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WASHINGTON, D.C. 20548

ACCOUNTING AND FINANCIAL
MANAGEMENT DIVISION

MAR 28 1984

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The Honorable James T. Broyhill
Ranking Minority Member
Committee on Energy and Commerce

Subject: Corporation for Public Broadcasting's Oversight of
National Public Radio (GAO/AFMD-84-44)

This is in response to your letter of March 13, 1984, in which you requested that we express an opinion on the adequacy of the Corporation for Public Broadcasting's (CPB) oversight of National Public Radio (NPR). Specifically, you asked us to: (1) determine if CPB fulfilled its statutory obligation under 47 U.S.C. 396(1) in regard to NPR, and (2) provide documentation supporting our conclusion.

SUMMARY

In our opinion, CPB and NPR have substantially complied with the literal provisions of 47 U.S.C. 396(1). However, like any Government agency that Congress has given the responsibility to administer a Government program, CPB has a general responsibility to exercise a proper degree of oversight of these activities to ensure that federal funds are properly used and accounted for. As stated in our testimony before the House Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce on February 10, 1984, CPB did not provide adequate oversight of NPR in fiscal years 1982 and 1983 to ensure that NPR was operating in a prudent and financially responsible manner.

The lack of effective oversight became significant in fiscal 1983 because NPR was undergoing a major corporate change which included increasing its reliance on non-federal funds to offset decreasing federal funds, increasing broadcast programming, and embarking on a new area of for-profit business ventures. Prudent business practice would indicate that increased oversight by CPB should have been provided during a period of such significant change in NPR financing and direction. This change in direction did not, however, prompt increased CPB oversight, such as an indepth analysis of NPR's fiscal 1983 proposed budget as a whole rather than the review of only those activities financed with federal funds.

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REQUIREMENTS OF 47 U.S.C. 396

Under subsections of 47 U.S.C. 396, CPB and NPR have certain obligations regarding fund transfers, financial management and records. Specifically, in regard to its oversight of NPR, CPB was required to issue, by November 1979, accounting principles for use by telecommunications entities to account fully for all funds received and expended by such entities. NPR is required to:

- keep its books, records, and accounts in such form as may be required by CPB,
- undergo a biannual audit in accordance with CPB's audit standards, and
- furnish biannually to CPB a copy of the audit report and such other information regarding finances, including annual financial statements, as may be required by CPB.

GENERAL OVERSIGHT REQUIREMENTS

The enabling legislation does not place any specific requirements on CPB with regard to overseeing the activities of entities receiving federal funds, in order to ensure that the funds are used in an appropriate manner. However, like any Government agency that the Congress has given the responsibility to administer a Government program, in our opinion CPB has a general responsibility to exercise a proper degree of oversight of these activities to ensure that federal funds are properly used and accounted for. We note that the Congress has recently enacted legislation that has placed more specific requirements on CPB with regard to its oversight of NPR's financial operations (Public Law 98-214, December 8, 1983).

CPB OVERSIGHT OF NPR

In March 1980, CPB issued its "Principles of Accounting and Financial Reporting for Public Telecommunications Entities", defining the "...nature, scope and applicability of the accounting principles and the basic financial statements to be prepared annually by...[NPR] as a condition of receipt of funds from CPB." This publication recommends the use of accounting procedures to clearly identify the sources and uses of all federal and non-federal funds.

NPR established a set of records and accounts and did undergo audits, the results of which were submitted to CPB. In each fiscal year from 1978 through 1982, NPR financial statements were audited by independent public accountants and, generally, the audit reports were unqualified, with the exception of certain minor accounting changes. The audits did reveal that there were some deficiencies in NPR's accounting procedures for federal funds, but these deficiencies were not considered significant. The problems with the accounting records, on which we testified, did not arise until the efforts in 1982 to install a new automated accounting system.

In addition to review of NPR audit reports, CPB maintained oversight of NPR through annual Production and Support Agreements. These agreements between CPB and NPR defined the funds which would be provided to NPR annually and the specific activities that NPR would carry out with these funds. The agreements were based on funding requests submitted by NPR and required quarterly financial reports. NPR was also required to submit an annual narrative report describing their performance under the agreements. CPB was permitted under the agreements to cease funding NPR activities if NPR did not comply with contract specifications. CPB could also require NPR to repay funds CPB determined were spent in a manner inconsistent with the agreements.

