of the ITVS/CPB Production and Operations agreements from FY2002 through FY2010. Therefore, it is reasonable for ITVS to interpret "CPB Funds" as referring not to all money received or held for CPB, including income derived from distribution of programs, and interest on such funds, and instead to interpret "CPB Funds" as meaning the narrower category of "CPB Funding" – *i.e.*, monies given by CPB up to the total amounts granted to ITVS from CPB under the Operations and Production agreements since FY2002, not including income subsequently earned from the distribution of ITVS programs, even if a portion of this income could become due to CPB after 15 years. Had CPB intended to apply the interest reporting requirement to a broader category of CPB funding, including interest on CPB's share of net proceeds, it would have done so by precisely defining the calculation to apply to such sums, particularly considering that CPB's right to the CPB share does not fully vest until after the 15th year and only if such funds excluding interest (the "retained CPB Share") were not committed to program production.

ITVS believes the OIG has misinterpreted the ITVS/CPB contract language and all references to interest due on ancillary income should be removed from the OIG report. ITVS respects the OIG's concern regarding interest calculated on all CPB funds, and believes it would be valid to make a recommendation for future versions of the ITVS/CPB Production agreement to require interest to be accrued on CPB's share of ancillary income.

Reporting Grant Variances - CPB Operations Budget

ITVS strongly disagrees with the following OIG statements:

- "There were variances that ITVS did not report."
- "There were budget reallocations that required approval."
- "ITVS financial reports did not meaningfully report actual expenses to CPB."
- "ITVS did not report Actual Expenses."

In Section IV. Payments, Reports and Records of the "ITVS Operations Contract 2008-2010" paragraph 6, the contract states, "ITVS agrees that all funds provided by CPB to ITVS under this Agreement are provided on a cost-reimbursement basis only, and that ITVS shall charge CPB only actual costs incurred in performance of this Agreement, up to the amounts reflected in the Total Operations Budget." The Total Operations Budget equals the total amount of CPB funding specified in the contract. Therefore it would be reasonable to assume that in regard to a budget based solely on funding from CPB, that actual expenses compared to this budget in a financial report should consist only of expenses "up to the amounts reflected in the Total Operations Budget."

ITVS throughout its history has had operations costs funded by sources other than CPB funds. The OIG report suggests ITVS should have included not only expenses funded by CPB up to the total Operations budget amount but also other non-CPB-funded operations expenses which were never intended to be covered by the CPB Operations Budget.

If the intent of both parties was to report all Operations Costs regardless of funding source, this would have required a different budget which included not only CPB-funded operations expenditures but all operations costs regardless of funding source.

ITVS has consistently reported only CPB funded-Operations Expenses against the CPB funded Operations Budget in this manner for the past 15 years without CPB grant administrators requesting otherwise or expressing any difference in interpretation. Using the old adage of apples and oranges, with apples being CPB Operating expenses and oranges being operating expenses funded by other sources, the CPB Operations Contract is a budget for apples and the OIG asks ITVS to report how much ITVS spent on apples and oranges and compare those amounts to a budget made for only apples and then further deduces that ITVS was not in compliance with its CPB contract because it did not request approval to spend more than the budget for apples. If the intent of the parties, were to show all Operations costs regardless of funding sources, the contract budget should include amounts for both apples and oranges, not just apples.

Expenses exceeding the CPB Operations Budget were paid for by ITVS with its own funds or funding from other sources. ITVS reasonably assumed these non-CPB funded costs would not be meaningful to CPB since it did not fund these expenses and were outside of the Total Operations Budget or the "Project" as defined in the contract.

The CPB Operations Budget was never intended to be a budget of ITVS' total Operations costs, but only of the Operations costs funded by the CPB grant. Evidence for this can be seen on each of ITVS' board-approved, organization-wide fiscal year budgets which show additional operating expenses funded by non-CPB funds. Over the years ITVS has provided financial statements to CPB on a quarterly and annual basis which showed the total costs of operations from all sources, hence ITVS has always made available to CPB its full cost of operations and production.

ITVS believes this finding is based on a misinterpretation of the contract language and should be removed from the OIG report.

<u>Reporting Grant Variances - Operations Budget to Actual Variances</u>

From FY2002 to FY2007 Production and Operation contracts were combined and existed in two three year agreements. The FY2008-FY2010 ITVS Operations Contract became a separate agreement from the Production contract. As is common in the first year of a major change in a contract document, there were several typographical errors. Unfortunately one of these errors was in "Section III. Budget and CPB Funding," paragraph 3 which was a new requirement not present in previous contracts and states the following:

"ITVS shall not make any increase or decrease in the Total Operations Budget without prior written CPB approval. ITVS may make discretionary budget reallocations within the Expense line items up to 10% or $5,000 of each line item of the Total Operations budget without prior CPB approval; however, explanation of material variances must be provided."

The error in the above paragraph was that the discretionary budget reallocation threshold should have been written as "10% <u>and</u> $5,000" of each budget line item. The difference is significant. Several line items on the FY08 Operations budget presented in the OIG report ranged from $1,000 to $4,000. With the typographical error, ITVS would have been required to request budget reallocations for $100 to $400 variances from the budget which would not have been reasonable given $100 equals 100th of 1% of the Operation grant funds. With the corrected language, ITVS did not have to request a budget reallocation unless the variance was greater than $5,000. The final sentence in the above quoted paragraph indicates the intent of budget reallocation requirements was to capture "material" or significant variances. Certainly, variances of less than $5,000 cannot be considered material when $5,000 equals less than half of 1% of the $967,000 Operations grant.

