CORPORATION FOR PUBLIC BROADCASTING

OFFICE OF INSPECTOR GENERAL

EXAMINATION OF KQED, INC., SAN FRANCISCO, CALIFORNIA, COMMUNITY SERVICE AND OTHER SELECTED CPB GRANTS ACTIVE DURING THE PERIOD OCTOBER 1, 2011 – SEPTEMBER 30, 2013

REPORT NO. ASJ1403-1409

September 29, 2014

Corporation
for Public
Broadcasting

Office of Inspector General

Date: September 29, 2014

To: Jackie J. Livesay, Vice President, Compliance

cc: Ted Krichels, Senior Vice President, System Development and Media Strategies
Bruce Theriault, Senior Vice President, Journalism and Radio

From: Mary Mitchelson, Inspector General

Subject: Examination of KQED, Inc., San Francisco, California, Community Service and Other Selected CPB Grants Active During the Period October 1, 2011 – September 30, 2013, Report No. ASJ1403-1409

We have completed an examination of KQED Inc. (KQED) Corporation for Public Broadcasting (CPB) Community Service Grants (CSG) and another selected grant, active during the period October 1, 2011 – September 30, 2013.[1] The objectives were to examine KQED's certifications of compliance with CPB grant terms to: a) claim Non-Federal Financial Support (NFFS) on its Annual Financial Reports (AFR) in accordance with CPB Financial Reporting Guidelines (Guidelines); b) expend CSG funds in accordance with grant agreement requirements; and c) comply with the Certification of Eligibility (Eligibility) requirements and the statutory provisions of the Communications Act of 1934, as amended (the Act).

Based on our examination we found:

- over-stated NFFS of $2,147,411 which resulted in potential CSG overpayments of $197,360 ($134,512 in 2014 payments and estimated potential overpayments of $62,848 in 2015[2]) reported as funds put to better use;
- questionable production expenditures of $34,988 for noncompliance with grant terms; and
- noncompliance with the statutory provisions of the Act for open meetings, open financial records, and equal employment opportunity (EEO) documentation requirements.

We recommend CPB management take the following actions, as further detailed in our specific recommendations:

[1] We included the Quest Project, Account No. 13763, for the period October 1, 2010 – January 31, 2012, in our testing.
[2] We calculated this potential overpayment based on CPB's FY 2014 Incentive Rates of Return for TV and Radio because the FY 2015 Incentive Rates of Return were not calculated as of the report date, per Exhibit F.

- require KQED to submit revised Fiscal Years (FY) 2012 and 2013 AFRs, Schedules A and C, eliminating ineligible revenues of $2,147,411;
- recover $134,512 in excess CSG payments made to KQED in FY 2014 based on NFFS reported in FY 2012 and adjust the station's 2015 CSG based on NFFS reported in FY 2013 to eliminate an estimated $62,848 in potential FY 2015 overpayments;
- require KQED to identify the corrective actions and controls it will implement to ensure future compliance with NFFS Guidelines;
- provide policy guidance to stations for reporting third party fees for underwriting as NFFS revenues;
- recover $34,988 in questioned costs and ensure KQED complies with grant terms for future CPB funded projects; and
- require KQED to submit to CPB its new written policies that explain how the station complies with open meetings, open financial records, and EEO requirements of the Act to ensure the policies adequately meet CPB requirements.

In response to the draft report, KQED did not agree with our findings dealing with over-stated NFFS for underwriting third party fees, in-kind contributions, and membership premiums. However, KQED did agree with $714,000 of $922,109 in findings on over-stated NFFS for payments. KQED did not agree with our findings regarding questioned costs for budget reallocations and indirect costs but did agree with questioned payroll costs of $694. KQED agreed with our findings dealing with the requirements of the Communication Act and took corrective action. KQED's written response to the draft report is attached in Exhibit I. We did not include the exhibits and policies attached to KQED's written response because they were extensive. This additional information is available upon request from our office.

This report presents the conclusions of OIG and the findings reported do not necessarily represent CPB's final position on these issues. This report contains recommendations OIG believes would be appropriate to resolve these findings. CPB officials will make final determinations on the reported findings in accordance with established CPB audit resolution procedures. Based on KQED's response to the draft report, we consider recommendations 1(a-e) and 2(a-b) unresolved, and recommendation 3, related to Act written procedures, resolved but open, pending CPB's management decision resolving our recommendations.

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 examination in accordance with *Government Auditing Standards* for attestation engagements. Our scope and methodology is discussed in Exhibit H**.**

BACKGROUND

KQED's[3] website states its mission is to serve as a community-supported alternative to commercial media. KQED operates three public television stations ("KQED," "KQEH" also known as "KQED Plus," and "KQET") in San Francisco, San Jose and Monterey, and two public

[3] KQED is also known as KQED Public Media for Northern California.

radio stations ("KQED-FM" and "KQEI-FM") in San Francisco (88.5) and North Highlands (89.3). KQED also develops content and applications for digital platforms and mobile devices and distributes its content and services via KQED.org and KQED Education, as well as other digital and mobile media technology.

KQED's website highlights its history, identifies its various stations, presents its programming schedule, provides interactive content; and contains information about membership and benefits, station operations, and upcoming events and meetings. Some highlights include:

- KQED TV went on the air in 1954 and currently produces local and national programs collaborating with filmmakers and documentary producers. KQED Public Television 9 has over 1.5 million household viewers and its digital television channels include KQED 9, KQED Plus, KQED Life, KQED World, KQED Kids and KQED V-me. KQED broadcasts programs from PBS, APT, and other distributors along with its own local programs.

- KQED Public Radio was founded in 1969 and reaches over 745,000 listeners providing information and entertainment composed of locally produced programs, as well as productions by National Public Radio, Public Radio International and the BBC.

CPB awards annual CSG grants to public television and radio stations based on the amount of NFFS claimed by all stations on their AFRs. The CSG calculation process starts with separate amounts appropriated for the television and radio CSG pools, adjusted by the amount of the base grants. The TV CSG pool is also adjusted by distance and local service grants and the Radio CSG pool is adjusted by rural support grants. The funds that remain are called the Incentive Grant Pools, one is for television and the other is for radio. The Incentive Rate of Return (IRR) is calculated by dividing the Incentive Grant Pools by the total weighted amount of NFFS claimed by all television/radio stations eligible to receive incentive grants. The IRR is then multiplied by the station's reported NFFS to calculate the incentive award amount of the station's total CSG. There is a two-year lag between the reported NFFS and CPB's calculation of the FY's CSG amount. For example, CPB used the NFFS claimed by KQED on its FY 2010 AFR to determine the amount of the CSG the station received in FY 2012.

During our audit period KQED received $9,783,011 from CPB for various grants as itemized in Exhibit A. KQED reported NFFS of $56,502,861 in FY 2012 and $58,478,318 in FY 2013 per Exhibit D. KQED's audited financial statements for the two FYs reported revenues of $73,688,455 in FY 2012 and $74,647,052 in FY 2013. KQED's FY begins October 1 and ends on September 30.

In addition to providing the CSG funds to KQED, CPB funded other project grants; we included one production agreement for the Quest Project (QUEST) in our testing, Exhibit E. QUEST was designed to work with six public media station partners ("Hub Stations") to create a new operational infrastructure and business model for affordability expanding the production of QUEST, a science, technology, engineering and math news program, including building new educational content and tools for students and audiences across the country.

RESULTS OF REVIEW

In our opinion, except for the noncompliance issues described below, KQED has complied with the requirements for the FY 2012 and 2013 TV and radio CSGs (Exhibits B and C) and the QUEST project (Exhibit E).

We examined KQED's management's assertions of compliance with CPB grant requirements: a) CSG Certification of Eligibility; b) CSG Legal Agreement; c) AFR Signature Page; and d) Certification of Final Financial Accounting for the QUEST project. The CSG Certification of Eligibility includes KQED's compliance with AFR/NFFS reporting in accordance with CPB's Financial Reporting Guidelines; Communication Act requirements for open meetings, open financial records, Community Advisory Board, EEO reporting, and donor lists; and discrete accounting requirements. Management is responsible for compliance with those requirements. Our responsibility is to express an opinion on management's assertions about its compliance based on our examination.

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

Our examination disclosed the following issues of noncompliance with NFFS financial reporting requirements, CPB grant agreement requirements, and Communications Act requirements:

- over-stated NFFS of $2,147,411 which resulted in potential CSG overpayments of $197,360 ($134,512 in 2014 payments and an estimated potential overpayment of $62,848 in 2015)[4] reported as funds put to better use;
- questioned production costs of $34,988 for noncompliance with grants terms; and
- noncompliance with open meetings, open financial records, and EEO documentation requirements.

FINDINGS AND RECOMMENDATIONS

OVER-STATED NFFS

Our audit found $2,147,411 in over-stated NFFS on KQED's FYs 2012 and 2013 AFRs as presented in the following table and detailed in Exhibit F. As a result, CPB may make CSG estimated overpayments of $197,360 to KQED ($134,512 overpaid in FY 2014 and an estimated CSG overpayment of $62,848 in FY 2015). We classified this amount as funds put to better use for reporting purposes because the funds overpaid to KQED could have been distributed to other public broadcasting entities.

[4] See footnote 2.

Over-Stated NFFS

Ineligible NFFS Categories	FY 2012 NFFS	FY 2013 NFFS	Total NFFS	Potential CSG Overpayment[5]
Payments	$752,109	$170,000	$922,109	$110,164
Underwriting third party fees	551,400	563,711	1,115,111	76,375
In-kind trades	56,874	32,540	89,414	8,934
Membership premiums	0	20,777	20,777	1,887
Total	**$1,360,383**	**$787,028**	**$2,147,411**	**$197,360**

KQED management indicated that revenues from ineligible payment sources and some in-kind trades were due to oversights in preparation of the AFRs and misinterpretations of the Guidelines. However, station officials did not concur that some in-kind trades, underwriting third party fees, and membership premiums were ineligible as NFFS.

Further discussion of our findings is presented below.

Payments Reported as NFFS

KQED reported payments of $922,109[6] that did not meet the source criteria for NFFS, i.e. received from state/local government or educational institution, as follows:

- $714,276 in presenting station fee payments;
- $117,038 in contract revenue payments; and
- $ 90,795 in miscellaneous income for fees and reimbursement payments.