In summary, CPB maintained oversight by review of each fiscal year's funding request from NPR and the negotiation of the annual Production and Support Agreement, review of quarterly financial statements from NPR, review of annual audit reports, and review of the annual narrative reports prepared by NPR on their operations under the agreements. There were also other oversight controls, such as: (1) CPB's approval of any change in a line item of NPR's funding request exceeding 10 percent, and (2) the normal communications existing in a contractual relationship. However, these controls, and the oversight exercised by CPB, were insufficient to identify NPR's 1983 financial crisis in a timely manner and to ensure that CPB was aware of issues which should be dealt with by either NPR or itself.

WEAKNESSES IN CPB OVERSIGHT

CPB oversight focused primarily on the annual Production and Support Agreements and technical matters required by 47 U.S.C. 396 and, consequently, did not include review of NPR's overall plans, budget, and operations. This focus was not a problem in years prior to fiscal 1983, when the majority of NPR funding was provided by CPB and when NPR was essentially on a stable course with minimum changes occurring in operations.

NPR's 1983 budget was based on a plan to reduce dependence on federal funds and reflected a major change in direction and scope of activities for NPR known as Project Independence. We found no evidence which indicates that CPB raised any challenging questions regarding these new directions, the sources or reliability of the non-CPB revenue estimates, or the achievability of any part of Project Independence. In addition, CPB did not raise any issues regarding contingency plans, the adequacy of personnel and systems, or other related matters. Also, no budget figures for NPR's new commercial ventures were submitted to CPB. As pointed out in our previous testimony, the failure to realize the Project Independence goals was one of the primary reasons for NPR's financial problems in fiscal 1983.

Because CPB was relying on annual audit reports and quarterly financial statements to monitor NPR operations, CPB did not learn of NPR's financial problems until too late. CPB did not receive

NPR's 1982 auditor's report, which reflected only a small surplus from operations and a working capital deficit, until January 1983. Similarly, CPB did not receive NPR's first quarterly financial report for fiscal 1983, which was incomplete, until February 1983. It was at that time that NPR's financial crisis was first recognized by NPR management. If monthly financial statements had been requested by CPB, NPR would not have been able to provide them because of the failure of its accounting system, discussed in our February 10, 1984 testimony. NPR's inability to provide monthly financial statements would have alerted CPB to NPR's financial management problems. CPB's reliance on quarterly and annual information was not adequate to provide sufficient oversight of NPR during a time of major transitions by NPR in its operations.

It is our opinion that the major changes in funding and operations planned by NPR in fiscal 1983 should have prompted CPB to significantly increase its oversight of NPR's overall operations, budget, and financial reporting. CPB, however, continued to monitor NPR as it had in the past and, as a consequence, CPB did not learn of NPR's financial problems until too late.

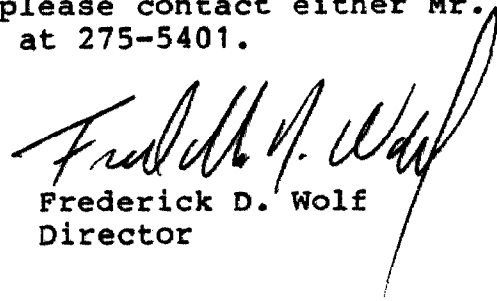
IMPROVEMENTS TO OVERSIGHT

As a result of the 1983 Loan Agreement, under which CPB provided \$7 million to NPR, significant enhancements to its oversight role have been implemented. Some of the key controls include: (1) a requirement that NPR's revenue assumptions in its annual budgets must be reviewed by an independent accountant, (2) NPR's operating budget must project revenues in excess of expenses, and (3) NPR must report monthly to CPB on its operations. Substantial progress has been made to improve CPB's oversight controls of NPR. Most of these changes and controls became effective during fiscal 1984 and, as a result, GAO is not in a position at the present time to determine if all controls are working effectively. In our February 10, 1984 testimony, we stated that CPB should continue using the controls included in the Loan Agreement and regularly review the procedures and controls to ensure they are operating effectively. While the system of controls as a process has been improved, its effectiveness depends upon both NPR and CPB personnel to adequately implement the system.

