United States Department of State

The Inspector General

December 16, 2013

Board of Governors
Broadcasting Board of Governors
330 Independence Avenue SW, Room 3360
Washington, DC 20237

Dear Members of the Board:

An independent certified public accounting firm, Kearney & Company, P.C., was engaged to audit the consolidated financial statements of the Broadcasting Board of Governors (BBG) as of September 30, 2013, and for the year then ended; to provide a report on internal control over financial reporting; and to report any reportable noncompliance with laws, regulations, contracts, and grant agreements it tested. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards and Office of Management and Budget audit guidance.

In its *Independent Auditor's Report on the Broadcasting Board of Governors 2013 Financial Statements* (AUD-FM-IB-14-14), Kearney & Company found

- the consolidated financial statements present fairly, in all material respects, the financial position of BBG as of September 30, 2013, and its net cost of operations, changes in net position, and budgetary resources for the year then ended, in accordance with accounting principles generally accepted in the United States of America;

- three material weaknesses[1] in internal control over financial reporting; and

- instances of reportable noncompliance with laws, regulations, contracts, and grant agreements tested.

The BBG 2012 consolidated financial statements were audited by a predecessor auditor whose report, dated November 16, 2012, expressed an unqualified opinion on those statements. The predecessor auditor reported on the consolidated financial statements of the prior period before restatement.

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[1] A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

As part of Kearney & Company's audit of the 2013 consolidated financial statements, Kearney & Company also audited the adjustments that were applied by BBG to restate its 2012 consolidated financial statements. In Kearney & Company's opinion, such adjustments are appropriate and have been properly applied. Kearney & Company was not engaged to audit the BBG 2012 consolidated financial statements other than with respect to the adjustments and, accordingly, Kearney & Company does not express an opinion or any other form of assurance on the 2012 consolidated financial statements as a whole.

Kearney & Company is responsible for the enclosed auditor's report, which includes the Independent Auditor's Report, the Report on Internal Control Over Financial Reporting, and the Report on Compliance With Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements, dated December 14, 2013, and the conclusions expressed in the report. The Office of Inspector General (OIG) does not express an opinion on BBG's consolidated financial statements or conclusions on internal control over financial reporting and compliance with laws, regulations, contracts, and grant agreements.

BBG's comments on the auditor's report are attached to the report.

OIG appreciates the cooperation extended to it and Kearney & Company by BBG managers and staff during this audit.

Sincerely,

Steve A. Linick
Inspector General

Enclosure: As stated.

cc: Leslie Hyland, BBG/CFO

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INDEPENDENT AUDITOR'S REPORT
AUD-FM-IB-14-14

To the Board of Governors and the Inspector General of the Broadcasting Board of Governors

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the Broadcasting Board of Governors (BBG), which comprise the consolidated balance sheet as of September 30, 2013, the related consolidated statements of net cost and changes in net position and the combined statement of budgetary resources for the year then ended, and the related notes to the consolidated financial statements (hereinafter referred to as the "consolidated financial statements").

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 14-02 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate under the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on the Consolidated Financial Statements

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BBG as of September 30, 2013, and its net cost of operations, changes in net position, and budgetary resources for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1 to the consolidated financial statements, in FY 2013, BBG adopted new accounting guidance issued by the Federal Accounting Standards Advisory Board (FASAB) – specifically, Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*. In addition, as discussed in Note 1 to the consolidated financial statements, BBG changed its method of reporting actuarial liabilities and benefit plan assets relating to after-employment benefits provided to Foreign Service National overseas staff in FY 2013. Our opinion is not modified with respect to these matters.

Other Matters

FY 2012 Financial Statements Audited by a Predecessor Auditor

BBG's consolidated financial statements as of, and for the year ended, September 30, 2012, were audited by a predecessor auditor whose report, dated November 16, 2012, expressed an unqualified opinion on those consolidated financial statements. The predecessor auditor reported on the prior period consolidated financial statements before restatement.

