

CORPORATION FOR PUBLIC BROADCASTING

OFFICE OF INSPECTOR GENERAL

**EVALUATION REPORT ON THE VIABILITY OF CPB'S INDIRECT
ADMINISTRATIVE SUPPORT BASIC METHOD OPTION**

REPORT NO. L-ACJ1706-1805

June 5, 2018

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Report in Brief

Why We Did This Evaluation

Our past audits of institutional stations claiming Indirect Administrative Support (IAS) Non-Federal Financial Support (NFFS) have found overstated NFFS related to stations' calculations of IAS. The accurate reporting of IAS NFFS is critical for the equitable distribution of the CSG funds to public broadcasters.

We judgmentally selected two stations to conduct a limited scope audit of NFFS reported as IAS in FY 2016. We reported separately on each station we audited and issued this summary report to CPB focusing on recommendations for systemic improvements to achieve more consistent reporting of IAS under the Basic Method.

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Evaluation Report on the Viability of CPB's Indirect Administrative Support Basic Method Option

What We Found

Based on limited scope station audits and our evaluation of the Basic Method, we believe it does not achieve CPB's goal to allocate costs to stations in proportions reasonably consistent with the stations' use of the licensee's resources.

Specifically, we found application errors in:

- calculating the institutional support allocation rate; and
- identifying indirect cost pools that include services that:
 - are an essential part of station operations;
 - are continuous and ongoing in support of the station;
 - the station uses or is required to use; or
 - were directly paid for by the station.

We also concluded that CPB's design of the Basic Method results in an inequitable allocation of licensee resources among all users of the services.

What We Recommend

That CPB evaluate whether the Basic Method remains an effective option for claiming IAS and consider developing a *de minimis* indirect rate option like that permitted under current federal guidelines

In response to the draft report, CPB disagreed with OIG conclusions but agreed that the Basic Method was complicated and said it is in the process of evaluating all appropriate methodologies for calculating IAS, a process which may be time consuming. We have not changed our findings or recommendations based upon CPB's response.

CPB management will make the final determination on our findings and recommendations



Corporation
for Public
Broadcasting

Office of Inspector General

Date: June 5, 2018

To: Jackie J. Livesay, Vice President, Compliance
Ted Krichels, Senior Vice President, System Development and Media Strategy
Kathy Merritt, Senior Vice President, Journalism and Radio

From: Mary Mitchelson, Inspector General 

Subject: Viability of Indirect Administrative Support Basic Method Option – Other Matters
Report Number L-ACJ1706-1805

Enclosed please find our final report which includes CPB's response to our draft report as Exhibit E. CPB officials must make a final determination on the findings and recommendations in accordance with established audit resolution procedures.

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

We performed our evaluation in accordance with the *Quality Standards for Inspection and Evaluation* established by the Council of Inspectors General on Integrity and Efficiency. We will post this report to the Office of Inspector General's website and appropriate congressional committees as required by the Inspector General Act of 1978, as amended. Please refer any public inquiries about this report to our website or our office.

Enclosure

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

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Summary

We found in our limited scope audits of KPBS TV and Radio (KPBS) (licensed to San Diego State University) and Houston Public Media (HPM) (licensed to the Board of Regents of the University of Houston System) significant errors in reporting Indirect Administrative Support (IAS). Both stations reported IAS under the Basic Method option of the Corporation for Public Broadcasting's (CPB) Financial Reporting Guidelines (Guidelines). These errors included claiming support costs for various institutional activities that were not traditional general and administrative costs. Further, we found that each station essentially developed its own method to claim IAS under the umbrella of the Basic Method. Finally, based on these audits and our evaluation of the Basic Method, we believe its design does not achieve CPB's goal to allocate costs to stations in proportions reasonably consistent with the stations' use of the licensee's resources.

Specifically, we found errors in:

- calculating the institutional support allocation rate; and
- identifying indirect cost pools that include services that:
 - are an essential part of station operations;
 - are continuous and ongoing in support of the station;
 - the station uses or is required to use; or
 - were directly paid for by the station.

In these two audits the stations' actions led to an inequitable distribution of licensee indirect costs to the stations and overstated IAS Non-Federal Financial Support (NFFS) of more than \$3.6 million, as detailed in Exhibit A. We found similar issues in our audit of WLRN TV/FM (WLRN), licensed to the School Board of Miami-Dade County, Florida.

None of the stations had recently evaluated the methodologies they used to claim IAS; they were just following past practices. Further, the stations' attestation examinations by independent public accountants (IPA) had not identified any issues related to IAS NFFS.