* * * *

Our comments presented in this letter are based on information obtained during our review of NPR's financial operations, which was performed for the House Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce. This review culminated in testimony before the subcommittee on February 10, 1984. We did not perform an extensive examination of CPB's operations and our comments are limited to CPB's oversight of NPR. The enclosure includes supporting evidence for our comments in this letter. If

you or your staff have any questions, please contact either Mr. Thomas D. Sholedice or Mr. Todd Givens at 275-5401.



Frederick D. Wolf
Director

Enclosure

ENCLOSURE

ENCLOSURE

THE CORPORATION FOR PUBLIC BROADCASTING'S
OVERSIGHT OF
NATIONAL PUBLIC RADIO

ENCLOSURE

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INTRODUCTION

The comments presented in this enclosure are based on information obtained during our review of the National Public Radio's (NPR) budgeting and financial operations for fiscal 1983. This review was performed for the House Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce. The results of this review were presented to the Subcommittee on February 10, 1984.

In the interest of providing quality telecommunications services responsive to the needs of the American people, the Congress created CPB "...to facilitate the development of public telecommunications and to afford maximum protection from extraneous interference and control (47 U.S.C. 396 (a))." Accordingly, CPB and qualified public radio stations created NPR to produce and distribute public radio programs, a function CPB could not legally perform itself. While CPB was created by 47 U.S.C. 396 in part to prevent interference with public broadcasting, CPB, as a grantor of federal funds, has a responsibility to exercise a proper degree of oversight over NPR operations.

REQUIREMENTS OF 47 U.S.C. 396

Under various subsections of 47 U.S.C. 396, CPB and NPR have certain obligations regarding fund transfers, financial management and records.

Specifically, in regard to its oversight of NPR, CPB was required to issue, by November 1979, accounting principles for use by telecommunications entities to account fully for all funds received and expended by such entities (47 U.S.C. 396 (1)(3)(A)).

In addition, CPB is required to:

- refrain from distributing funds to NPR unless NPR's governing body holds open meetings preceded by reasonable notice to the public and without prior registration or request for any other information, notwithstanding NPR's right to hold closed sessions for the purpose of proprietary discussions (47 U.S.C. 396 (k)(4)),
- refrain from distributing funds to NPR unless NPR maintains its annual financial and audit reports available for public inspection (47 U.S.C. 396 (k) (5)), and
- receive assurances, prior to providing funding, that no NPR employee or officer was receiving compensation in excess of the basic pay rate in effect for Level I of the Executive Schedule under section 5312 of Title 5 (47 U.S.C. 396 (k) (10)).

As stated in 47 U.S.C. 396 (1)(3)(B)(i-iii), NPR is required to:

- keep its books, records, and accounts in such form as may be required by CPB,
- undergo a biannual audit in accordance with CPB's audit standards, and
- furnish biannually to CPB a copy of the audit report and such other information regarding finances, including annual financial statements, as may be required by CPB.

GENERAL OVERSIGHT REQUIREMENTS

The enabling legislation does not place any specific requirements on CPB with regard to overseeing the activities of entities receiving federal funds, in order to ensure that the funds are used in an appropriate manner. However, like any Government agency that the Congress has given the responsibility to administer a Government program, in our opinion CPB has a general responsibility to exercise a proper degree of oversight of these activities to ensure that federal funds are properly used and accounted for. We note that the Congress has recently enacted legislation that has placed more specific requirements on CPB with regard to its oversight of NPR's financial operations (Pub.L.No. 98-214, December 8, 1983).

CPB OVERSIGHT OF NPR

In March 1980, CPB issued its "Principles of Accounting and Financial Reporting for Public Telecommunications Entities", defining the "...nature, scope and applicability of the accounting principles and the basic financial statements to be prepared annually by...[NPR] as a condition of receipt of funds from CPB." These principles, with which NPR must comply, combined with the requirement for biannual audits, provided the basis for CPB oversight of NPR finances.

In addition, CPB oversight of NPR is implemented through annual contracts with NPR called Production and Support Agreements. These agreements specifically define the activities that NPR will perform for the specified levels of CPB funding. Each agreement is based on an annual funding request, called a Comprehensive Funding Proposal, submitted by NPR to CPB. Under the terms of the Production and Support Agreements, CPB is permitted to cease funding NPR activities if NPR does not comply with the contract specifications. CPB may also recover from NPR any funds spent in a manner that is inconsistent with the agreements.