The station provided presenting station services to both public broadcasting entities (PBE's) and independent producers to package and deliver programs into the national public television distribution system. In exchange the station receives fees for these services. It also produced programs and provided other services and educational material for government, PBE's, CPB, educational institutions, foundations, and businesses. KQED classified the fees received for these services as either contract services or production revenue. Additionally, KQED received fees resulting from bad debt recovery, miscellaneous other services provided, sales of premiums to staff, various refunds, or reimbursements as other miscellaneous income.

Presenting Station Fees are defined as exchange transactions in CPB's Application of Principles of Accounting and Financial Reporting to Public Telecommunications Entities, May 2005 Edition (Principles). This guidance discusses a contribution versus an exchange transaction (payment).

[5] Exhibit F shows the detail calculation for TV and radio for each year and IRR.
[6] KQED received $3,231,986 for these categories of payments; all but the questioned $922,109 were properly recorded on its AFRs.

> A public broadcasting entity sometimes charges an independent program producer for introducing a program into distribution among public broadcasters by acting, for example as the "presenting station" in the PBS National Program Service.
>
> …the fee that is received or retained for introducing the program into public broadcasting distribution represents an exchange transaction, and not a contribution.

Principles, Section 3.3.

Further CPB Guidelines differentiate the criteria for each revenue form (contribution or a payment) and its eligibility as NFFS and define eligible source criteria for each.

> NFFS begins with revenues reported in the financial statements, but not all revenue is NFFS…in terms of NFFS criteria, revenue is divided into two distinct categories: contributions and payments. With the exception of the recipient criteria (see Sec. 2.3), the criteria for contributions are not the same as the criteria for payments. A contribution is an unconditional transfer of cash or other assets or settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer from one entity to another… A **payment,** on the other hand, is a reciprocal transfer (i.e., an exchange transaction) of cash or other assets in which each party receives and sacrifices approximately equal value.

Guidelines, Section 2.2.

> The universe of eligible sources for contributions is relatively large: any source except the federal government or another public broadcasting entity, while the universe of eligible sources for payments in exchange transactions is relatively small: only eligible sources are state and local governments and educational institutions. Educational institutions are defined as degree-granting institutions.

Guidelines, Section 2.3.2.

Because the presenting station fees, contract revenues, and miscellaneous income from fees are payments and the payments were not received from eligible sources, the payments are ineligible as NFFS.

KQED did not interpret CPB Guidelines to include presenting station fees as payments and therefore did not apply the source criteria to determine eligibility for NFFS when preparing the AFRs. As a result, KQED erroneously claimed the fees as NFFS in FYs 2012 and 2013. Station officials agreed that the contract revenue and some of the miscellaneous fee payments are ineligible as NFFS. KQED informed us that some of the miscellaneous fees were bad debt recovery for underwriting contributions, and underwriting is eligible as NFFS. However, we did not concur, as some of the bad debt recovery was for payments, and we could not determine if the bad debt related to underwriting was previously deducted from NFFS. CPB revised the AFR reporting format in FY 2013 to clarify reporting that separately identifies fees for services that are ineligible as NFFS. KQED properly excluded those types of payments from NFFS in FY 2013.

Ineligible payments totaled $922,109 and will result in a CSG overpayment of $110,164 ($89,426 overpaid in FY 2014 and an estimated potential overpayment of $20,738 in FY 2015). See calculations in Exhibit F.

Underwriting Third Party Fees

Our review of underwriting contributions found KQED claimed $1,115,111 as NFFS for third party fees retained by National Public Media (NPM),[7] a for profit entity, to obtain donor underwriting contributions. Because the station did not receive the full value of the donations received by NPM or take constructive receipt of the $1,115,111 retained by NPM, these funds should not be eligible as NFFS, even though underwriting is a contribution and therefore eligible as NFFS.

The Guidelines provide criteria regarding eligible recipients for contributions.

> Generally, contributions or payments received in part or in whole by third parties for the benefit of the public broadcaster but for which the public broadcaster does not take constructive receipt will neither meet financial statement revenue recognition criteria nor NFFS criteria.

Guidelines, Section 2.3.2.

As background, KQED processes underwriting contributions in three different ways. It receives contributions directly from donors and recognizes the full amount of the donation as a contribution and as NFFS. It also receives contributions processed through ad agencies. The station recognizes the net amount received from the ad agency as a contribution and as NFFS after the ad agency deducts its fee (typically 15 percent). KQED's third method for receiving contributions is through NPM. NPM either contracts directly with an underwriter or with the underwriter's ad agency and then places a work order with KQED to air the underwriting credits. KQED recognizes as NFFS the gross amount of contributions processed by NPM, even though NPM retains its commission (15-20 percent) and remits only the net amount to KQED. This is in contrast to how KQED handles contributions from an ad agency where the fees paid to the ad agency are not recognized as revenue or NFFS. KQED expenses NPM commissions but not ad agency fees.

KQED entered into a National Radio Underwriting Agreement with NPM whereby the station appointed NPM as its exclusive national underwriting placement representative. As NPM's website notes, it is in the business to not only represent the station's underwriting inventory, but it also creates sponsorship packages to achieve the underwriter's national or regional presence by placing underwriting within local public media stations and the national network. Therefore, NPM's role is similar to that of an ad agency.

[7] NPM website states "National Public Media is a subsidiary of National Public Radio (NPR), owned in partnership with PBS and WGBH, the largest producer in public television. We are a corporate sponsorship sales team for all NPR network stations, PBS stations and the digital assets of NPR and PBS."

The station treats NPM as an independent sales contractor representing the station's inventory of underwriting with the same access to the station's inventory as its internal account executives. KQED considers NPM commissions, which the station does not take receipt of, the same as commissions paid to its internal account executives on underwriting contributions collected and expensed as a cost of underwriting in its financial statements.[8]

The station set uniform "gross" pricing for underwriting prior to making deductions for ad agency fees and applied this pricing mechanism for the broadcast of credits to NPM donors, as well as to the station's direct donors. The station said it used generally accepted accounting principles (GAAP) accounting methods for recognizing gross revenues (net contributions) and believes it has fairly presented NFFS.

CPB's Guidelines do not specifically address ad agency or NPM fees under its guidance on third party recipient and constructive receipt of contributions, therefore the station has recorded revenue based on its interpretation of GAAP requirements.[9] CPB does provide guidance on handling auctions and other special events that similarly have direct costs associated with receiving the donor's contribution.[10] CPB's auction and special events guidelines require that the expenses incurred to receive these contributions be deducted from NFFS, no matter how they are treated for financial reporting purposes.

With the increasing collaboration efforts to promote public media (e.g., use of NPM), to ensure the consistent treatment of NPM and agency fees across the public broadcasting community, CPB should provide specific guidance for the treatment of NPM and ad agency fees, where the costs of these services are offset against contributions received by third parties consistent with the intent of CPB's Guidelines, Section 2.3.2.

The direct third party fees of $1,115,111 retained for underwriting but claimed as NFFS result in CSG overpayments of $76,375 ($39,152 overpaid in FY2014 and an estimated potential overpayment of $37,223 in FY 2015), as calculated in Exhibit F.

In-Kind Trades

In our examination of in-kind trades we found 3 transactions totaling $89,414 of 12 tested, were not eligible as NFFS because they were either exchange transactions,[11] policy exclusions, or unfulfilled trade amounts. In addition, two of the three transactions did not meet CPB's valuation or documentation requirements for in-kind contributions.

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[8] Internal Account Executives generally earn 4-6 percent commissions on underwriting whereas NPM commissions are 15-20 percent.

[9] Our audits of two other public broadcasting stations that used NPM services found that these stations treat NPM fees the same as ad agency fees and exclude the fees (direct third party costs) from revenue and NFFS.

[10] Guidelines AFR Line 14 special fundraising instructions state: "Only net special fundraising revenues (the gross special fundraising revenues less all direct, third-party expenses for the event) are eligible as NFFS."

[11] Guidelines, Section 2.2 defines an exchange transaction as a payment, a reciprocal transfer of cash or other assets in which each party receives and sacrifices approximately equal value. Section 2.5.2 provides additional guidance for advertising and underwriting determination for NFFS. Advertising is considered an exchange transaction not meeting criteria for payments and not eligible to be included as NFFS.

CPB's Guidelines exclude several types of trades from NFFS for policy reasons. These include:

> Promotional items - Donated promotional items such as tickets to performances… are not eligible as NFFS.
>
> Contributions in quid pro quo transactions – If the station exchanges something of value other than underwriting for an in-kind contribution, then the fair value of what the station gives the contributor must be deducted from the fair value of the contribution received to determine the NFFS value of the transaction. There is only NFFS value in the transaction if the fair value of the contribution received by the station is greater than the fair value of any goods or service the station gives in return to the donor.

Guidelines, Section 2.4.2.

We found that KQED entered into trade agreements with donors that provided local advertising, tickets, dining passes, or other goods and services in exchange for underwriting credit. More specifically, the tickets and the quid pro quo web advertising transactions are both excluded from NFFS for policy reasons and were not eligible to be reported as NFFS.

The Guidelines also stipulate valuation and documentation requirements for eligible in-kind donations. These include:

> . . . the donor's usual and customary fees charged to a paying customer for equivalent goods and services must serve as the basis for determining fair value. . . .

Guidelines, Section 2.6.3.

> . . . the Grantee records the fair value of the in-kind contribution received based on the donor's/sponsor's valuation, NOT based on a value from a "rate card" to the underwriting spots acknowledging the donor's in-kind contribution . . . .

Guidelines, Section 2.6.6.

> Trade underwriting agreements or contracts do not satisfy CPB's documentation requirements for in-kind contributions claimed as NFFS. A trade underwriting agreement is a promise to give that confirms only the intent to trade an in-kind contribution; it does not demonstrate that an in-kind contribution was actually received by the station. Instead, Grantees need to secure and retain documentation from the underwriter that is tantamount to a receipt for the goods or services it received and claimed as NFFS. In order to satisfy CPB's documentation requirement the documentation must originate from the donor and it must contain the following elements:
>
> - A description of the goods or services donated
> - The date(s) of the donation
> - The value of the donated goods or services and the method of valuation (e.g., lawyer's hourly rate x hours worked)

- Explicit statement of the donors intent to donate or trade the goods or services
- Signature, name and title of the donor or donor's representative.