As part of our audit of the FY 2013 consolidated financial statements, we also audited the adjustments described in Note 18 that were applied to restate the FY 2012 consolidated financial statements. These notes describe the amount of the restatements and the effect on the financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to BBG's FY 2012 consolidated financial statements other than with respect to the adjustments, and accordingly, we do not express an opinion or any other form of assurance on the FY 2012 consolidated financial statements as a whole. Our Report on Internal Control Over Financial Reporting includes a discussion of the significant internal control deficiencies that failed to prevent or detect the misstatements.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Deferred Maintenance (hereinafter referred to as "required supplementary information") be presented to supplement the consolidated financial statements. Such information, although not a part of the consolidated financial statements, is required by OMB Circular A-136, *Financial Reporting Requirements*, and FASAB, which consider it to be an essential part of financial reporting for placing the consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing it for consistency with management's responses to our inquiries, the consolidated financial statements, and other knowledge we obtained during our audits of the consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Message from the BBG Chairman, the Performance Information, the Letter from the Chief Financial Officer, the Inspector General's Statement on FY 2012 Management and Performance Challenges, the Agency Response to the Management and Performance Challenges, the Summary of Financial Statement Audit and Management Assurances, and the Improper Payments Information Act Reporting are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards* and OMB Bulletin No. 14-02, we have also issued reports, dated December 14, 2013, on our consideration of BBG's internal control over financial reporting and on our tests of BBG's compliance with certain provisions of laws, regulations, contracts, and grant agreements for the year ended September 30, 2013. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards,* and OMB Bulletin No. 14-02, in considering BBG's internal control over financial reporting and compliance.

Kearney & Company

Alexandria, Virginia
December 14, 2013

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Governors and the Inspector General of the Broadcasting Board of Governors

We have audited the consolidated financial statements of the Broadcasting Board of Governors (BBG) as of and for the year ended September 30, 2013, and have issued our report thereon dated December 14, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered BBG's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate under the circumstances for the purpose of expressing our opinion on the consolidated financial statements but not for the purpose of expressing an opinion on the effectiveness of BBG's internal control. Accordingly, we do not express an opinion on the effectiveness of BBG's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 14-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies; therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the following sections, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the following deficiencies in BBG's internal control to be material weaknesses.

Material Weaknesses

I. Grantee Monitoring and Accounting for Grant Advances

BBG has three grantees that it funds through annual grant agreements: Radio Free Europe/Radio Liberty, Radio Free Asia, and Middle East Broadcasting Networks. The grantees are responsible for developing broadcast content (radio and television news programs), which is distributed by BBG. The three grantees annually receive approximately one third of BBG's funding. We identified control deficiencies relating to BBG's management of its grantees that, when combined, constituted a material weakness in internal control. The individual deficiencies we identified are summarized as follows:

- <u>Grantee Monitoring</u> – BBG is responsible for monitoring how its grantees use BBG funds to ensure the grantees adhere to relevant laws and regulations as well as the terms and conditions specified in the grant agreements. BBG's process for overseeing grantee activities and compliance consisted mainly of maintaining a binder for each grantee that contained signed grant agreements, amendments, financial plans, funding requests, payment vouchers, and the monthly financial reports prepared by each grantee. Although, BBG was maintaining binders for each grantee, we noted the following instances where BBG did not sufficiently monitor the three grantees:
    - BBG did not have specific procedures in place for post-award monitoring to ensure grantees were not using Federal awards for unallowable costs.
    - BBG did not obtain and review property listings for all grantees. The property listing obtained from one grantee lacked the necessary information to reconcile to accounting records, and BBG grant officials could not document that follow up had been performed.
    - The FY 2012 OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, audit reports for one grantee identified an issue related to unallowable costs. Although BBG was responsible for issuing a management decision on this issue, there was no evidence that BBG officials were aware of this finding.
    - BBG does not have oversight policies and procedures in place to ensure grantees have mandated procurement procedures.
    - BBG's grant terms and conditions state that grantees should provide advance notification of new contracts and leases exceeding certain thresholds for BBG approval. No documentation was provided showing that BBG grant officials obtained this required information from the grantees.
    - There was no evidence that the grantees had requested and been provided with disposition instructions from BBG concerning disposals of property over a certain threshold acquired using Federal funds.
    - There was no evidence of grantee certifications regarding disbarment and suspension.

BBG has developed a handbook to provide guidance to BBG officials about the administration and oversight of grants. Although the handbook specifies monitoring procedures, it does not define specific roles and responsibilities. In addition, staff turnover and the lack of sufficient oversight protocols led to inconsistent execution and documentation of grant monitoring. The lack of effective grantee oversight procedures increases the risk of waste, fraud, and abuse of Federal funds.