The annual agreements reiterate the requirement of the law that NPR account for funds in accordance with CPB's accounting principles and such other methods of accounting as CPB may develop. In addition, the agreements provide more specific requirements which can be divided into three areas: NPR's use of

federal funds, NPR's required financial reporting, and NPR's compliance with governing laws and regulations.

NPR's Use of Federal Funds

The Production and Support Agreements prohibit NPR from using federal funds for any purposes other than those outlined in the agreements. CPB can also require NPR to repay funds expended for unallowable activities under the agreements. NPR must maintain supporting documents to justify all costs incurred for production and support services performed. CPB may verify costs incurred under these agreements at any time. In addition, NPR must obtain CPB's written approval of any reallocations of more than 10 percent of the total amount budgeted for a particular activity.

NPR's Required Financial Reporting

Under the terms of the agreements, NPR must provide current financial accounting reports, including a balance sheet, income statement, and a statement of changes in fund balances, for each quarter of each fiscal year. NPR is also required to provide: (1) quarterly supplemental financial statements showing NPR income by major sources, and (2) comparative budget reports. CPB is allowed to monitor various NPR activities quarterly and to review Indirect and General and Administrative cost allocations annually. Finally, NPR must provide CPB a final detailed written and audited financial accounting and a final narrative report describing NPR's performance under each annual agreement. The reports are required to contain information specifically outlined in the agreement, as well as information regarding programming, personnel, and NPR activities in general.

NPR's Compliance with Laws and Regulations

The Production and Support Agreements reiterate NPR's required compliance with laws and regulations as defined by the Public Broadcasting Act of 1967, as amended, and the Public Telecommunications Act of 1978. This includes provisions for NPR's financial reporting, public Board meetings, and limits on compensation of employees. The agreements also permit CPB to have access, for purpose of audit and examination, to records pertaining to any funds received or expended for public telecommunications purposes.

Finally, NPR must obtain CPB's approval of any proposed NPR subcontract, other than those related to production or acquisition of programs, in excess of \$50,000 or which substantially changes the manner in which NPR provides service.

WEAKNESSES IN CPB OVERSIGHT

CPB reviews focused primarily on the annual Production and Support Agreements and, consequently, did not include comprehensive reviews of all NPR's financial operations. This was less of an

issue in fiscal years prior to 1983, when the majority of NPR funding was provided by CPB. In the fiscal 1983 NPR budget, however, CPB funding was planned at only 48 percent of total revenues, with the majority of revenues to be provided by non-federal sources. There is no evidence which indicates that CPB raised any challenging questions regarding either the sources or reliability of the non-federal revenues. No budget figures for the commercial ventures NPR was beginning were submitted to CPB, and we are not aware of any requests by CPB for such information from NPR. In addition, there were weaknesses in CPB's oversight of NPR's compliance with the Production and Support Agreements.

Use of Federal Funds and Financial Reporting

The following summarizes CPB's statement of the results of independent audits of NPR for the past five years (1978 through 1982):

- In fiscal 1978, Deloitte Haskins and Sells audited NPR's financial statements and found the operations to be satisfactory. However, a minor qualification was rendered due to a change in the method of accounting for the tape and supplies inventory. Due to a lack of adequate detail records, the specific expenditures of funds provided by CPB could not be separately identified from total expenditures. Since CPB funds amounted to approximately 82% of the total NPR budget, the impact of this condition was not considered particularly significant by CPB.
- In fiscal 1979, NPR received an unqualified audit from Deloitte Haskins and Sells, and again the CPB share of the total budget (83%) limited the impact of the lack of detail accounting records for specific expenditures of federal funds, according to CPB.
- For fiscal 1980, Deloitte Haskins and Sells completed an audit of NPR's operations. A minor qualification was rendered, with respect to a technical accounting change, that had no significant impact on the financial statements. CPB's commitment represented 90% of the total budget. In addition, Price-Waterhouse was engaged by CPB to test detail expenditures of CPB-provided funds. Their analysis produced no significant deficiencies, according to CPB.
- Deloitte Haskins and Sells rendered unqualified audit reports for fiscal 1981 and fiscal 1982. It was CPB's plan to audit expenditures under the fiscal 1982 Production and Support Agreement beginning in March 1983. However, due to the surfacing of NPR's financial problems and the ensuing audits by GAO and Coopers and Lybrand, CPB terminated its audit work.