Based on this limited sample, we recommend that CPB evaluate whether the Basic Method remains an effective option for claiming IAS and consider developing a *de minimis* indirect rate option like that permitted under current federal guidelines.¹

In response to our draft report, CPB disagreed with our conclusions, stating they were based on a small sample that had limited system-wide impact and that the Basic Method is designed appropriately and has been effective for many years. CPB did acknowledge that the Basic Method is complicated and stated that it is in the process of evaluating all appropriate methodologies for calculating IAS. CPB anticipates the process may be time consuming, in part because it may involve consulting with the public broadcasting system.

Based on CPB's response, we have not changed our findings or recommendations.

¹ Federal guidelines permit a grantee to claim 10 percent of Modified Total Direct Costs (MTDC) as indirect costs without a negotiated and approved indirect cost plan.

This report presents the conclusions of the OIG and the findings do not necessarily represent CPB's final position on the issues. CPB's response to the draft report did not address our specific recommendations other than stating that at this point CPB disagreed with our conclusions about the Basic Method without doing additional research and evaluation.

Based on CPB's response to the draft report, we consider our recommendations to be unresolved pending CPB's final determination. CPB officials will make final determinations on our findings and recommendations in accordance with established CPB audit resolution procedures.

We prepared this report following the Council of Inspectors General on Integrity and Efficiency's Quality Standards for Inspection and Evaluations. Our scope and methodology is discussed in Exhibit D.

Background

CPB's grant agreement for Community Service Grants (CSG) allows institutional stations to report as NFFS indirect support they receive from their institutional licensees for costs that are essential and continuous to station operations, provided the stations would need to incur the costs directly had the services not been received as an indirect benefit. Stations may claim institutional support, physical plant operations, and occupancy value as IAS.

CPB allows institutional licensee stations to apply one of the following four methods to calculate their IAS:

- Grantee Developed Method (allowed since 1975, CPB pre-approval required);
- Federal Other Sponsored Activities (OSA) Rate – using a MTDC Base (allowed since 1996);
- Federal OSA Facilities & Administrative (F&A) - using a Salaries & Wages Cost Base (allowed since 1996); or
- Basic Method, net direct expense or salaries and wages options (CPB developed and allowed since 1996).

CPB's original 1996 guidance for the Basic Method articulated a goal to allocate costs to stations in proportions reasonably consistent with the stations' use of licensee resources. This goal is consistent with federal indirect cost guidelines that state the allocation basis must result in an equitable distribution of costs based on benefits received.

The Basic Method is the most used of all the permissible methods, and its use has notable effects on CSG awards. In fiscal year (FY) 2016, 247 (43 percent) of all grantees reporting NFFS claimed IAS, and 162 out of the 247 applied the Basic Method. Grantees using the Basic Method claimed \$79,076,257 (57 percent) of the total \$138,023,893² in IAS reported. See Exhibit B.

The amount of NFFS reported by a station is a factor in the calculation of its CSG award two years later. The IAS included in NFFS reported in FY 2016 resulted in estimated FY 2018 CSG

² This figure includes institutional and physical plant support and occupancy value before required deductions.

payments of \$11,705,267, or 3.6 percent of the estimated total CSGs to be paid that year. The portion based upon the IAS Basic Method is \$6,349,785, or 2 percent of total estimated CSG payments in FY 2018. Further, an error in one station’s CSG calculation affects the amount of money remaining in the CSG pool to be awarded to other stations.

Most of the stations reporting IAS in FY 2016 were licensed to universities (221 of 247 or 90 percent), and most of them applied the Basic Method (146 of 221, 66 percent). See the following table.

Method of Reporting IAS FY 2016

Stations Reporting IAS FY 2016	Basic Method	Federal OSA MTDC	Federal OSA Salaries	Grantee Developed Method	Total	Percent Institution
University	146	41	10	24	221	90%
Non-University	16	4		6	26	10%
Total TV and Radio	162	45	10	30	247	
Percent Method	66%	18%	4%	12%		

CPB has acknowledged that the Basic Method is the most complicated IAS option and advised that the rate should be prepared by a trained accountant and should be audited. In addition to CPB’s limited desk reviews, CPB said it relies on the station’s certification and the independent auditor’s attestation of compliance with CPB Guidelines to ensure its guidance is being followed.