- Grant Advances – We found that BBG did not record funds advanced to its grantees in its annual financial statements. Our review of the grantees' financial statements identified significant cash balances provided by BBG that, according to accounting principles, should be reported as advances by the grant-making organization. Instead, BBG recorded an expense as soon as the funds were transferred to the grantees. Because BBG did not have a sufficient process in place to monitor its grantees, BBG officials did not have a complete understanding of grantee operations and financial management practices and were unaware that the grantees had significant unused funds.

  As a result of our findings, BBG requested financial information from the grantees, which should have been easy for the grantees to provide, in order to report the required grant advances in BBG's financial statements. According to BBG officials, the grantees did not provide requested information in a timely manner to facilitate the preparation of BBG's financial statements. Because BBG's grantees were unwilling or unable to provide the requested information, BBG had no alternative but to consider other methods, which were less precise, to estimate the material grant advances. Based on the material misstatement identified during the audit, BBG restated its FY 2012 financial statements.

II. Property, Plant, and Equipment

As of September 30, 2013, BBG reported over $100 million in net property, plant, and equipment (PP&E), which included real and personal property. We identified control deficiencies with BBG's PP&E processes that, when combined, constituted a material weakness in internal control. The individual deficiencies we identified are summarized as follows:

- Recording Transmitting Stations as Assets – BBG facilitates its broadcasting mission by using Government-owned transmitters, physical radio stations, and broadcasting stations strategically located around the world. We found that BBG had 85 FM radio and 5 television transmitting stations worldwide that had not been recorded as PP&E. Instead, BBG had recorded the costs associated with the transmitting stations as expenses. Although BBG had several controls in place to reconcile property inventories and search for unrecorded capital assets, the controls did not identify the unrecorded transmitting stations. The transmitting stations were being tracked outside of BBG's primary property management system. In addition, there was not an effective communication mechanism between the BBG officials that were aware of the costs of the transmitting stations and BBG financial reporting staff. As a result of the lack of controls, PP&E and expenses were materially misstated. BBG recorded an estimated amount for the transmitting stations for its FY 2013 financial statements and restated its FY 2012 financial statements.

- Removing Assets from Service – Agencies are responsible for ensuring that PP&E is appropriately valued and reported in the financial statements. Assets that are no longer providing service to the organization should be written off. We found two transmitting facilities that had ceased operations in 2007 and were permanently out of service. At these two locations, we identified 22 assets included in BBG's financial statements that were impaired, obsolete, or permanently removed from service. BBG did not have an effective process in place to obtain information on assets that had been removed from service and, therefore, PP&E and expenses were misstated.

- Accounting for Leases – BBG leases real property in overseas and domestic locations under varying types of lease agreements. During FY 2013, BBG had more than 80 leases, the majority of which were reported as operating leases. Operating leases allow for the use of an asset, but do not convey ownership rights. Capital leases are leases that transfer substantially all of the benefits and risks of ownership. We reviewed lease agreements to ensure that capital leases were not being inaccurately reported as operating leases. We were unable to determine whether all lease agreements were appropriately recorded because BBG did not maintain information needed to assess the applicability of capital lease criteria. Specifically, BBG did not document the fair market values, economic useful lives, present values of future lease payments, or details on lease purchase options.

  BBG used a manual data call process to obtain information on leases annually. However, the manual data call process was ineffective in obtaining the data needed to assess leases for capitalization in accordance with accounting standards. For instance, the data call request sent to posts each year did not request all of the necessary information. In addition, the data call request was only sent to posts where officials from Headquarters were aware a lease existed. Without an effective process to track and assess leases for capitalization, property and expenses may be misstated on BBG's financial statements.

- Unrecorded Leasehold Improvements – Periodically, BBG funds renovations or improvements to its leased facilities. BBG capitalizes significant improvements to leased facilities that exceed $25,000. We found two renovation projects at leased property that were not included in PP&E as required. Instead, BBG had recorded the costs associated with these projects as expenses because BBG did not have a process in place to ensure that significant leasehold improvements were recorded accurately. As a result PP&E and expenses were misstated.