The correction of this language was discussed in an e-mail to CPB dated January 22, 2009. An amendment to the contract was discussed but not deemed necessary by CPB. That the language should read "10% and $5,000" and that the grant would be administered as if it was written as so was agreed upon by both ITVS and CPB.

The closing FY08 and FY09 Operations reports were prepared with this understanding which resulted in none of the variances requiring explanations. The fact that CPB did not ask for any explanations in the acceptance of these reports indicates there was agreement on the treatment of the error in the contract.

ITVS believes the OIG finding is based on a typographical error in the contract and should be removed from the OIG report.

Discrete Accounting Needed for Producers

ITVS believes that its reporting requirements of producers and its review procedures provide reasonable assurance that the ITVS monies are spent in accordance to the ITVS/CPB production agreement and program production budgets.

Section VII of the ITVS/CPB agreement requires that records be obtained "to fully disclose: (i) the total cost of the program funded and/or acquired pursuant to this agreement; (ii) the CPB funding; (iii) the amount and nature of that portion of Program costs supplied by other sources, if any; and (iv) such other records as will facilitate an effective audit." This language does not require ITVS to ask producers to code individual transactions in their accounting systems to individual income sources.

ITVS requires that producers have segregated accounting systems and bank accounts for each production they may be working on. Periodic financial reports are submitted at each stage of delivery of contract requirements itemizing individual transaction details which add up to the total project funding, costs, and budget. All individual production costs are reviewed from the ITVS/producer contract date to ensure all ITVS funding is spent on valid costs of production. Any under budget savings are returned to ITVS or withheld from final payment. ITVS has been able to conduct successful and effective audits of its producers with the records required and believes other auditing entities could as well.

ITVS disagrees with the OIG interpretation of the ITVS Production Contract and believes the contract does not include language that requires ITVS to have its producers maintain their project accounting records at the individual transaction level by each funding source on a mandatory basis. Although ITVS can respect the OIG making a recommendation in regard to this issue for future contracts, ITVS believes this should not be noted as an area of non-compliance to the ITVS Production Contract and should be removed as a finding from the report.

Restructuring Future Grant Agreements and Clarifying Terms

Throughout this section of the OIG report there were errors in calculations. They are as follows:

CPB Cash Balances

The OIG reports states in several areas that for FY 2009 the average CPB cash balance ITVS held is $5.7 million. This average is based on four month end of quarter cash balances for the year. An average cash balance calculated using 12 month end cash balances is more accurate and equals $3.45 million. If the balance of CPB's share of Ancillary Income ($574,000) and Interest on CPB funds ($544,000) is added to the average CPB cash on hand, the average cash balance would be equal to $4.6 million, which is a full $1.1 million below the OIG reported average cash balance used in several comments. This is an overstatement of the average cash balance by 24%.

ITVS spent on average $1.1 million of cash per month during the past threee years. $4.6 million would equal four months and one week of CPB cash on hand. This amount appears to be a reasonable average cash balance given that ITVS receives payments from CPB on a quarterly basis.

Interest on CPB Funds Amounts

As of September 30, 2009 interest on CPB funds amounted to $543,911. As noted earlier, ITVS strongly disagrees that the ITVS/CPB Contract requires ITVS to accrue interest on CPB's share of Ancillary Income.

For the sake of discussion, if interest earned on Ancillary Income since 2002 were to be calculated, interest on Ancillary Income would equal $7,076 as of 9/30/09 and not $70,000 as reported by the OIG.

The related calculation, if it were required, would relate only to interest earned on CPB's share of Ancillary Income generated by programs funded by the FY2002 to FY2009 contracts (and not all of the CPB share of Ancillary Income earned in those related fiscal years). Ancillary Income earned from programs funded by ITVS/CPB Production Agreements prior to FY2002 would not be subject to the "Interest on Funds" clause since no such clause existed in contracts prior to FY2002. No amendments relating to interest due on CPB funds have been made to earlier contracts between ITVS and CPB.

Update to Use of Interest and Ancillary Income

As of fiscal year ending September 30, 2010, ITVS had spent $565,000 of the reported $573,623 of CPB's share of Ancillary Income.

As of fiscal year ending September 30, 2010, ITVS had spent $514,781 of the reported $543,911 of interest earned on CPB funds. In both cases, the Ancillary Income and interest income amounts were spent on new production licensing agreements to create new programming for public television.

Conclusion

In summary, ITVS believes that of the four non-compliance issues listed in the OIG report, only one finding, the failure to submit annual reports covering interest earned on CPB Production and Operations grant funds, should be considered valid. ITVS disagrees with the three remaining findings and related recommendations for the reasons given in this document.

In regard to recommendations regarding restructuring future grant agreements with CPB, ITVS looks forward to evaluating these recommendations and other ideas with CPB's contracting team to determine what would be the most mutually beneficial and practical agreements for both ITVS and CPB.