Guidelines, Section 2.6.4.

To illustrate, one $50,000 trade agreement ($42,500 claimed as NFFS)[12] for local advertising and merchandise and/or services included tickets and gallery passes (i.e., VIP guests or to be used as promotional giveaways), items which are excluded from NFFS for policy reasons. Additionally, the trade agreement did not provide specific donor valuation for the tickets, passes, or other services donated as required by CPB's Guidelines. Further, KQED did not receive documentation from the donor acknowledging the fulfilment of the trade agreement.

KQED officials did not agree that the trade should be excluded from NFFS because the donor provided other services besides the tickets, e.g., printing KQED's logo on the back of tickets along with other ads on posters, banners, newsletters, playbills, brochures, other printed materials, and websites. Station officials subsequently provided the donor's valuation, which included $5,300 for tickets and passes; however, the valuation was for the FY 2013 trade agreement and not the FY 2012 trade revenue we questioned. At the time of our draft audit, KQED indicated it is in the process of getting fulfilment documentation to support this trade. KQED did however exclude a similar trade from NFFS in FY 2013 after receiving guidance from CPB.

In another in-kind trade received for local advertising, we questioned $32,540 in FY 2013 NFFS for the exchange transaction portion of the trade. The donor received quid pro quo benefits for on-line web advertisements on KQED's website. KQED typically excludes donations for on-line web advertisements from NFFS. In FY 2013 the station misinterpreted the Guidelines and did not exclude the questioned exchange portion of the trade from NFFS as it had done in prior years.

Finally, in the third trade we questioned $14,374 in FY 2012 NFFS for a donor's unfulfilled trades. KQED recognized NFFS based on KQED's rates and underwriting aired. The donor did not complete all of the trade and the trade receivable was written off at FY 2012 year end. Therefore, the station recognized the in-kind value of the trade at its rates as NFFS but did not receive any donated value for the unfulfilled trade.

Station officials said they did not see anything in CPB's Guidelines that excluded the unused trade from NFFS reporting. Since KQED aired all the underwriting credits per the trade agreement KQED asserted the unfulfilled trade is an expense and the total value of the trade agreement should be eligible as NFFS. We disagree because KQED did not actually receive that contribution.

The ineligible in-kind contributions transactions totaled $89,414, resulting in CSG overpayments of $8,934 ($5,935 in FY 2014 overpayments and an estimated potential overpayment of $2,999 in FY 2015), as calculated in Exhibit F.

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[12] KQED properly excluded $7,500 from NFFS for its on-line web advertising as the exchange portion of the trade.

Membership Premiums

Our review of station board minutes and accounting records identified $20,777 in membership benefits claimed as NFFS. Membership benefits included invitations to events such as performances, dinners and luncheons. These events are in essence a "Thank-You" gift or premium cost of membership. KQED did not deduct these event costs from contributions claimed as NFFS. The Guidelines provide instructions for reporting membership contributions and excluding high end premiums that are not of insubstantial value from NFFS.

> Grantees frequently provide "thank you gifts" (a.k.a "premiums") in exchange for membership contributions…Thank you gifts may be anything of value from low-end premiums…to high-end premiums (e.g. boxed set CDs…gourmet foods and wine, tickets to performances, dinners or other events).

Guidelines, AFR Instructions line 10.1.

The IRS describes these as quid pro quo contributions (i.e., premiums), and CPB follows IRS criteria for quid pro quo contributions. CPB requires premiums that are not of insubstantial value must be excluded from NFFS.

The station held an event on May 2, 2013 and invited 200 Signal Society and 60 Producer's Circle level members (major donors). The cost of the event was $20,777. The station's website states "To thank you for supporting our mission, Signal Society and Producer's Circle donors receive enhanced benefits." Included in these benefits were "invitations to Signal Society-only special events… and receptions with public media personalities." Additionally, Producer's Circle donors receive the same benefits as Signal Society donors benefits, including "invitations to intimate events with public media personalities…"

KQED considered this event as stewardship of major donor members to inform them of current and future content at KQED and not a "thank you gift, premium or fundraising event." Accordingly, it did not provide donors with quid pro quo amounts for tax purposes or exclude it from NFFS. Station officials stated there was no way to put an individual value on these events as it may invite a certain number of donors, but only some show up, therefore it could not determine an individual quid pro quo amount to give to the donor. Additionally, the station said these donors were invited to several events throughout the year and they may or may not attend and are not required to attend, nor is KQED obligated to give them anything.

We concluded the Guidelines require the costs of this event be excluded. The $20,777 in event costs overstated membership donations resulting in an estimated potential FY 2015 CSG overpayment of $1,887, per Exhibit F.

Recommendations

1) We recommend CPB management take the following actions:

   a) Require KQED to submit revised AFRs eliminating ineligible revenues for Fiscal Years 2012 and 2013;

   b) Recover $134,512 in excess CSG payments made to KQED based on the FY 2012 reported NFFS;

   c) Reduce FY 2015 CSG payments based on the revised FY 2013 AFR and recover the potential overpayment estimated as $62,848;

   d) Require KQED to identify the corrective actions and controls it will implement to ensure future compliance with NFFS Guidelines; and

   e) Provide policy guidance to stations for reporting third party (NPM and ad agency) fees as NFFS revenues.

KQED Response

Payments Reported as NFFS

In response to our draft audit, KQED acknowledged that it did not correctly report $714,000 of presenting station fee payments in FYs 2012 and 2013 based on its clearer understanding of CPB's Principles of Accounting that were not specifically addressed in CPB's Guidelines. The station is revising its internal procedures for AFR reporting so this error does not happen again. For the over-stated $117,038 in contract revenue payments, KQED said it interpreted CPB Guidelines for treatment of service contract revenues consistently, but CPB's revision of the AFR in 2013 clarified that fees for services were ineligible as NFFS, and KQED properly excluded them in 2013.

Underwriting Third Party Fees

Station officials disagreed with the proposed adjustment of $1.1 million in NPM commissions. KQED stated that CPB provided no guidance on the treatment of underwriting placement fees and therefore it recorded the underwriting revenue placed by NPM and the related commission expense based on the economic substance of the transaction in compliance with GAAP. The station cited FASB guidance for principal agent consideration for recognizing revenue and applied this guidance for the NPM transactions and reported the gross revenues. KQED management further stated that NPM is an independent contractor who acts as KQED's representative, similar to its internal account executives that sell KQED underwriting inventory and are eligible for commissions. KQED reports the gross internal underwriting sales and expenses the commissions paid to its internal account executives. KQED did the same for NPM. It recognized the contributions processed by NPM as revenues and expensed the commissions paid for its services.

KQED officials stated that constructive receipt was not applicable as the economic substance of the transaction was adhered to in its treatment of the commission expense. Further, KQED stated that it could change its contract with NPM and have NPM remit the total underwriting it received from the donor to KQED. KQED would then pay NPM its commission. As a result, the economic substance would not change; the total contributions received are revenues and the commissions are expenses.

In-Kind Trades

KQED management did not agree with two of the three proposed in-kind trade NFFS adjustments totaling $89,414. The station said that the first trade was for $50,000 ($42,500 claimed as NFFS) included both eligible and ineligible donated amounts, and requested that the NFFS adjustment be revised to include only $17,500 as the ineligible portion. Additionally, KQED stated that it had omitted $29,000 in eligible NFFS for the trade with the same donor in 2013 and requested CPB to now accept it as eligible.

KQED agreed with the second NFFS adjustment for $32,540 in over-stated NFFS and stated it was due to an oversight in reporting. Finally for the third trade, KQED reiterated that it did not agree with the audit adjustment related to the $14,374 of unfilled trades. KQED said CPB did not provide policy guidance for unfilled trades and said by airing the underwriting credits it was entitled to the trade revenue.

Membership Premiums

Management did not agree with the $20,777 NFFS adjustment for membership premiums and reiterated that the amount in question should not be considered a thank you gift because the primary purpose of the event was to keep major donors informed about the station's programming and services and to meet and greet staff. Further, it stated that there was no fair value that could be assessed to the donor at the time of the contribution and could not be considered an exchange transaction i.e., no quid pro quo.

OIG Review and Comment

Based on KQED's response we consider recommendations 1(a-d) unresolved pending CPB's management decision. Our evaluation of KQED's response by finding type is presented below. Recommendation 1(e) was directed to CPB management and is unresolved pending CPB's management decision.

Payments Reported as NFFS

KQED acknowledged that CPB's FY 2013 AFR guidance clarified that fee for services were ineligible as NFFS and presenting station fees were also ineligible per CPB's Principles of Accounting. KQED's response did not address the $90,795 in over-stated miscellaneous income for fees and reimbursement payments. As a result, our finding totaling $922,109 in over-stated NFFS for payments remains unchanged.

Underwriting Third Party Fees

We acknowledge KQED's position regarding FASB and GAAP financial statement reporting, however, that does not change our position on interpreting CPB's guidance to exclude third party direct costs from NFFS. We also acknowledge that NPM was representing KQED in soliciting underwriting contributions, and the treatment of commissions on those contributions is not specifically addressed in CPB Guidelines for inclusion as NFFS. The Guidelines do provide a definition of eligible recipients that includes contributions received by third parties for the benefit of the public broadcasters. This definition states that public broadcasters cannot claim as NFFS contributions received by third parties when the station does not take "constructive receipt" of the funds received by the third party. Constructive receipt is not further defined in the context of NFFS in the Guidelines.

CPB's guidance on third party recipients and the constructive receipt of funds remitted to the station by third parties needs to be clarified. CPB's more specific guidance on auctions and special events require all third party direct costs associated with the auction or special event be excluded from NFFS no matter how it is treated in the financial statements. In contrast, the third party recipient guidance under Section 2.3.2 is less specific and has led to varying interpretations. We have found in two other audits that stations are excluding the commissions paid and retained by NPM from station revenues and in the subsequent NFFS reporting. The lack of specificity in CPB's guidance to address the direct costs of third party fundraising by NPM and ad agencies has contributed to this inconsistency. Because KQED reported NPM's gross underwriting receipts as NFFS, without deducting the direct costs associated with the fundraising (NPM fees), as required in CPB's similar third party guidance on auctions and special events, we find that NPM fees should have been excluded from KQED's NFFS. Therefore, we have not changed the $1,115,111 in questionable NFFS for third party recipient fees.