In FY 2017, we initiated limited scope audits of KPBS and HPM to assess their reporting of IAS NFFS under the Basic Method. Our audits identified over \$3.6 million in overstated IAS, a 21 and 37 percent variance respectively in what each station reported versus what our audits included. See Exhibit A. We found similar reporting issues in our audit of WLRN.

Issues related to applying the Basic Method

Our recent audits identified inconsistencies among the three stations in applying the Basic Method option: 1) to calculate the institutional support allocation rate; and 2) to identify administrative cost pools that provide essential, continuous, and ongoing benefit to the station. Specifically, our audits found an inequitable distribution of licensee indirect costs to stations in calculating the institutional support allocation rate. We also found that stations claimed more costs than the traditional general and administrative costs listed on CPB worksheets. We concluded that the methods used by stations were so varied the stations were essentially applying their own methodologies under the Basic Method umbrella, without having received CPB’s review and approval under the Grantee Developed Method option.

In addition, as CPB has stated, the Basic Method is complicated, with over six pages of instructions. It requires detailed analysis of licensee and stations costs, multiple calculation steps, and the subjective determination of which cost pools benefit the station. This process is further complicated because the station’s functional expense categories often are not the same functional categories as its licensee.

CPB's original goal for the Basic Method option was to allocate costs to the station in proportions reasonably consistent with the station's use of licensee resources. However, we found that the Basic Method as designed cannot achieve an equitable allocation rate, because it does not ensure that all institutional users of the general and administrative cost pools are included in the calculation of licensee direct activities (the denominator in the calculation rate -- when the denominator is smaller, the percentage or rate is higher).

Further, CPB's Guidelines defining allowable institutional administrative cost pools could be improved. The Basic Method instructions do not address situations where stations do not limit institutional costs benefiting the station to the functional institutional support category or where other administrative type costs are captured under other functional categories not identified in CPB's Guidelines.

The majority of the overstated NFFS we found was from functional categories not identified in CPB's Guidelines for costs that we would not categorize as general and administrative.³ CPB's written instructions should also highlight the need to adjust licensee indirect cost pools for costs paid directly by the station or paid by the licensee through its appropriation to the station. While such an adjustment may be inherent in any indirect cost calculation, i.e., a direct cost cannot also be included in an indirect cost pool, it was a significant problem in two of the stations we audited.

Finally, CPB's Basic Method guidance provides instructions related to university cost functions but does not include guidance for other types of institutional stations, such as local school districts or state authorities, which have different functional cost categories. In our audit at WLRN, which is licensed to a school district, we found the station had difficulty matching its cost functions to those articulated in CPB's guidance.

Below, we discuss our findings related to: 1) calculating the institutional support allocation rate and 2) identifying general and administrative cost pools benefiting the station.

1) Calculating the institutional support allocation rate

Even though CPB officials said its 1996 guidance establishing the IAS Basic Method that it was modeled on the federal method for indirect costs, CPB's method varies in a significant respect. CPB's method does not result in a true indirect to direct cost ratio because the method does not include all functional categories receiving benefits from the licensee's indirect costs in the calculation of the rate.

The Federal MTDC allocation methodology provides a relatively simple method - indirect divided by direct to calculate the percentage indirect cost rate. To illustrate, the OSA MTDC federal method takes total expenses for an entity and distributes them into direct and indirect expense cost pools (less capital expenditures, unallowable costs, and subawards over \$25,000) to calculate an indirect rate as shown in the example below.

³ For example, stations included costs for support services in academic affairs, student services and auxiliary service functions in their institutional support cost pools.

Federal Guidance - - MTDC Allocation Methodology

Total costs = \$600,000	Indirect \$100,000	=	20% indirect rate
	(less unallowable costs)		

	Direct \$500,000		
	(less MTDC exclusions)		

The federal indirect rate less any CPB required deductions may then be applied to the station’s net direct expenses (MTDC that were included in the institutional licensee’s direct cost base used to calculate the institutional support rate less any unallowable costs).

In contrast, while the federal methodology accounts for all licensee costs (classified as either direct or indirect), CPB’s Basic Method does not.⁴ It directs stations to develop their institutional support rate using specific functional reporting categories that do not fully account for the licensee’s total costs. Thus, CPB’s Basic Method does not result in a true indirect to direct cost ratio. Including only CPB-defined mission/program functions in the rate calculation results in the station receiving a greater burden of licensee indirect costs than it would under the federal indirect methodology.⁵

CPB formulas for calculating these rates are based on a relationship between the station and licensee expenses for institutional support and are shown below. See Exhibit C for a Basic Method example.