III. Budgetary Accounting and Funds Control

BBG lacked sufficient reliable funds control over its accounting and business processes to ensure budgetary transactions were properly recorded, monitored, and reported. Our audit identified control deficiencies that, when combined, we considered to be a material weakness. The individual deficiencies we identified are summarized as follows:

- FY 2012 Apportioned Authority – BBG receives funding through annual appropriations, which is apportioned to BBG by OMB. On its statement of budgetary resources (SBR), BBG reports the extent to which resources are obligated or unobligated. For unobligated balances, BBG is required to further distinguish whether the amounts are apportioned or unapportioned. We noted a negative balance of $17 million reported as Apportioned Authority on BBG's FY 2012 SBR, which is an abnormal balance. Upon investigation, BBG management noted that the balance should have been approximately $7 million. BBG officials indicated that the erroneous apportionment balance was due to the method used by BBG's accounting system to post certain collections and year-end closing entries. BBG did not perform effective reviews and comparative analyses of its FY 2012 financial data, which should have detected the error. Without developing and implementing effective routine financial reviews, material errors and anomalies in the financial statements may not be identified and corrected. As a result of this material error, BBG restated its FY 2012 financial statements.

- Timeliness of Obligations – BBG should record an obligation in its financial management system when it enters into an agreement, such as a contract or a purchase order, to purchase goods and services. We identified a number of instances where obligations were not created in a timely manner, such as obligations that were not recorded within 15 days of executing obligating document, obligations that were recorded prior to executing the obligating document, and obligations that were posted subsequent to the receipt of goods and services or the start of the period of performance for a contract. BBG did not have an adequate process in place to ensure that its employees were complying with Federal requirements related to the creation, approval, and timely recording of obligations. Without an effective obligation process, controls to monitor funds and make timely payments may be compromised, which may lead to violations of the Antideficiency Act and the Prompt Payment Act.

- Unliquidated Obligations – Once recorded, obligations remain open until they are fully reduced by disbursements, are deobligated, or until the appropriation funding the obligations is cancelled. Unliquidated obligations (ULO) represent the cumulative amount of orders, contracts, and other binding agreements for which the goods and services ordered have not been received, or the goods and services have been received but payment has not yet been made.

  We identified numerous invalid ULOs. For domestic obligations, BBG had not effectively implemented ULO review procedures. Specifically, BBG officials did not perform timely follow-up with program offices to ensure invalid ULOs were identified and liquidated. For overseas obligations, BBG did not have a process to obtain a population of ULOs or have a standard process to ensure ULOs were periodically reviewed for validity. As a result of the identified errors, BBG had an overstatement of obligations of $16 million. In addition, funds that could have been used for other purposes remained in unneeded obligations.

The material weaknesses described above were not identified by BBG's FY 2013 Federal Managers' Financial Integrity Act assessment.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance. We consider the following deficiency in BBG's internal control to be a significant deficiency.

Significant Deficiency

I. Information Technology

BBG uses several financial management systems to compile information for financial reporting purposes. BBG's main domestic financial management and accounting system is Momentum, which is provided by an external service provider. The external service provider is responsible for maintaining a number of information technology (IT) controls. However, Momentum is accessed through BBG's general IT support systems. Therefore, IT deficiencies noted in the general systems could potentially impact Momentum as well. For overseas accounting and budget execution, BBG uses the Regional Financial Management System (RFMS) provided by the Department of State (Department). The Department is responsible for maintaining an adequate general and application control environment over this system.

The Office of Inspector General (OIG) annually performs an evaluation of BBG and Department information security program compliance with IT requirements as required by the Federal Information Security Management Act (FISMA).

We evaluated the internal control structure surrounding the general support systems and key financial applications used by BBG. We noted weaknesses and vulnerabilities in BBG's general support systems and several key financial applications maintained by BBG and the Department. We identified a number of weaknesses that, when combined, we considered to be a significant deficiency. The individual deficiencies noted are as follows:

- <u>General Support Systems</u> – Collectively, the control deficiencies noted by OIG in its FY 2013 FISMA report[1] related to BBG's general support systems represented a significant deficiency to enterprise-wide security as defined by OMB guidance. OIG reported that the most significant security deficiencies were related to BBG's risk management framework, continuous monitoring program, and the incident response and reporting program. These control weaknesses impact BBG's general support system, which is used to access the Momentum system.