In-Kind Trades

Regarding KQED's response to unqualified in-kind trades, we agree with KQED's response for the first trade of $42,500 that $17,500 of the trade would be eligible for NFFS, if we received documentation of the fulfillment of that trade as required by CPB guidance, i.e., a letter from the donor on its letterhead acknowledging the donation and valuation. We did receive copies of KQED's website showing sponsorship of the donor's 2013 event, but nothing directly from the donor and nothing for events in 2012. In addition, although the station subsequently provided a breakout of the donated trade to allow for eligible and ineligible donated valuation, it was for 2013 and 2014. The $42,500 in overstated NFFS was for 2012.

For the second trade, KQED agreed that NFFS was over-stated by $32,540. For the third trade, we do not agree that the $14,374 unfilled trade was eligible as NFFS. As stated previously, CPB Guidelines value the donated trade as the fair value received not the value of the stations rate card for credits aired. Since KQED did not receive all the trade advertisements per the agreement and subsequently wrote off the receivable, it did not receive a donation that was eligible for NFFS. As a result, our finding on over-stated in-kind trade NFFS of $89,414 remains unchanged.

Membership Premiums

Regarding membership premiums, based on our review of board minutes, corresponding expenses for the event identified in our finding above, and KQED's website describing benefits associated with the level of membership of those invited to this event, we concluded that there was a fair value benefit received by the attending members. We also note that under GAAP, KQED would be required to assess the benefit the donor receives related to KQED's various levels of membership donations, including assessing the fair value received for the fair value returned in order to determine whether these transactions are contributions, exchanges, or a combination of both. Further, NFFS Guidelines require that benefits of more than an insubstantial value be considered premiums or thank you gifts and are not eligible as NFFS. As a result, we did not change our finding on questionable membership premiums of $20,777.

QUESTIONED COSTS

Our review of the QUEST production grant identified questioned costs of $109,340. We questioned these items due to a lack of compliance with grant requirements as discussed further below. CPB's portion totaled $34,988 per Exhibit G. Specifically, we found:

- $66,788 (2.2 percent) in budget category reallocations that were not approved by CPB in writing. CPB's portion totaled $21,372.
- $40,382 in indirect costs charged that were not allowable because "third party" sub-recipients' direct costs were included in the base used to calculate indirect cost charges. CPB's portion totaled $12,922
- $2,170 ($1,887 in payroll and $283 related overhead costs) that was not a QUEST project cost. CPB portion totaled $694.

Budget Reallocations

Our comparison of the budget to actual expenditures found that KQED did not receive written approval from CPB for budget reallocations or variances over $5,000 or 25 percent of a single budget category. Further, KQED did not report on all budget variances in accordance with grant terms.

The grantee committed to the obligations and requirements in the grant, and in the Terms and Conditions for Television, Radio and Other Media Production Grants (Terms and Conditions). This commitment included complying with budget and financial reporting requirements, including the requirement that changes to the budget be approved for some reallocations and the form of financial reports to be submitted to CPB.

> Changes to the Budget. Once a Budget has been approved… the Grantee may make reallocations among Budget line items or categories (except those covering "above the line" salaries, equipment, and general administrative/overhead expenses) without CPB's approval so long as no such reallocation involves an increase or decrease in any single Budget category in excess of the greater of 25% of such category or $5,000… .Each

> Grantee must specifically identify, report and explain any and all Budget reallocations in its interim and final financial accounting to CPB.

Terms and Conditions, 4.D.

> Form of Financial Reports. All financial reports must:
>
> (i) set forth the amounts originally provided in the Budget for each line item and the amounts expended under each line item to date;
> (ii) specifically identify and explain any variances in excess of the limits set forth in Section 4(D) hereof (both in dollars and percentages) from the Budget that exist or are expected;
> (iii) include a certification that the Grant Project can be completed on schedule and within the Budget or provide a detailed explanation setting forth the reasons why the Grant Project may not be completed on schedule or within the Budget.

Terms and Conditions, 4.K.

KQED certified a final financial report with variance amounts reported and explanations for some of the variances. KQED's interim financial reports did not identify variances or potential budget reallocations as required. KQED agreed that it did not receive written approval from CPB for budget reallocations but said it did report relevant variances in its interim and final reports. Further, KQED said CPB approved the reports and made grant payments, so the grantee was not made aware by CPB of any noncompliance issues and did not agree that these budget reallocations should be questioned. We did not find evidence of approval of KQED's budget reallocations in CPB's contract file.

These unapproved budget reallocations totaled $66,788. CPB's portion was $21,372, per Exhibit G.

Indirect Costs

Our review of the indirect costs charged to the QUEST project found that the total direct costs of sub-recipients (6 Hub stations, $419,216) were included in the base used to calculate the project's indirect cost charges. Sub-recipients generally do not receive any benefit from an organization's overhead activities, and if they do it is at a significantly reduced rate.

Since the QUEST project also received federal funding from the National Science Foundation (NSF), the indirect cost methodology used to charge indirect costs should be consistently applied to both the federal and CPB funds. Federal guidelines permit grantees to apply the indirect cost rate to the first $25,000 of a sub-recipient grant or sub-contract. We applied this methodology in our calculation of questioned indirect costs totaling $40,382, per Exhibit G. CPB's portion was $12,922.

CPB's Terms and Conditions define the types of records a grantee must keep and the authorized uses for its funds.

> Records. A Grantee must keep books, records, and accounts relating to the Grant and the Grant Project sufficient to:
> (i) enable CPB to verify all direct costs, overhead, and administrative allocations associated with the Grant Project;
> (ii) disclose fully the amount and use of the proceeds of the Grant, the Total Project Cost, and the amount and nature of any portion of the Total Project Costs supplied by sources other than CPB; and
> (iii) permit an effective audit.

Terms and Conditions, 4. G.

> Authorized Uses of CPB Funds. No Grantee may apply amounts received under a Grant to any purpose other than actual costs incurred in the performance of the Grant Project in accordance with its Budget.

Terms and Conditions, 4. F.

Federal OMB Circular A-122, Cost Principles for Non-Profit Organizations, General Principles, stipulates that factors affecting allowability of costs under federal grants.

> b. conform to any limitations or exclusions set forth in these principles or in the award as to types or amount of costs items.
> c. be consistent with policies and procedures that apply uniformly to both federally financed and other activities of the organization.

OMB Circular A-122, Section A.2.

A-122 further defines direct and indirect costs and allowable methodologies for claiming indirect costs.

> The distribution base may be total direct costs (excluding capital expenditures and other distorting items, such as major subcontracts or subgrants), direct salaries and wages, or other base which results in an equitable distribution.

OMB Circular A-122, Section D.2.c.

A-122 also provides guidance on exclusions for subgrants and subcontracts under the multiple allocation base method.

> Distribution basis. Indirect costs shall be distributed to applicable sponsored awards and other benefiting activities within each major function…salaries and wages, fringe benefits, materials supplies, services, travel, and subgrants and subcontracts up to the first $25,000 of each subgrant or subcontract (regardless of the period covered by the sub-grant or subcontract).

OMB Circular A-122, Section D.3.f.

OMB's guidance recognizes that sub-recipients do not receive the same level of overhead support as internal KQED activities. KQED's indirect cost rate was based on its actual costs in its audited financial statements (e.g., general and administrative costs that include payroll, human resources, finance, information technology, and the executive office). However, KQED included its sub-recipient direct costs in the base it used to calculate the project's indirect costs, resulting in a disproportionate amount of KQED's indirect costs being charged to this project. As a result, we have applied the Federal guidelines and questioned $40,382 in indirect costs. CPB's portion totaled $12,922.

KQED officials said it charged indirect rates based on the approved grant budget and it believes these costs are allowable under the agreement. KQED further explained that it applied Circular A-122 guidance in developing its indirect cost rate and that its actual rate was greater than the 15 percent authorized in the grant budget.

Payroll Costs

Our testing of 37 expenditures found one transaction where an employee's timesheet (72 hours) was erroneously charged to the QUEST project for $3,672. We found that 35 hours ($1,785) was applicable to the QUEST project but the remaining 37 hours ($1,887) were incurred for other projects. As a result, we questioned $2,170 ($1,887 plus $283 for indirect costs) in project costs. CPB's portion totaled $694, per Exhibit G.

> Authorized Uses of CPB Funds. No Grantee may apply amounts received under a Grant to any purpose other than actual costs incurred in the performance of the Grant Project in accordance with its Budget.

CPB's Terms and Conditions, 4. F.

KQED officials explained that the employee worked on the CPB QUEST project, but he erroneously miscoded his timesheet to the inactive QUEST project number for 35 hours and did not identify a specific project for the remaining 37 hours. KQED recharged the entire timesheet 72 hours (80 less 8 hours for paid time off) to the CPB QUEST project without allocating the 37 hours to the non-QUEST activity.

Recommendations

2) We recommend CPB management:

   a) recover $34,988 in questioned CPB funds; and

   b) ensure KQED adequately explains future budget modifications and obtains CPB's written consent to revise budget amounts in accordance with grant agreement terms.

KQED Response

KQED management disagreed with the budget reallocations and indirect cost findings but agreed with the questioned payroll cost finding.

Budget Reallocations

KQED agreed that it should have requested advance approval from CPB on budget changes per the grant agreement, however it does not agree with the proposed adjustment of $21,372. KQED further stated that it had submitted three financial reports to CPB along with narratives and none had been denied or returned with questions regarding line item variances. Thus, KQED inferred that the variances were approved.

Indirect Costs

Station officials did not agree with the draft report finding questioning $16,517 in indirect costs on sub-recipients and a contractor costs on the QUEST project. KQED did not agree that the indirect costs related to the consultant contractor should be questioned because the contractor was a vendor and cited OMB Circular No. A-133 Section B 210. KQED stated that federal guidelines permit grantees to apply indirect cost rate to contractors (consultants). Further, it stated indirect costs were charged on the federal NSF grant contractor base costs. Additionally, KQED referenced OMB Circular No. A-122, Section A.2 stating that other contractors costs incurred on the QUEST project do not apply because they are not "major subcontractor or subgrants." They acted as vendors and as such could be charged the indirect rate.