<i>CPB Basic Method Net Direct Expenses</i>	
<i>Institutional Rate Calculation =</i>	
Station Net Direct Expenses	
<i>(total station expenses less capital outlays, depreciation, amortization, in-kind, licensee indirect admin support, donated property, & other indirect or non-cash outlays)</i>	

Licensee Net Direct Expenses	
<i>(direct costs for instruction, research, and public service functional categories less capital outlays and net pension liabilities)</i>	

⁴ CPB Basic Method guidance provides two options for calculating the institutional support rate, on a net direct expense basis or a salaries and wages basis. Both are structured using the functional cost categories for a university station to make these calculations. The university stations applied CPB’s Basic Method guidance using the net direct expense option; WLRN used the salaries and wages option under the Basic Method.

⁵ We did not find this inequity in the method to calculate the Physical Plant Operations and Maintenance rate, because it is based on a comparison of square foot usage, a true ratio between station and licensee usage.

***CPB Basic Method Salaries and Wages
Institutional Rate Calculation***

Station Salaries

Licensee Salaries and Wages for Direct Activities

(direct salaries and wages for instruction, research, and public service functional categories)

In both of these formulas, the denominators do not include direct costs or salaries for additional functional categories that receive common indirect benefits from the licensee. The station's net direct expenses (numerator) may include both program/mission and support functions. For the licensee net direct activities (denominator), the guidance specifies that only the licensee's CPB-defined program/mission function categories (instruction, research, public service) should be included in the denominator. Because it excludes the non-mission function categories (e.g., academic support, student services, auxiliary services) from the denominator, the calculation does not produce a true ratio to calculate IAS when non-mission function categories have received benefits from the licensee's common administration costs. Thus, the Basic Method results in higher allocation rate to calculate IAS than would the approach under federal guidance.

Further, CPB's guidance for applying the Basic Method could be improved. It does not specify that the station's net direct expenses need to be included in the licensee's net direct expenses to provide a basis for comparison. Further, the Guidelines do not define what it means by station net direct in relation to the station's program and support functional expenses. Nor does the guidance require stations to reconcile their costs with the licensee costs when calculating these ratios to ensure their accuracy.

Our audits also found that the stations did not include all their public service mission costs, which included the station's direct costs in the licensee's net direct expenses (denominator), thus increasing the allocation rate the station applied to licensee cost pools to calculate IAS. These errors were identified when OIG requested the stations to reconcile station expenses to licensee expenses. CPB's earlier guidance (FY 1996 – FY 2009) addressed such situations stating, "In calculating these ratios, be sure to include the station's cost and square footage in the applicable denominator." However, this guidance was subsequently eliminated and is not currently included.

Finally, CPB's guidance also does not account for making these ratio calculations in a non-university environment. The following table illustrates the different functional categories used by stations, universities, and school districts.

Typical Functional Expense Statement - Activities

Station	Crosswalk	University	Local School District
Program/Mission Programming and Production Broadcasting Program Information		Program/Mission Instruction Research Public Service*	Program/Mission Instructional Services
Support Membership/Fundraising Underwriting General and Administration		Support Academic Support Student Services Institutional Support Operation and Maintenance of Plant Student Grants and Scholarships Auxiliary Enterprise Services Depreciation & Amortization	Support Instructional Support Services** Pupil Transportation Services Operation and Maintenance of Plant General & School Administration Community Service Student Support Services School Board & others

* TV & Radio station total direct costs may include station direct program and support costs and are included in the University's mission costs for Public Service.

** TV & Radio station total direct costs are included in the School District's support costs for Instructional Support Services.

In our audit of WLRN, we found that the station had to adapt CPB's university functional categories to those of its school district licensee. This conversion complicated both the calculation of the institutional support rate and the identification of administrative cost pools that benefited the station to which to apply that rate.⁶

2) Identifying general and administrative cost pools benefiting the station

CPB's guidance requires stations to identify the cost pools included in their IAS on Schedule B, lines 2c.1 and 3d.1, as illustrated below.

⁶ Our finding at WLRN was that the institutional support rate calculation understated licensee salaries for direct activities by excluding salaries for instructional support, student services, and school administration, resulting in a higher percentage rate to claim IAS.