The weakness in accounting procedures for expenditures of federal funds has been a continuing problem that CPB brought to the attention of NPR on numerous occasions. However, reports provided to CPB have always shown, in totals, the expenditures of federal and non-federal funds. The lack of detail records was corrected for financial reporting purposes by use of percentage formulas to allocate costs between federal and non-federal funds.

Because NPR did not have a formalized system for accounting for individual expenditures of federal funds, and the percentage formulas used to allocate costs were not supported by a formal cost allocation system, it was difficult to match CPB funds and related expenditures to ensure such funds were not used to perform any function or service not specifically contained in the agreement.

CPB was aware of the above situation but felt that its impact was minimal in 1978-1980, when more than 80 percent of NPR's budget was composed of CPB funds. However, no CPB audit work in this area was performed in 1981, when CPB funds declined to only 66 percent of the total NPR budget. Instead, reliance was placed on the Deloitte Haskins and Sells unqualified audit report. An audit of the 1982 Production and Support Agreement was begun in the spring of 1983, but was subsequently terminated after NPR's financial crisis was made known. Internal CPB correspondence indicates that the weakness in NPR's accounting procedures for federal funds was brought to NPR's attention on numerous occasions. As late as June 1983, this weakness remained.

Although CPB required the timely submission of financial and supplemental reports, their records indicate that NPR was not in compliance with these requirements for fiscal 1982. The first and third quarterly financial and budget reports were submitted as much as five months late, and the second quarter report was never filed. The final financial accounting report was never submitted, although audited financial statements were made available. The final narrative report was late, and CPB records do not indicate that the supplemental statement detailing income by major source was filed for the first three quarters. The lack of timely and complete financial reporting was not, to our knowledge, raised with NPR as a major concern by CPB. In our opinion, CPB should have realized the significance of such information at a time when NPR was planning major changes in its operations and financing.

In fiscal 1983, all required reports were submitted on time with the exception of the supplemental statement detailing income received by major source. This statement was subsequently received by CPB, one month late. Because the agreement only required quarterly reporting, the first reports for fiscal 1983 were not received by CPB until the financial problems at NPR had been identified. It was then too late for anything less than the massive budget reductions which were subsequently made.

Compliance with Laws and Regulations

NPR also failed to comply with certain requirements of the laws and regulations. NPR failed to pay payroll taxes during its financial crisis. This was a violation of both federal and state law. In addition, the NPR Finance Department failed to withhold

taxes on employee bonuses, a violation of IRS regulations and laws. These violations were not reported to CPB. The statutory pay ceilings were also potentially violated by NPR when it paid salary advances that effectively increased officers' salaries beyond the statutory limits. Again the transactions were not reported to CPB. These advances have since been repaid to NPR. Because of the failure of NPR to report these matters to CPB, we do not believe they represent a failure on the part of CPB oversight.

MAJOR REQUIREMENTS OF THE CPB-NPR LOAN AGREEMENT

Following the financial problems that surfaced at NPR in early 1983, CPB and NPR entered into a loan agreement, in part to preserve the public radio satellite transmission system. Under this agreement, CPB's oversight responsibilities can be divided into three areas: oversight of NPR's use of federal funds, oversight of NPR's required financial reporting, and oversight of the NPR sale and leaseback of its satellite distribution equipment.

CPB has the authority to withhold distribution of loan funds to NPR if there are no assurances that a system of financial controls and procedures exists at NPR to ensure that financial transactions are accounted for in a manner consistent with generally accepted accounting principles. The Loan Agreement provides that for each of the fiscal years covered by the agreement, NPR will develop an annual budget under which reasonably projected expenditures will not exceed reasonably projected revenues. In fact, the budget must reflect a sufficient surplus to eliminate NPR's deficit and repay any CPB advances during the term of the agreement. A public accounting firm is to examine the management assumptions used in preparing the budget and render an opinion on the reasonableness of the assumptions. In addition, CPB will approve NPR's budget on the grounds of financial prudence. Subsequent to this approval, NPR will not make any revisions or reallocations between the line items that will exceed 10 percent without prior written CPB approval. When requesting an advance under the Loan Agreement, NPR is to explain how the advance will impact upon its budget.