Finally, KQED stated that since CPB approved the QUEST budget, with a fifteen percent indirect rate charged on both contractor and sub-recipients direct costs, it complied with the terms and conditions of the grant and the indirect costs were authorized.

Payroll Costs

KQED agreed with the $694 in questioned payroll costs, stating that it did not have additional documentation to support the charge to the QUEST project.

OIG Review and Comment

Based on KQED's response we consider recommendation 2(a) unresolved, pending CPB's management decision. Recommendation 2(b) is directed to CPB management and we consider it unresolved pending CPB's management decision. Our evaluation of KQED's response by finding type is presented below.

Budget Reallocations

KQED's response to the draft report acknowledged it should have requested advance approval of its budget changes but did not agree the budget variances should have been questioned, because CPB approved payments for the project and did not request an explanation for the budget variances. Since CPB did not formally approve the budget modifications in accordance with grant terms, questioned costs of $21,372 for budget reallocations remain unchanged, pending CPB's management decision.

Indirect Costs

Based on KQED's response, we reduced our questioned indirect costs for consultant contractor costs by $3,595, because the consultant could be classified as a vendor under OMB Circular No. A-133. We made this correction in our overall conclusion and in the finding presented in this report. We do not agree that the remaining questioned indirect costs of $12,922 for sub-grantee Hub costs can be classified as vendors.

Further our review of the QUEST-NSF Project Expenses budget report for a prior period, presented as Exhibit F to KQED's attached response, indicated that no overhead was to be charged on sub-contracts. Since KQED did not provide us with the NSF QUEST budget for our audit period to verify that all sub-grant costs were also excluded from indirect costs during our audit period, we applied the Federal guidelines to allow a $25,000 limit to the cost base used to calculate indirect costs. We do not agree that the full Hub sub-grantee costs should be included in the base used to claim indirect costs, because the Hub's did not receive services from many of the cost pools included in the indirect cost allocation methodology. As a result, the $12,922 for sub-grantee Hub indirect costs remains questioned, pending CPB's management decision.

Payroll Costs

KQED'S response acknowledged that no additional documentation could be found to support the 37 hours charged to the QUEST project. As a result, the $694 in questioned payroll costs remain unchanged.

COMMUNICATIONS ACT NONCOMPLIANCE

Our examination found that KQED did not fully comply with the statutory provisions of the Act or the CPB Certification Requirements for Station Grant Recipients (Certification Requirements) for establishing policy documentation to explain how it complied with open meetings, open financial records, and EEO requirements under the Act.

Documented Procedures

Our examination found that the station did not have written policies documenting its open meetings, open financial records, and EEO compliance practices. KQED officials explained to us how the station complied with these requirements, but agreed it did not have written procedures during the audit period.

The Act provides that stations have open meetings, open financial records, and meet EEO requirements. CPB Certification Requirements explain the Act and require each station to develop documentation indicating the manner of compliance.

> Each station,…is to develop documentation indicating…for example, the recognition of the open meeting provision by the relevant boards and committees, the procedure for the open meetings, the method used to give reasonable notice to the public, examples of notices of open meetings, examples of statements of explanation for closed meetings, and…meetings. And, the type of records made available for public inspections…, the mechanisms by which the records are made available…, and any limitations placed on access to the file by the entity.

CPB Certification Requirements Section V, Open Meetings and Open Financial Records.

CPB also requires stations to meet EEO requirements and document its compliance.

> Each licensee or permittee of a public broadcast station… is to develop documentation that may be used to verify the statistical employment information reported to CPB through the SABS or SAS and/or included in the public record. In addition, each station should develop documentation indicating the manner of compliance with public records requirements of this provision of the law.

CPB Certification Requirements – Section V, C. EEO.

Although station officials could orally explain how it was in compliance with the Act requirements, it did not have written policy documentation as required. These policies are essential to ensure compliance with the Act and provide the public with information about station operations. During our audit fieldwork the station established these policies and procedures and formalized them in writing.

Recommendation

3) We recommend CPB require KQED to submit to CPB its newly adopted written policies that explain how the station complies with open meetings, open financial records, and EEO requirements to ensure the policies adequately meet CPB requirements.

KQED Response

KQED agreed with and corrected the finding and submitted its new policies to CPB.

OIG Review and Comment

We consider this finding resolved but open pending CPB's acceptance of KQED's new policies.

Exhibit A

CPB Payments to KQED
October 1, 2011 – September 30, 2013

CPB Grants	FY 2012	FY 2013	Total
TV			
Community Service Grant	$2,859,133	$3,205,524	$6,064,657
Interconnection	$55,616	$64,771	$120,387
Distance Service	$24,107	$23,178	$47,285
Total TV	**$2,938,856**	**$3,293,473**	**$6,232,329**
Radio			
Unrestricted Community Service Grant	$1,080,906	$1,176,173	$2,257,079
Restricted Community Service Grant	$381,755	$415,401	$797,156
Total Radio	**$1,462,661**	**$1,591,574**	**$3,054,235**
Total TV and Radio	**$4,401,517**	**$4,885,047**	**$9,286,564**
Other Grants			
Quest – Content & Distribution Grant #13763	$297,158	$0	$297,158
American Graduate – Public Media Community Hub Grant #14377	$31,500	$115,500	$147,000
FM Power Upgrade KQEI Grant #13647	$29,242	$0	$29,242
American Archives Content Inventory Grant #14088	$23,047	$0	$23,047
Total Other Grants	**$380,947**	**$115,500**	**$496,447**
Total TV, Radio and Other Grants	**$4,782,465**	**$5,000,547**	**$9,783,011**

Exhibit B

KQED
TV Annual Financial Reports
Years Ending September 30, 2012 and 2013

Line	Description	FY 2012	FY 2013
	Schedule A,		
	Source of Income		
1	Amounts provided directly by federal government agencies	$489,999	$736,555
1.D.	National Endowment for the Arts and Humanities	449,999	0
1.E.	National Science Foundation	40,000	430,977
1.F.	Other Federal Funds: Dept Commerce $300,000, Other $5,578	0	305,578
2	Amounts Provided by Public Broadcasting Entities	**4,067,038**	**3,456,730**
2.A.	CPB-CSG	2,859,133	3,205,524
2.B.	CPB - all other funds from CPB	577,221	80,437
2.C.	PBS - all payments except copyright royalties and other pass-through payments	509,733	77,764
2.D.	NPR- all payments except pass-through payments.	44,464	25,776
2.E.	Public broadcasting stations - all payments	76,487	67,229
2.F.	Other PBE funds	0	0
3	Local boards and departments of education or other local government or agency sources	6,297	5,099
4	State boards and departments of education or other state government or agency sources	119,534	131,933
5	State colleges and universities	21,748	7,384
6	Other state-supported colleges and universities	499	0
7	Private colleges and universities	17,528	25,894
8	Foundation and nonprofit associations	2,015,277	2,717,700
9	Business and Industry	2,893,591	2,542,781
10	Membership and Subscription	16,329,752	16,085,547
	Form of Revenue		
14	Special fundraising activities (gross)	1,084,815	1,257,788
15	Passive income	418,074	471,080
16	Gains and losses on investments, charitable trusts and gift annuities and sale of other assets (other than endowment funds)	1,835,858	1,246,049
17	Endowment revenue	2,460,913	1,516,206
18	Capital contributions	0	0
19	Gifts and bequests from major individual donors	8,421,138	6,367,098
20	Other Direct Revenue	45,523	78,249
	Total Item 3-20	35,670,547	32,452,808
21	**Total Revenue**	**$40,227,584**	**$36,646,093**

Exhibit B (continued)

KQED
TV Annual Financial Reports
Years Ending September 30, 2012 and 2013

Line	Description	FY 2012	FY 2013
	Adjustments to Revenue		
22	Federal revenue from line 1.	$489,999	$736,555
23	Public broadcasting revenue from line 2	4,067,038	3,456,730
24	Capital funds exclusions	0	765,000
25	Other revenue on line 21 not meeting the source, form, purpose, or recipient criteria to be included as NFFS	2,380,384	78,249
26	Other automatic subtractions from total revenue	3,701,230	4,574,091
	Total Adjustments to Revenue	**10,638,651**	**9,610,625**
27	**Total Direct Non-Federal Financial Support**	**$29,588,933**	**$27,035,468**
	Schedule C		
1	PROFESSIONAL SERVICES (must be eligible as NFFS)	$1,594	$70,856
2	GENERAL OPERATIONAL SERVICES (must be eligible as NFFS)	0	0
3	OTHER SERVICES (must be eligible as NFFS)	1,131,168	733,346
4	**Total in-kind contributions** - services and other assets eligible as NFFS (sum of lines 1 through 3), forwards to Line 3a. of the Summary of Non-federal Financial Support	**1,132,762**	**804,202**
5	IN-KIND CONTRIBUTIONS INELIGIBLE AS NFFS	263,484	236,774
6	**Total in-kind contributions** - services and other assets (line 4 plus line 5), forwards to Schedule F, line 1c. Must agree with in-kind contributions recognized as revenue in the AFS.	**$1,396,246**	**$1,040,976**
TV	**Schedule E**		
	PROGRAM SERVICES		
1	Programming and production	$16,372,840	$15,634,548
A	TV CSG	0	3,205,524
B	TV Interconnection	0	64,771
C	Other CPB Funds	0	23,178
D	All non-CPB Funds	0	12,341,075
2	Broadcasting and engineering	5,571,554	5,351,315

Exhibit B (continued)