Institutional and Physical Plant Support Cost Pool Check list

Institutional Support		Physical Plant Operation and Maintenance Support	
Budget & Analysis	Campus Mail	Building Maintenance	Custodial Services
Computer Operations	Insurance	Director of Operations	Elevator Maintenance
Financial Operations	Legal	Grounds and	
Payroll	President's office	Landscaping	Motor Pool
Purchasing	Human Resources	Refuse Disposal	Roof Maintenance
Internal Audit	Other	Utilities	Security Services
		Facilities Planning	Other

None of the three stations we audited provided this information or noted that they were claiming “other” functional support activities on their Annual Financial Reports (AFR). For example, one of the university stations claimed tech service costs that were included in the student support services functional expense category because it said the station received indirect support from this cost group for use of the university’s key card system. In our opinion, these costs were not general and administrative type costs as listed on CPB’s worksheets. CPB’s guidance neither limited permissible costs to the specific types nor adequately addressed “other” support type costs that could be reasonably claimed.

Additionally, we found that CPB’s guidelines did not address adjusting the benefiting costs pools by any administrative costs or fees paid directly by the station. To illustrate, one of our university station audits found that the station had paid utility expenses through a direct appropriation, but these costs were also included in the indirect cost pool for operation of maintenance of plant. Because these expenses were directly charged to the station, an adjustment was needed to first eliminate all such costs from the indirect cost pool and then add the direct charge to the licensee net direct activities.⁷ While the station should have recognized that reporting the same costs as both direct and indirect is not permitted in any indirect cost calculation, CPB’s guidance did not address such a situation.

CPB’s earlier guidance highlighted that “any fees paid to the licensee for overhead recovery, assessment, “use fee”, etc., must be excluded from the total indirect administrative support...,” but this language was eliminated in subsequent versions. However, AFR, Schedule B worksheet totals still required stations to deduct fees paid to the licensee for overhead recovery, assessments, etc. In two of our audits, the stations did not make these deductions. (It did not apply to the third audit.) CPB should determine whether these adjustments are similar to deductions CPB requires for the fees paid to the licensee for overhead expenses (as required on CPB’s AFR Schedule B total worksheet and now specified in FY 2017 guidance) from the total IAS calculated and should address and highlight such adjustments in the Guidelines instructions.

⁷ Federal guidance states “Costs incurred for the same purposes in the like circumstances must be treated consistently as either direct or F&A costs...” 2 CFR § 220, Appendix A, D.1.

Conclusion and contributing causes

We concluded that the stations' varying interpretation and implementation of the Basic Method guidelines, coupled with the original intent of the Guidelines (i.e., allocate costs in proportions reasonably consistent with the station's use of the licensee resources), warrant eliminating the method or improving its guidance. Specifically, CPB's Basic Method and Guidelines:

- specify that only certain functional categories be used in the calculation of the institutional support rate, when other functional categories also receive benefits from the licensee's general and administrative cost pools, thus it does not result in a true indirect to direct cost ratio;
- do not limit costs to specified general and administrative costs nor adequately address the "other" types of support costs that may be included in addition to general and administrative costs in the institutional support functional category when identifying cost pools benefiting the station; and
- are structured for university stations reporting based on university functional expense categories; they do not address other types of institutional stations' functional reporting (e.g., school districts, government authorities).

Additionally, CPB has not recently assessed whether the Basic Method is achieving its goal to allocate licensee costs to the station in proportions reasonably consistent with the station's use of licensee resources. CPB has relied on stations' IPA's attestation of compliance with CPB Guidelines regarding IAS, which is insufficient because we have found that the auditor review of IAS is often limited.

Likewise, stations we audited relied on past practices established years ago to report IAS without periodic review of their efficacy. They also did not have adequate procedures to determine if the support they received from the licensee was reasonable (i.e., in relation to market costs, resources received, or time spent for the services received from the licensee). For example, we found one station claimed approximately \$1 million for royalty distribution payments as IAS when it had directly paid for its licensing fees and royalties. It also could not adequately support what benefit it received for the \$1 million in indirect royalty distribution support from the university, which was primarily royalties related to patents and academic research.

Based on our findings and analysis, we make the following recommendations.

Recommendations

We recommend that CPB management:

- 1) Eliminate the Basic Method and allow institutional stations to:
 - a) use a federal approved rate if the station expenses are included in the rate calculation; or
 - b) if the licensee does not have a federal approved rate that includes the station's expenses allow a station to:
 - i) use a CPB-defined *de minimis* rate to apply to the station's direct costs; or
 - ii) use a Grantee Developed Method approved by CPB.