- <u>Domestic Accounting System Access Controls</u> – As part of our audit, we tested BBG's Momentum system access controls by reviewing whether employees who had separated from BBG during FY 2013 had their access to Momentum revoked. [Redacted] (b) (5) [redacted]

[1] *Audit of the Broadcasting Board of Governors Information Security Program* (AUD-IT-IB-14-02, Oct. 2013).

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- Overseas Accounting System Account Monitoring and Separation of Duties – OIG's FY 2013 FISMA report[2] for the Department identified deficiencies with the general support systems at the Department similar to ones identified at BBG. OIG concluded that the issues identified were a significant deficiency to enterprise-wide security. RFMS is hosted on the Department's general support systems.

  We also performed testing on RFMS during the audit of the Department's FY 2013 financial statements and found that the Department did not effectively monitor RFMS for suspicious behavior or malfunctions. For example, the Department did not have an effective process to log and independently monitor changes to the permissions granted to user accounts. In addition, we found deficiencies that impacted the ability of the Department to identify and mitigate problems with RFMS users that had incompatible duties. Specifically, we found that the Department had not defined many RFMS user roles, and we identified RFMS users that had been assigned a combination of roles that potentially allowed users to perform end-user accounting transactions.

In general, we and OIG found that BBG had not implemented effective standards, policies, processes, and procedures over its information security program, including its financial applications. With respect to separated employees with Momentum accounts, we determined that BBG did not have a formal process to communicate employee separations to the Momentum system administrators. For RFMS, because of the deficiencies noted with the IT security program at the Department, BBG needs to implement additional controls to ensure that financial information is being processed accurately and completely by the Department.

Poor controls over IT security can affect the integrity of financial applications, which increases the risk that sensitive financial information could be accessed by unauthorized individuals or that financial transactions could be altered either accidentally or intentionally. IT weaknesses increase the risk that BBG will be unable to accurately report financial data.

During the audit, we noted certain additional matters involving internal control over financial reporting that we will report to BBG management in a separate letter.

BBG's Response to Findings

BBG management has provided its response to our findings in a separate memorandum attached to this report. We did not audit management's response, and accordingly, we express no opinion on it.

[2] *Audit of the Department of State Information Security Program* (AUD-IT-14-03, Nov. 2013).

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting and the results of that testing and not to provide an opinion on the effectiveness of BBG's internal control. This report is an integral part of an audit performed in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and OMB Bulletin No. 14-02, in considering BBG's internal control over financial reporting. Accordingly, this report is not suitable for any other purpose.

Kearney & Company

Alexandria, Virginia
December 14, 2013

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH APPLICABLE PROVISIONS OF LAWS, REGULATIONS, CONTRACTS, AND GRANT AGREEMENTS

To the Board of Governors and the Inspector General of the Broadcasting Board of Governors

We have audited the consolidated financial statements of the Broadcasting Board of Governors (BBG) as of and for the year ended September 30, 2013, and have issued our report thereon dated December 14, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*.

Compliance

As part of obtaining reasonable assurance about whether BBG's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material impact on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 14-02 that we determined were applicable. We limited our tests of compliance to these provisions and did not test compliance with all laws, regulations, contracts, and grant agreements applicable to BBG. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 14-02 and which are summarized as follows:

- *Federal Grant Regulations.* BBG is responsible for monitoring the use of funds provided to its grantees to ensure the grantees adhere to relevant laws and regulations. As noted in our Report on Internal Control Over Financial Reporting, we identified control deficiencies that resulted in noncompliance with the following Federal grant regulations:

    - OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations*, sets forth standards for obtaining consistency and uniformity among Federal agencies in the administration of grants to non-profit organizations.
    - OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, establishes principles for determining the costs of grants, contracts and other agreements with non-profit organizations.
    - OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, sets forth standards for obtaining consistency and uniformity

among Federal agencies for the audit of non-profit organizations expending Federal awards.

- *Prompt Payment Act*. This act requires Federal agencies to make payments in a timely manner, pay interest penalties when payments are late, and take discounts only when payments are made within the discount period. BBG did not always make payments within 30 days, as required. Additionally BBG did not always pay interest on payments made after the 30-day requirement or accurately calculate the interest that was paid.