KQED
TV Annual Financial Reports
Years Ending September 30, 2012 and 2013

Line	Description	FY 2012	FY 2013
2	A. TV CSG	$0	$0
	B. TV Interconnection	0	0
	C. Other CPB Funds	0	0
	D. All non-CPB Funds	0	5,351,315
3	Program information and promotion	3,074,217	3,813,158
	A. TV CSG	0	0
	B. TV Interconnection	0	0
	C. Other CPB Funds	0	0
	D. All non-CPB Funds	0	3,813,158
	SUPPORT SERVICES		
4	Management and general	4,860,440	4,602,367
	A. TV CSG	0	0
	B. TV Interconnection	0	0
	C. Other CPB Funds	0	0
	D. All non-CPB Funds	0	4,602,367
5	Fund raising and membership development	8,596,291	8,278,125
	A.TV CSG	0	0
	B. TV Interconnection	0	0
	C. Other CPB Funds	0	0
	D. All non-CPB Funds	0	8,278,125
6	Underwriting and grant solicitation	2,472,777	2,452,725
	A.TV CSG	0	0
	B.TV Interconnection	0	0
	C. Other CPB Funds	0	0
	D. All non-CPB Funds	0	2,452,725
7	Depreciation and Amortization (if not allocated)	0	0
8	**Total Expenses (sum of lines 1 to 7) must agree with audited financial statements**	**$40,948,119**	**$40,132,238**

Exhibit C

Radio Annual Financial Reports
Years Ending September 30, 2012 and 2013

Line	Description	FY 2012	FY 2013
	Schedule A		
	Source of Income		
1	Amounts provided directly by federal government	$0	$414,076
2	Amounts provided by Public Broadcasting Entities (e.g. CPB, PBS, NPR, etc., including other stations and regional networks. See Guidelines for complete list.)	1,529,234	1,667,422
2.A.	CPB - Community Service Grants - Unrestricted	1,080,906	1,176,173
2.A.	CPB - Community Service Grants - Restricted	381,755	415,401
2.B.	CPB-all other funds	3,932	0
2.C.	PBS- all payments except copyright royalties and other pass through payments.	10,880	0
2.D.	NPR - all payments except pass-through payments	16,917	16,927
2.E.	Public broadcasting stations - all payments	22,489	40,279
2.F.	Other PBE funds	12,355	18,642
3	Local Boards and Departments of Education or other local government	45,544	124,596
4	State boards and departments of education or other state government or agency sources	127,746	123,628
5	State colleges and universities	401,887	393,421
6	Other state-supported colleges and universities	376	22,050
7	Private colleges and universities	656,109	738,819
8	Foundation and nonprofit associations	3,391,893	6,634,595
9	Business and Industry	7,057,390	6,767,427
10	Memberships and subscriptions	10,334,730	9,561,638
	Form of Revenue		
14	Special fundraising activities	816,338	1,182,525
15	Passive Income	220,294	405,332
16	Gains and losses on investments,	1,310,256	1,197,184
17	Endowment revenue	1,856,478	1,456,748
18	Capital fund contributions	0	0
19	Gifts and bequests from major individual donors	3,054,128	5,144,825
20	Other Direct Revenue	32,970	72,619
21	**Total Revenue**	**$30,835,373**	**$35,906,905**

Exhibit C (continued)

Radio Annual Financial Reports
Years Ending September 30, 2012 and 2013

Line	Description	FY 2012	FY 2013
	Adjustments to Revenue		
22	Federal revenue	$0	$414,076
23	Public broadcasting revenue	1,529,234	1,667,422
25	Other revenue on line 21 not meeting the source, form, purpose, or recipient criteria to be included as NFFS	1,312,447	14,463
26	Other automatic subtractions from total revenue	2,717,420	3,526,492
26.B	Special fundraising event expenses	0	0
26.D	Realized and unrealized net investment gains/losses	-7,891	-95,932
26.E	Unrealized investment and actuarial gains/losses	1,318,147	1,293,116
26.F	Realized and unrealized net investment gains/losses	1,407,164	1,072,840
26.G	Rental income	0	59,883
26.H	Fees for services	0	0
26.J	Other revenue ineligible as NFFS	0	228,121
26.K	FMV of high-end premiums	0	968,464
27.	**Total Direct Non-Federal Financial Support**	**$25,276,272**	**$30,284,452**
	Schedule C, In-Kind Contributions		
1	PROFESSIONAL SERVICES	$8,061	$68,078
2	GENERAL OPERATIONAL SERVICES	3,808	0
3	OTHER SERVICES (must be eligible as NFFS)	493,025	286,118
3.c	Local Advertising	493,025	286,118
4	**Total In-Kind Services**	**504,894**	**354,196**
5	IN-KIND CONTRIBUTIONS INELIGIBLE AS NFFS	724,358	698,882
6	**Total in-kind contributions - services and other assets (line 4 plus line 5),**	**$1,229,252**	**$1,053,078**

Exhibit C (continued)

Radio Annual Financial Reports
Years Ending September 30, 2012 and 2013

Line	Description	FY 2012	FY 2013
Radio	**Schedule E, Expenses:**		
	Program Services		
1	Programming and production	$9,162,914	$9,752,611
	A. Restricted Radio CSG	0	415,401
	B. Unrestricted Radio CSG	0	1,176,173
	C. Other CPB Funds	0	0
	D. All non-CPB Funds	0	8,161,037
2	Broadcasting and engineering	2,025,534	2,245,520
	A. Restricted Radio CSG	0	0
	B. Unrestricted Radio CSG	0	0
	C. Other CPB Funds	0	0
	D. All non-CPB Funds	0	2,245,520
3	Program information and promotion	1,583,687	2,144,900
	A. Restricted Radio CSG	0	0
	B. Unrestricted Radio CSG	0	0
	C. Other CPB Funds	0	0
	D. All non-CPB Funds	0	2,144,900
	Support Services		
4	Management and general	2,503,863	2,588,831
	A. Restricted Radio CSG	0	0
	B. Unrestricted Radio CSG	0	0
	C. Other CPB Funds	0	0
	D. All non-CPB Funds	0	2,588,831
5	Fund raising and membership development	4,982,388	4,749,336
	A. Restricted Radio CSG	0	0
	B. Unrestricted Radio CSG	0	0
	C. Other CPB Funds	0	0
	D. All non-CPB Funds	0	4,749,336
6	Underwriting and grant solicitation	1,225,402	1,359,554
	A. Restricted Radio CSG	0	0
	B. Unrestricted Radio CSG	0	0
	C. Other CPB Funds	0	0
	D. All non-CPB Funds	0	1,359,554
7	Depreciation and Amortization if not allocated	0	0
	Total Expenses (sum of lines 1 to 7) must agree with audited financial statements	**$21,483,788**	**$22,840,752**

Exhibit D

Summary of Non-Federal Financial Support
For the periods ending September 30, 2012 and 2013
Certified by Head of Grantee and Independent Accountant's Report

Line	Description	TV FY 2012	Radio FY 2012	Total FY 2012
	Summary of Non-Federal Financial Support:	**TV**	**Radio**	
1	Direct Revenue (Schedule A)	$29,588,933	$25,276,272	$54,865,205
2	Indirect Administrative (Schedule B)	0	0	0
3	In-Kind Contributions (Schedule C)	1,132,762	504,894	1,637,656
4	**Total Non-Federal Financial Support**	**$30,721,695**	**$25,781,166**	**$56,502,861**

Line	Description	TV FY 2013	Radio FY 2013	Total FY 2013
	Summary of Non-Federal Financial Support:	**TV**	**Radio**	
1	Direct Revenue (Schedule A)	$27,035,468	$30,284,452	$57,319,920
2	Indirect Administrative (Schedule B)	0	0	0
3	In-Kind Contributions (Schedule C)	804,202	354,196	1,158,398
4	**Total Non-Federal Financial Support**	**$27,839,670**	**$30,638,648**	**$58,478,318**

Exhibit E

QUEST CPB Grant #13763
Final Financial Report
October 1, 2010- January 31, 2012

Budget Category	Budget	Actual	Variance
Revenues[13]			
CPB Grant	$990,527		
Grantee Guarantee	1,993,511		
Total Revenues	**$2,984,038**		
Expenses			
KQED Project Administration Costs			
Staff	$351,609	$376,349	($24,740)
Contract Fees	104,110	132,734	(28,624)
Administration/Expenses	71,203	7,325	63,878
Travel	3,585	$8,642	(5,057)
Project Administration Costs Subtotal	**$530,507**	**$525,050**	**$5,457**
KQED Educational Component Costs			
Staff	$176,624	$161,308	$15,316
Contract Fees	19,700	14,540	5,160
Administration/Expenses	7,590	17,306	(9,716)
Travel	5,150	6,119	(969)
Educational Component Costs Subtotal	**$209,064**	**$199,273**	**$9,791**
KQED Interactive Costs			
Staff	$460,587	$473,297	($12,710)
Web Development & Design	30,450	21,798	8,652
Other Expenses	1,000	23,175	(22,175)
Travel	1,350	1,151	199
Interactive Costs Subtotal	**$493,387**	**$519,421**	**($26,034)**
KQED Television Costs			
Production Supplies	$72,507	$31,133	$41,374
Travel	2,750	6,483	(3,733)
Production Equipment	78,502	88,044	(9,542)
Staff	472,578	529,747	(57,169)
Television Costs Subtotal	**$626,337**	**$655,407**	**($29,070)**

[13] KQED did not report revenues on its interim and final financial reports submitted to CPB, the revenues included on this report are from the grant agreement budget. During our audit fieldwork we noted $997,642 in NSF revenues were included in the QUEST detail trial balance as part of the Grantee Guarantee revenues.

Exhibit E (continued)

CPB Grant #13763 - QUEST
Final Financial Report
October 1, 2010- January 31, 2012

Budget Category	Budget	Actual	Variance
KQED Radio Content Costs			
Staff	$249,966	$267,232	($17,266)
Other Expenses	0	5,771	(5,771)
Travel	7,583	4,826	2,757
Radio Content Costs Subtotal	**$257,549**	**$277,829**	**($20,280)**
KQED Promotion Costs			
Staff	$44,256	$36,033	$8,223
Paid Advertising	9,000	16,462	(7,462)
Other Expenses	5,500	1,792	3,708
Promotion (Station Training) Costs Subtotal	**$58,756**	**$54,287**	**$4,469**
Total Direct Costs without Hubs	**$2,175,600**	**$2,231,268**	**($55,668)**
Indirect Costs: KQED Overhead (13%)[14]	**$326,340**	**$334,690**	**($8,350)**
HUB Stations Costs			
Administration/Expenses	$210,000	$210,000	$0
Content (Asset) Production	194,696	194,696	0
Training	14,520	14,520	0
Hub Station Costs Subtotal	**$419,216**	**$419,216**	**$0**
Indirect Costs: KQED Overhead on Hub Stations Costs (13%)	**$62,882**	**$62,882**	**$0**
Total Project Expenses	**$2,984,038**	**$3,048,057**	**($64,019)**

[14] Approved dollars in budget calculated based on 15% indirect rate.