- c) If CPB decides the Basic Method remains a viable option, revise the methodology and guidance to calculate a more accurate and equitable institutional support rate and define what indirect costs can be claimed by:
 - i) using the federal simplified methodology (i.e., indirect over direct costs) to calculate the institutional support rate and eliminate the functional reporting categories from the guidance;
 - ii) limiting indirect cost pools that can be claimed to purely general and administrative type costs as currently identified on the Schedule B, Lines 2c.1 and 3d.1 checklists and eliminate the use of other categories that are unique to a given institutional environment;
 - iii) requiring stations to:
 - (1) prepare crosswalks/reconciliations – ensuring the station’s expenses are in the licensee’s expenses used to calculate the institutional support rate; and
 - (2) adjust any direct costs paid by the station to the licensee or included in a direct appropriation for administrative services received from the licensee and included in the indirect cost pools used to claim indirect administrative support; and
 - iv) continuing to use current Basic Method guidance for claiming indirect administrative support for physical plant and occupancy support.

CPB Response

In response to our draft report, CPB stated that: 1) the CSG overpayments we found in our two limited scope audits had limited impact and better CPB guidance would not have mattered because the stations had not consulted it in years; 2) our sample was too small to support our conclusions; 3) the Basic Method’s design is appropriate; and 4) it has been in effective for 22 years, OIG has never questioned it before, and the IAS calculation must be attested to by an IPA. CPB agreed that the Basic Method is complicated and stated it is in the process of evaluating all appropriate methodologies for calculating IAS. CPB anticipates that process may be time consuming, in part because it may involve consultation with the public broadcasting system. We have included CPB’s response to our draft report as Exhibit E.

OIG Review and Comment

Based on CPB’s response to the draft report our recommendations remain unresolved pending CPB’s final management decision. We disagree with CPB’s assertions and have not changed our findings or recommendations.

With regard to impact, we note that the \$326,110 in CSG awards we concluded were overpaid to the two stations in our limited scope audits were also unavailable for distribution to other stations receiving CSG awards. Because the yearly amount of CSG funds is fixed, an error by one station affects all the other stations receiving CSGs. Further, the stations’ failure to timely consult CPB’s guidance does not mitigate CPB’s responsibility to offer clear guidance for those stations that do. We noted that some of the errors the two stations made were not sufficiently addressed in the guidance or CPB had eliminated the specific instructions that would have been helpful.

With regard to our limited sample, we clearly state that we judgmentally selected the stations for our IAS audits. We did not project our results on the universe, but these two audits allowed us to more critically evaluate CPB's Basic Method Guidelines and methodology.

CPB's point that the Basic Method includes mission costs by design does not rebut our conclusion that it is less equitable than the federal method. Our point is that all licensee major functions, including non-mission costs such as academic affairs and student services (which at a university can be very large) must be included in the denominator when compared to station costs. Otherwise, those non-mission functions are not bearing their fair share of the licensee's indirect costs, and the mission functions are bearing too much.

Finally, the length of time a policy has been in place is simply irrelevant. If anything, the length it has been in place without being questioned may be a reason that it should be revisited. Further, CPB's reliance on the attestations of IPAs is apparently misplaced, given the reporting errors that we have found, and the IPAs are not engaged to opine on the effectiveness of CPB's methodology.

For these reasons, we have not changed our findings or recommendations.

**Limited Scope Audit
Overstated Indirect Administrative Support
FY 2016**

AFR Schedule B	Overstated NFFS – FY 2016		
Basic Method Net Direct Expense Option	KPBS	HPM	Total
Institutional support allocation rate error	-0.300%	0.012%	-0.288%
Institutional costs not benefiting the station	\$ 276,854	\$ 2,476,369	\$ 2,753,223
Total physical plant support costs	\$ 225,179	\$ (24,784)	\$ 200,395
Total costs benefiting station	\$ 502,033	\$ 2,451,585	\$ 2,953,618
Physical plant allocation rate error	-0.390%	0.069%	-0.321%
Fees paid to licensee for overhead recovery, assessment, etc. that should have been deducted from NFFS	\$ 731,209		\$ 731,209
Total IAS Questioned/Overstated NFFS	\$ 1,233,242	\$ 2,451,585	\$ 3,684,827
FY 2018 CSG overpayments	\$ 123,706	\$ 202,404	\$ 326,110
Percentage variance reported to OIG audit	21%	37%	