- *Antideficiency Act.* The Antideficiency Act (ADA) prohibits BBG from (1) making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation or fund in excess of the amount available in the appropriation or fund unless authorized by law; (2) involving BBG in any obligation to pay money before funds have been appropriated for that purpose, unless otherwise allowed by law; and (3) making obligations or expenditures in excess of an apportionment or reapportionment, or in excess of the amount permitted by agency regulations. Several potential ADA violations have been identified at BBG. We found that BBG recorded an obligation related to an annual grant agreement that was in excess of its annual appropriation, which is a potential ADA violation. In addition, we noted a BBG fund with a negative balance. Finally, the Office of Inspector General (OIG) identified two practices that were potential ADA violations related to the use of personal services contracts and contractors without valid contracts in place.

- *Federal Acquisition Regulation.* The Federal Acquisition Regulation (FAR) is the primary guidance for Federal acquisitions of supplies and services using appropriated funds. OIG is currently conducting an audit of BBG's acquisition functions. Based on the preliminary results of the audit, OIG has identified instances of noncompliance with the FAR during pre-solicitation, pre-award, and contract administration phases of the acquisition process, including inadequate performance of full and open competition and price determination.

- *Internal Revenue Service Code.* The Internal Revenue Service (IRS) is the U.S. Government agency responsible for tax collection and tax law enforcement. IRS is assessing how BBG processes payments to certain individuals engaged to support BBG. The IRS has questioned BBG's practice of not withholding Federal employment taxes on compensation to personal service contractors (PSC) and purchase order vendors (POV). The IRS issued a "notice of proposed adjustment" in 2013, concluding that BBG should have treated PSCs and POVs as employees, rather than independent contractors, for tax purposes. BBG is in the process of responding to the IRS review. However, BBG may be liable for employment taxes relating to PSC and POV payments dating back to 2010.

- *Federal Managers' Financial Integrity Act* – The Federal Managers' Financial Integrity Act requires executive branch agencies to establish and maintain effective internal control. The heads of agencies must annually evaluate and report on the effectiveness of the internal control and financial management systems that protect the integrity of

Federal programs. We found that BBG did not complete its annual evaluation in FY 2013.

Except as noted above, our tests of compliance with the provisions of selected laws, regulations, contracts, and grant agreements disclosed no other instances of noncompliance that would be reportable under the standards applicable to financial audits contained in *Government Auditing Standards* and OMB Bulletin No. 14-02.

During the audit, we noted certain additional matters involving compliance that we will report to BBG management in a separate letter.

BBG's Response to Findings

BBG management has provided its response to our findings in a separate memorandum attached to this report. We did not audit management's response, and accordingly, we express no opinion on it.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on the effectiveness of BBG's compliance. This report is an integral part of an audit performed in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and OMB Bulletin No. 14-02, in considering BBG's compliance. Accordingly, this report is not suitable for any other purpose.

Kearney & Company

Alexandria, Virginia
December 14, 2013

BROADCASTING BOARD OF GOVERNORS
UNITED STATES OF AMERICA

December 16, 2013

The Honorable Steve A. Linick
Deputy Inspector General
Office of Inspector General
2201 C Street, N.W.
Washington, DC 20520

Dear Mr. Linick:

The Performance and Accountability Report (PAR) is our principal report to the President, Congress, and the American people on our stewardship of the public funds to which we have been entrusted. The PAR is a key element and essential discipline in disclosing the BBG's financial status and providing transparency and accountability. The PAR provides a comprehensive view of the BBG's financial activities set against the backdrop of the global issues and engagements we face as a small agency working to advance U.S. broadcasting interests abroad.

I am pleased that the BBG has received an unqualified audit opinion for FY 2013. I recognize that there were material weaknesses and significant deficiencies identified during the course of audit that will require continued focus and dedication throughout the agency. We remain committed to corporate governance and continuing to improve our financial management and internal controls. We are dedicated to addressing these items and meeting these challenges.

Our ultimate goal is to support an accountable and efficient financial platform that furthers the BBG's global broadcasting operations and mission as well as provide accurate and high-value financial information for decision-makers. Given the global and complex nature of our operations, there will always be areas of concern and opportunities for improvement. We understand that fact, and I am confident in our resolve as we continue to manage the BBG's finite resources on behalf of America's taxpayers in support of U.S. International Broadcasting.

I want to thank Kearney & Company for their efforts and professionalism in working through the many complex issues associated with the BBG's financial processes.

Sincerely,

Leslie Hyland
Chief Financial Officer

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