NPR is required to ensure that its financial reporting system provides CPB with continuous access to all financial books and records at NPR. As a precondition of the loan, CPB required NPR to implement a financial accounting system that can separately and properly account for all CPB funds, provide CPB with details on how overhead was determined and allocated, develop a monitoring and accounting plan for properly distributing overhead to distribution services, and to repay all other lines of outstanding credit. NPR must submit monthly detailed financial status reports, quarterly reports detailing NPR's progress under the Loan Agreement, and a yearly independently audited financial statement report and accompanying management letters. Finally, NPR was required to submit reports and documents related to the sale and leaseback of certain satellite distribution equipment prior to executing the Loan Agreement.

CPB OVERSIGHT OF NPR'S COMPLIANCE
WITH THE LOAN AGREEMENT

The terms of the Loan Agreement have been closely adhered to through NPR's first quarter of fiscal 1984 operations. The fiscal 1984 budget submitted by NPR met all the requirements specified in the Loan Agreement, and was approved by CPB on September 29, 1983. The additional financial reporting requirements set out in the Loan Agreement were also met. This included the submission of monthly financial reports to CPB within a specified period of time. The only exception was the November 1983 financial report received by CPB eight days late.

The format of the monthly reports submitted to CPB gives the Corporation the ability to determine that funds are spent as they were budgeted. In addition, NPR has rewritten policies and procedures to ensure control over the budget and internal control systems.

CPB has remained in contact with NPR regarding the implementation of the new automated financial accounting system. Prior to February 10, 1984, a module for the tracking of cost accounting information had not been fully implemented. CPB required a status report on the implementation of this module by February 10, 1984.

CPB also properly exercised its responsibility for overseeing NPR's sale and leaseback of certain satellite distribution equipment in accordance with the stipulated terms of the agreement. The terms of the sale and leaseback were properly adhered to, and signing of both the sale and leaseback contracts took place on August 2, 1983.

CPB'S TESTIMONY ON ITS OVERSIGHT RESPONSIBILITY

As stated in testimony before the Subcommittee on February 10, 1984, the Corporation for Public Broadcasting and the public radio stations established NPR to provide those services to public radio that CPB is legally prohibited from providing directly. They believe the relationship between NPR and CPB is contractual and represents a delicate balance between oversight and infringement. Annual contracts negotiated between CPB and NPR establish both the level of funding for the production and distribution of programs to public radio stations and NPR's financial reporting requirements. However, CPB feels this contractual relationship does not establish direct control over the administration, operations, or governance of NPR. Thus, the reporting requirements negotiated through the annual Production and Support Agreement and other contracts are essential to keep CPB informed of NPR's financial situation. CPB feels its primary responsibility is to approve NPR's Funding Proposal prior to the start of each fiscal year and ensure that funds are spent in accordance with the proposal. In the past, CPB has relied on the reports issued by NPR independent financial auditors to verify that CPB funds were being used on appropriate

activities. A limited audit commissioned by CPB in fiscal 1980 indicated that NPR's financial system's ability to track both CPB funds and their related overhead was adequate. The audits, combined with the other financial information provided by NPR, gave CPB every indication that CPB funds were being properly spent. According to CPB, their evaluation of NPR's financial status is only as good as the information NPR provides.

According to CPB, they continued to rely on NPR internal and external financial reports to monitor the use of CPB funds through the first six months of fiscal 1983. It was only after the April 1983 Public Radio Conference, at which time NPR management made public the projected \$5.8 million operating deficit for the year-end, that CPB felt it could no longer rely on the financial information being provided by NPR.

In retrospect, CPB indicated its oversight may have been inadequate to detect the growing financial problems at NPR prior to the announcement of the financial crisis in mid-fiscal 1983. CPB officials agree that the Corporation should have recognized earlier that the reporting system at NPR would be inadequate to handle NPR's planned expansion activities.

The controls set in place by both the Loan Agreement and the enactment of Public Law 98-214 (Federal Communications Commission's Authorization Act of 1983, December 8, 1983), combined with prior legislation, have helped to more clearly define CPB's oversight responsibilities. The legislation requires that CPB may not distribute any funds authorized to be appropriated by the legislation unless NPR complies with additional financial control, budgeting, and reporting requirements. It is anticipated by CPB that this clarification will go a long way toward preventing a recurrence of the NPR 1983 financial crisis.