Exhibit F

KQED TV and FM Over-stated NFFS FY12 & FY13

Over-stated NFFS	**FM FY12**	**FM FY13**	**Total FM**	**TV FY12**	**TV FY13**	**Total TV**	**Total FY12**	**Total FY13**	**Total FY12 & FY13**
Ineligible payment sources									
Presenting Station Fees				$ 544,276	$170,000	$714,276	$ 544,276	$170,000	$ 714,276
Contract Revenues				117,038		117,038	117,038		117,038
Misc Income	$38,197		$38,197	52,598		52,598	90,795		90,795
Subtotal Ineligible payments	**$38,197**		**$38,197**	**$713,912**	**$170,000**	**$883,912**	**$752,109**	**$170,000**	**$922,109**
CPB's FY 2014 Incentive Rate of Return	6.115%	6.115%	6.115%	12.199%	12.199%	12.199%			
CSG overpayment	**$2,336**		**$2,336**	**$87,090**	**$20,738**	**$107,828**	**$89,426**	**$20,738**	**$ 110,164**
Underwriting 3rd party fees									
NPM Fees	**$462,063**	**$518,442**	**$980,506**	**$89,337**	**$45,268**	**$134,605**	**$551,400**	**$563,711**	**$1,115,111**
CPB's FY 2014 Incentive Rate of Return	6.115%	6.115%	6.115%	12.199%	12.199%	12.199%			
CSG overpayment	**$28,253**	**$31,701**	**$59,954**	**$10,898**	**$5,522**	**$16,421**	**$39,152**	**$37,223**	**$76,375**
Ineligible In-Kind Trade									
Donor A	$12,750		$12,750	$29,750		$29,750	$42,500		$42,500
Donor B		15,945	15,945		16,595	16,595		$32,540	32,540
Donor C	3,740		3,740	10,634		10,634	14,374		14,374
Subtotal Ineligible In-Kind Trade	**$16,490**	**$15,945**	**$32,435**	**$40,384**	**$16,595**	**$56,979**	**$56,874**	**$32,540**	**$89,414**
CPB's FY 2014 Incentive Rate of Return	6.115%	6.115%	6.115%	12.199%	12.199%	12.199%			
CSG overpayment	**$1,008**	**$975**	**$1,983**	**$4,926**	**$2,024**	**$ 6,951**	**$ 5,935**	**$2,999**	**$ 8,934**
Membership premiums		**$10,641**	**$10,641**		**$10,136**	**$10,136**		**$20,777**	**$ 20,777**
CPB's FY 2014 Incentive Rate of Return	6.115%	6.115%	6.115%	12.199%	12.199%	12.199%			
CSG overpayment		**$651**	**$ 651**		**$1,236**	**$1,236**		**$1,887**	**$1,887**
Total over-stated NFFS	**$516,750**	**$545,029**	**$ 1,061,779**	**$843,633**	**$241,999**	**$ 1,085,632**	**$1,360,383**	**$787,028**	**$2,147,411**
CPB's FY 2014 Incentive Rate of Return	6.115%	6.115%	6.115%	12.199%	12.199%	12.199%			
Potential CSG overpayment/funds put to better use	**$31,597**	**$33,326**	**$64,924**	**$102,915**	**$29,522**	**$ 132,436**	**$134,512**	**$62,848**	**$197,360**

Exhibit G

CPB Grant #13763- QUEST Questionable Production Grant Expenditures

Condition		Unallowed Cost			CPB %	CPB's Portion of Questioned Costs	Notes
Questioned Budget Reallocations							
Net Variances less greater of $5,000 or 25% of Budget		$66,788			32%	$21,372	Note 1
Condition	**Hub Expenditures**	**Excess over $25K**	**Indirect Rate**	**Questioned Indirect Costs**	**CPB %**	**CPB's Portion of Questioned Costs**	**Notes**
Questioned Indirect Costs							
QUEST Hubs	$419,216	$269,216	15%	$40,382	32%	$12,922	Note 2
Condition	**Payroll Expenditures**	**Unallowed Cost**	**Indirect Rate**	**Indirect Costs on Unallowed Costs**	**CPB %**	**CPB's Portion of Questioned Costs**	**Notes**
Questioned payroll costs							
Unsupported payroll charges	$1,887	$1,887			32%	$604	Note 3
(indirect on unallowed)			15%	$283	32%	90	
Total questioned payroll costs	**$1,887**	**$1,887**		**$283**	**32%**	**$694**	
		Unallowed Cost	**Unallowed Indirect Costs**	**Total Questioned Costs**	**CPB %**	**CPB's Portion of Questioned Costs**	
Total Questioned Grant Costs		**$68,675**	**$40,665**	**$109,340**	32%	**$34,988**	

1) Budget variances for actual costs over budget. Net variances less the greater of $5,000 or 25% for under budget items was $26,602, CPB's portion was $8,513.
2) CPB QUEST grant included sub-grants to 6 Hub stations each over $25,000, disallowed direct costs for indirect allocation over $150,000
3) Employee 5/15/11 payroll timesheet for 72 hours identified 35 hours as QUEST project costs, we questioned $2,170 for the remaining 37 payroll hours ($1,887 payroll charge plus $283 indirect) which were not identified as QUEST project hours.

Exhibit H

Scope and Methodology

We performed an examination to determine KQED's compliance with CPB Financial Reporting Guidelines, provisions of the Communications Act, grant certification requirements, and other grant provisions. The scope of the examination included reviews and tests of the information reported by the station on its AFR and reconciled to audited financial statements for the years ending September 30, 2012 and September 30, 2013, grant certifications of compliance with Act requirements, and certifications of Final Financial Reports submitted to CPB.

We tested the allowability of NFFS claimed on KQED's radio and TV AFRs by performing financial reconciliations and comparisons to underlying accounting records (general ledger) and the audited financial statements. We reviewed underwriting agreements and other documentation supporting revenues reported. Specifically, we reviewed 58 NFFS revenue transactions totaling $4,012,861 of $56,502,861 in FY 2012 and 59 NFFS revenue transactions totaling $5,833,814 of $58,478,318 in FY 2013.

We reviewed the allowability of expenses charged to selected CPB grants (CSG, TV Interconnection and Distance Service Learning, and the QUEST project). To determine that expenditures were incurred in accordance with the grant terms, we reviewed $7,812,328 of $9,286,546 expenses (84 percent)[15] reported on the CPB CSG grants in FYs 2012 and FY 2013 and $387,677 of $2,644,850 (15 percent) of direct QUEST costs reported in FYs 2011 and 2012. We reviewed production agreements, grant agreements, vendor invoices, and other documentation supporting expenditures tested.

We also reviewed corporate policies, records, and documents supporting the station's compliance with the Act requirements to: provide advance notice of public meetings; make financial and EEO information available to the public; operate a Community Advisory Board; and provide documents supporting compliance with donor lists and political activities prohibitions. We also reviewed the station's website and policies to determine its compliance with CPB's new Eligibility transparency requirements. Our procedures included interviewing station officials and its independent public accountant.

We gained an understanding of internal controls over the preparation of AFRs, cash receipts, and cash disbursements. We also gained an understanding of KQED's policies and procedures for compliance with certification of eligibility requirements, Communications Act, and CPB grant agreement terms for allowable costs. We used this information to assess risks and plan the nature and extent of our testing to conclude on our objectives.

Our fieldwork was conducted from March 2014 through June 2014. Our examination was performed in accordance with the *Government Auditing Standards* for attestation examinations.

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[15] KQED expends all CSG funds (excluding Interconnection and Distance Service Learning) on PBS and NPR dues and programming expenses

KQED

Exhibit I

September 12, 2014

William J. Richardson III
Deputy Inspector General
Corporation for Public Broadcasting
Office of Inspector General
401 Ninth Street, NW
Washington, DC 200004-2129

Re: Examination of Community Service and Other Selected Grants KQED Inc. for the Period October 1, 2011 – September 30, 2013

Dear Mr. Richardson,

Thank you for sending Draft Report No. ASJ1403-XXXX for our review and comment. Following is our formal response to the draft report.

I OVER-STATED NFFS

Payments Reported as NFFS:

We interpreted the CPB guidelines consistently in our treatment of service contracts. CPB revised the AFR reporting format in FY2013 to clarify that fee for services were ineligible as NFFS and we then correctly excluded contract revenue from NFFS.

We acknowledge that we did not correctly report $714K of presenting station fee payments in 2012 and 2013. We should have treated these payments as exchange transactions ineligible as NFFS per CPB's Principles of Accounting. The audit helped us understand more clearly the CPB Guidelines on eligibility as NFFS. We are revising our internal AFR documents to specifically identify contributions and payments that do not meet the requirement of NFFS so that this error does not occur again.

Underwriting Third Party Fees similarity

We do not agree with the proposed adjustment of $1.1M on NPM commissions. CPB provides no guidance on the treatment of underwriting placement fees. KQED, therefore, has been recording this underwriting revenue and related commission expense based on the economic substance of the transaction in compliance with Generally Accepted Accounting Principles (GAAP)[1]. We are aware that other public media stations have taken the same approach as KQED

[1] FASB 650-45, Revenue Recognition - Principal Agent Consideration, provides guidance on whether an entity can recognize revenue based on the gross amount billed to a customer or the net amount retained (i.e., the amount billed to a customer less the amount paid to a supplier(or in this case, NPM)). Indicators that need to be considered when recognizing revenue on the gross amount billed are as follows:

and are reporting gross underwriting revenue as NFFS. Our interpretation is that NPM's role is similar to KQED's Account Executives ("AEs"), thus NPM's fees are correctly treated the same as the AE's commission expense and not deducted from gross revenue on the AFR.