Exhibit B

Method of Reporting IAS FY 2016

Institution	Basic Method								IAS	
	Radio		TV		Total				Total all Methods	
	\$ Amount	Stations	\$ Amount	Stations	\$ Amount	Stations	% Basic \$ Amount to Universe	% Basic Stations to Universe	\$ Amount	Stations
Local Authority	1,389,594	11	1,354,221	3	2,743,815	14	50%	70%	5,504,578	20
State	123,101	1	519,744	1	642,845	2	30%	33%	2,139,452	6
University	44,619,720	114	31,069,877	32	75,689,597	146	58%	66%	130,379,863	221
Totals	46,132,415	126	32,943,842	36	79,076,257	162	57%	66%	138,023,893	247

CPB Basic Method Net Direct Option

Example Calculation – Basic Method Net Direct Option

Station Expenses*			Licensee Expenses			Licensee Expenses			Station
Program/Mission	Station Net Direct	÷	Program/Mission	Licensee Net Direct	=	Institutional Support Rate	Licensee Institutional Support Cost Pool		Indirect Admin Support/NFES
Programming and Production	\$ 3,000,000		Instruction	\$ 257,309,534					
Broadcasting	\$ 2,200,000		Research	\$ 155,450,524					
Program Information	\$ 100,000		Public Service	\$ 49,750,548					
Total Program Services	\$ 5,300,000			\$ 462,510,606					
Support									
Membership and Fundraising	\$ 2,000,000								
Underwriting	\$ 200,000								
General and Administration	\$ 2,000,000								
Total Support	\$ 4,200,000						Institutional Support**	\$ 78,187,002	
Total Expenses	\$ 9,500,000						Less Non-benefit costs	Alumni Relations, Other	\$ (3,000,000)
Less: Non-Cash and Capital Outlays	\$ (1,725,000)		Less: Capital Outlays	\$ (12,000,000)					
Station Net Direct	\$ 7,775,000	÷	Licensee Net direct	\$ 450,510,606	=	1.7%	Total station benefiting cost pool	X	\$ 75,187,002
									=
									\$ 1,297,592
* functional category included depreciation, amortization, indirect costs							** Per financial statement does not include other support activities		
Physical Plant Operations						Physical Plant Support Rate	Physical Plant Operations Cost Pool	\$ 54,008,297	
							Less Non-benefit costs	Custodial services, other	\$ (8,000,000)
Station Net Assignable Square Footage	50,000	÷	Licensee Net Assignable Square Footage	12,000,000	=	0.42%	Total station benefiting cost pool	X	\$ 46,008,297
									=
									\$ 1,489,293
Total Indirect Support before occupancy Value									
Occupancy Value								\$ 50,000	
									\$ 50,000
Total Indirect Support before Deductions for fees and other									\$ 1,539,293

Effective IAS rate = Net Station (\$7,775,000) ÷ Total Indirect support (\$1,539,293) = 20 percent

Scope and Methodology

Our past audits of institutional stations claiming IAS NFFS have found overstated NFFS related to stations' calculations of IAS. The accurate reporting of IAS NFFS is critical for the equitable distribution of the CSG funds to public broadcasters.

We analyzed CPB's records of NFFS reporting to identify stations that reported over \$1 million of IAS in FY 2015, and we narrowed our scope to focus on stations that applied CPB's Basic Method for calculating their NFFS and that had not been recently audited by OIG. We judgmentally selected two stations to conduct a limited scope audit of NFFS reported as IAS in FY 2016. We reported separately on each station we audited. In addition, we also recently audited IAS when conducting an attestation audit of another station that applied the Basic Method. This report is a summary report to CPB focusing on recommendations for systemic improvements to achieve more consistent reporting of IAS under the Basic Method.

We conducted this evaluation in accordance with the Council of Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation*.



May 1, 2018

VIA ELECTRONIC MAIL

Ms. Mary Mitchelson
Inspector General
Corporation for Public Broadcasting
401 Ninth Street NW
Washington, D.C. 20004

Dear Ms. Mitchelson,

RE: Viability of Indirect Administrative Support Basic Method Option – Other Matters Report
Number L-ACJ1706-XXXX

We appreciate the recommendations contained in the above referenced memo dated April 16, 2018, pertaining to the Basic Method Option used by certain institutional stations for determination of the non-federal financial support (NFFS) value of indirect administrative support (IAS). At this point, without doing additional research and evaluation on all IAS methodologies, we disagree with your conclusions about the basic methodology.

The following provides support for our position that the basic method reasonably allocates a station's licensee costs based on the station's resulting benefit consistent with our objectives, as explained below.