NPM is an independent sales contractor that represents KQED for national underwriting placements and not an ad agency. Our AE's are in-house sales employees that represent KQED for both local and national placements. Like our AE's, NPM contracts directly with underwriters or the underwriters' ad agencies. We provide NPM access to our inventory at the same rates that our AE's offer to potential underwriters. Both NPM and AE's place work orders with KQED to air the underwriting credits. After the airing of spots, and after payment is received from the underwriter, both NPM and AEs receive a commission based on their underwriting sales. As a result, the accounting treatment for their commissions is also treated the same. The gross amount of contributions processed by both NPM and AEs are recognized as revenue, and the commissions for their services are expensed.

Regarding constructive receipt, this is not applicable since the economic substance of the transaction is adhered to in our treatment of the commission expense. Also, there is nothing contractually mandated in our relationship with NPM that requires us to allow them to deduct their commissions prior to sending the underwriting payments to us (see attachment, **Exhibit A**) NPM is our vendor and the contract is structured to allow deduction of commission as a matter of convenience to both parties. The client pays agency, agency pays NPM, NPM deducts its commission and sends the net balance to KQED. However, there are instances in which KQED has received payment directly from the client. As a result, NPM invoiced KQED for its commission and KQED submitted payment. If necessary, we could revise the contract to have NPM remit the entire payment from the underwriter directly to KQED, or have NPM pay us the full value of the underwriting they receive. KQED would then remit to NPM's its earned

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- **The Entity is the Primary Obligor in the Arrangement**: Per **FASB 605-45-45-4**, "Whether a supplier or an entity is responsible for providing the product or service desired by the customer is a strong indicator of the entity's role in the transaction. If an entity is responsible for fulfillment, including the acceptability of the products or services ordered or purchased by the customer, that fact is a strong indicator that an entity has risks and rewards of a principal in the transaction and that it should record revenue gross based on the amount billed to the customer." In the case of KQED, in the contract with NPM, Section 5, Duties of the Station, KQED is the one responsible for running corporate support announcements ordered for the client, not NPM. Also, under section 6 of the contract with NPM, Rights of Rejection, NPM cannot bind or obligate KQED to national underwriters without the specific approval of KQED.
- **The Entity Has General Inventory Risk**: Per **FASB 605-45-45-5**, "Unmitigated general inventory risk is a strong indicator that an entity has risks and rewards as a principal in the transaction and, therefore, that it should record revenue gross based on the amount billed to the customers." NPM has access to KQED's underwriting inventory; however, KQED bears the risk and rewards of the sale and non-sale of underwriting spots.
- **The Entity Has Latitude in Establishing Price**: Per **FASB 605-45-45-8**, "If an entity has reasonable latitude, within economic constraints, to establish the exchange price with a customer for the product or service, that fact may indicate that the entity has risks and rewards of a principal in the transaction and that it should record revenue gross based on the amount billed to the customer." According to section 7 of the contract between KQED and NPM on rates, KQED sets the gross rates and these rates apply to both NPM's clients and KQED's direct clients.

commission. The economic substance would not change – the total contributions are revenue, the commissions are expenses, just like the AEs commissions.

Unqualified In-Kind Trades

Response to first trade: KQED has been trading with the donor ([redacted]) for over five years and services provided by the donor have been consistent from year to year. We do not agree with the entire proposed in-kind trade 2012 adjustment because, based on more recent valuation of the trade from the donor for years 2013 and 2014 (see attachments, **Exhibit B**), approximately 50% can be reported as NFFS and approximately 50% relate to ineligible tickets, passes and online web advertising costs (see attached . The contract between KQED and the donor (see attached **Exhibit C**) states that, in exchange for underwriting credits to the donor, the donor provides advertising for KQED in the form of KQED logo printed on the back of tickets and on posters, banners, newsletters, playbills, brochures and other printed materials, including the donor's annual donor wall. The trade agreement between the donor and KQED did not break out the value of disallowed tickets, passes and web advertising versus the other ads, however, there is value associated with the other ads. In the future, we will ensure that trade contracts with this donor properly segment the value of tickets, passes and web advertisements so that we know exactly what to include and exclude in the AFR as NFFS. In the meantime, we would like the proposed adjustment be reduced by half to properly reflect the amount included in NFFS in error $17,500 (($50K/2)-$7.5K already excluded)) .

In the 2013 AFR report, based on guidance from CPB staff, we excluded the entire $50,000 in-kind trade with this donor. Since then, we have received from the donor a more detailed valuation of the trade and it appears that we could have included all but the $21,000 related to tickets and passes and online web advertising (see attached **Exhibit B**). We therefore understated eligible NFFS in the 2013 AFR report. We kindly request that the attached documentation be reviewed and that consideration be made to add back $29,000 to the 2013 AFR as eligible NFFS as an offset to the error of $50K above.

Response to second trade: We agree with the FY13 in-kind trade proposed audit adjustment related to on-line web advertisements on KQED's website. We typically exclude donations for on-line web advertising but this was an oversight on our part. The amount that should have been excluded from NFFS is $32,540.

Response to third trade: We do not agree with the proposed in-kind trade audit adjustment related to unfulfilled trades. First, CPB Financial Reporting Guidelines do not provide guidance on the treatment of the unused portions of trade revenue. Second, per contract terms, once the agreement expires, the trade cannot be extended and, therefore, the donor cannot fulfill their remaining trade, thus satisfying and completing the in-kind transaction. KQED provided the underwriting credits valued at KQED's rates for the entire agreement amount. We believe that the $14,374.75 is properly included in NFFS for FY 2012

Membership Premiums

We do not agree with the proposed $20,777 membership benefit audit adjustment. Line 10.1 of CPB's Financial Reporting Guidelines says that "thank you gifts" or premiums which may include tickets to performances, dinners or other events should be excluded from NFFS. The event in question should not be considered a thank you gift because the primary purpose of this particular event was to keep major donors informed of the organization's programming and services and to provide them with the opportunity to meet and greet various staff.

In addition, there is no measurable fair market value that can be assessed to the donor at the time of the contribution and the event is more of a constituent communication rather than an exchange transaction. This is because major donors that are invited to these functions as an acknowledgement may or may not attend at their discretion. Also, no tickets are sold at these events and there is no quid pro quo.

II QUESTIONED COSTS

Budget Reallocations

We agree that we should have requested advance approval from CPB on budget changes per the grant agreement and CPB grant requirements. However, we do not agree with the proposed audit adjustment of $21,372 because had we properly submitted a request for approval of budget variances, there is no indication that CPB would have denied the request. In addition, during the grant period, there were three financial reports that were submitted to CPB per the Schedule of Deliverables and Disbursements and none of these financial reports together with narratives were denied or returned to KQED with questions regarding line item variances. It was inferred that the variances were approved since no communication to the contrary was received from CPB.

Indirect Costs

We do not agree with the proposed audit adjustment of $16,517 related to indirect cost charged to the QUEST project for sub-recipients and contractor. The argument in the report is that since funding for QUEST came from both the National Science Foundation and CPB, that indirect cost methodology used to charge direct costs should be consistently applied.

First, the argument for consistency should not be applied to contractor charges who are acting as vendors (See A-133 Section B 210, **Exhibit D**). Federal guidelines permit grantees to apply the indirect cost rate to contractors (consultants) and the contractor in question is a vendor under A-133 (see vendor contract, **Exhibit E**). Also, we pulled the approved budget for the NSF Quest grant for a three year period, 2007, 2008 and 2009 and, for all these grants, indirect cost was charged to contractor base costs on the QUEST project (see attached **Exhibit F**). The audit report references OMB Circular A-122, Section A.2., to support the audit adjustment related to contractors, however, the contractors on the project do not fall under the excluded category listed in this section. They are not "major subcontractor or subgrants", they acted as vendors, and as such the indirect cost rate can be charged to the entire amount of the contract cost.

Second, the "Quest" budget in the initial grant proposal to CPB clearly identified a 15% charge on the direct costs of sub-recipients and contractor. We complied with the terms and conditions of the CPB grant which says, under section 4.G., Authorized Uses of CPB Funds, that "no Grantee may apply amounts received under a Grant to any purpose other than actual costs incurred in the performance of the Grant Project in accordance with its <u>Budget</u>". The costs charged to the project were in accordance with the approved budget and the approved CPB QUEST budget included a 15% charge on sub-recipient and contractor direct costs.

Payroll Costs

We agree with the proposed audit adjustment of 694.0 related to the employee payroll timesheet adjustment. As we explained during the audit, the employee timesheet reflected 72 hours straight time and eight hours Paid Time Off. Of the 72 chargeable hours, 35 hours were coded on the timesheet to an inactive QUEST project number funded by CPB. The remaining thirty seven hours were not identified to a specific project. Unfortunately, the entire 72 hours was charged to QUEST. No additional documentation could be found to support the additional 37 hours charged to the QUEST project.

III. COMMUNICATIONS ACT COMPLIANCE

As the OIG report indicates, during the audit fieldwork KQED formalized in writing the policies the station has followed in complying with the CPB open meeting, open financial records and EEO requirements. KQED provided CPB with copies of these written polices during the fieldwork, but in response to the OIG recommendation that CPB require KQED to submit those policies, we have attached them here.

Sincerely,

Mitzie Kelley

Mitzie Kelley
Chief Financial Officer, KQED Inc.

AUDIT REPORT NO. ASJ1403-1409
KQED, Inc.

Exhibit A – Agreement between KQED and NPR
Exhibit B – Valuation of Trade from YBCA for FY13 and FY14
Exhibit C – Contract between KQED and YBCA
Exhibit D – OMB Circular A-133, Subrecipient & Vendor Determination
Exhibit E – Contract between Rockman et al and KQED (NCPB)
Exhibit F – Approved Budgets for NSF Quest Grant for FY 2007-2009

Procedures for Compliance with CPB Employment Statistics Reporting and Public Availability Requirements

Procedures for Compliance with CPB Open Financial Records Requirements

KQED Open Meetings Compliance Procedures

The above information referenced in the response from KQED is available upon request

Contact our office at:

202.879.9669

or

Corporation for Public Broadcasting
Office of Inspector General
401 Ninth Street, NW
3rd floor
Washington, DC 20004