Impact of the Misreporting: less than 1%

To understand the implications of the report it is important to note that public media stations raised \$2,376,767,457 in non-federal financial support in 2016 of which the misreporting in these two audits accounts for less than 1 percent. The resulting overpayments in each station's community service grants (CSG) are shown below. Moreover, the audit of KPBS found that 60 percent of the errors were the result of costs that were incorrectly included as both indirect and direct costs and that it had not reviewed its accounting for these costs or our instructions explaining how to calculate IAS i.e. our Financial Reporting Guidelines (Guidelines) in at least 15 years. Similarly, the other station audited acknowledged that it had not reviewed the Guidelines in eight years. These errors are confirmation that the Guidelines were not the source of the misreporting.

	NFFS	CSG	Overpayment
KPBS Television & Radio	\$27,433,432	\$3,175,722	\$123,706 ¹
Houston Television & Radio	\$19,721,159	\$2,338,322	\$198,104 ²

Statistical Sample: 2.4%

Your recommendations are based on a sample of two joint licensees, “judgmentally” selected in part, because they reported more IAS using the basic methodology than any other stations. These results are not a statistically reliable sample considering that there are 164 television and radio stations that use this method. While any audit may yield instructive information, a 2.4 percent sample size is not a sufficient basis to determine that the allocation is not reasonable or to support the other conclusions in your report.

Basic Method Includes Mission Costs

You provide no evidence to prove that the basic method results in a misallocation when compared to the federal method for calculating indirect costs. We designed the basic method to recognize only “mission” costs when calculating IAS. Mission costs are defined in the Guidelines as instruction, research and public service, net of capital outlays. We deliberately excluded non-mission costs, such as football and other sports teams, academic support, auxiliary services and student services. In addition, mission costs may not be included unless they meet several conditions, primarily that they provide an “essential and continuous benefit” to the station. With this approach and consistent with our objectives, the station’s indirect costs are limited and in direct proportion to its licensee’s mission costs. To illustrate, if we increased the KPBS licensee’s net direct activities costs \$25,000,000 higher than the station reported, the rate would decrease only slightly: from 5.8 to 5.36 percent for television and 2.32 to 2.15 percent for radio (see Exhibit A, attached).

Basic Methodology Effective 22 Years

Since we introduced the basic method over the past 22 years, we are not aware of any audits until recently that questioned the effectiveness of this methodology nor expressed any concerns about the Guidelines. Your prior audits cited the Guidelines to support your findings. Therefore, we strongly disagree with your conclusions.

Additionally, to ensure accurate reporting we require the station’s IAS calculation be reviewed and attested to by its independent auditor when it submits that information to CPB. The underlying principles are well-known to independent accountants and we are not certain why they did not detect the errors. While we welcome any suggestions on how to improve the Guidelines, there is no evidence in either audit that proves that the Guidelines played a role in the misreporting. We believe our approach continues to be sound.

¹ The amount differs slightly from that reported by the OIG because the actual incentive rate of return was unavailable.

² The amount differs slightly from that reported by the OIG because CPB recognized a small portion of auxiliary costs that were disallowed by the OIG, which reduced the CSG overpayment.

Lastly, you note that the basic methodology is complicated and on that we agree. We are in the process of evaluating all appropriate methodologies for calculating indirect costs to improve the consistency and accuracy of reporting those costs which may be time consuming, in part because we anticipate it will involve a system consultation.

Regards,



Jackie J. Livesay
Assistant General Counsel & Vice President, Compliance

CC: VIA ELECTRONIC MAIL

Michael Levy, Executive Vice President & Chief Operating Officer, CPB
Steven J. Altman, Executive Vice President & Chief Policy & Business Affairs Officer, CPB
J. Westwood Smithers, Jr., Senior Vice President & General Counsel, CPB
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Katherine Arno, Director, TV CSG Policy & Review, CPB
Andrew Charnik, Director, Radio CSG Policy & Administration, CPB
Nadine Feaster, Director, Grants Administration, CPB

Exhibit A

Basic Methodology vs. Proposed Methodology

Using KPBS as an example, if its licensee's net direct expenses are increased by a hypothetical \$25 million, the rates for television and radio are slightly reduced. This rate is one of two components (i.e. it is combined with the physical plant support component).

Net Direct Expenses	Basic Methodology	Proposed Methodology
Television:		
Station's Net Direct	\$17,496,287	\$17,496,287
Divided by: Licensee's Net Direct	\$301,446,102	\$326,446,102
Rate	5.80%	5.36%
Radio:		
Station's Net Direct	\$7,003,540	\$7,003,540
Divided by Licensee's Net Direct	\$301,446,102	\$326,446,102
Rate	2.32%	2.15%