



National Science Foundation • Office of Inspector General
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MEMORANDUM

Date: June 16, 2016

To: Jeffery Lupis
Division Director, Division of Acquisition and Cooperative Support

From: Marie A. Maguire *Marie A. Maguire*
Assistant Inspector General for Audit (Acting)

Subject: Audit Report No. 16-1-020, Performance Audit of Management Fees at National Ecological Observatory Network (NEON)

This memorandum transmits the Cotton & Company LLP report for the performance audit of management fees awarded by the National Science Foundation (NSF) to the National Ecological Observatory Network (NEON).

For the period October 1, 2011 to September 30, 2014, the auditors found that NEON's use of management fees was not in accordance with its NSF proposals and that a significant portion of the fees were not used for ordinary and necessary expenses to facilitate basic business operations. Funds provided as management fees were used to pay for lobbying, alcohol, and entertainment, among other things. NEON, in its response dated May 19, 2016, did not dispute the audit or facts contained in the report.

As such, the auditors made five recommendations in the report related to management fees. Please coordinate with our office during the six month resolution period, as specified by OMB Circular A-50, to develop a mutually agreeable resolution of the audit findings.

OIG Oversight of Audit

To fulfill our responsibilities under generally accepted government auditing standards, the Office of Inspector General:

- Reviewed Cotton & Company's approach and planning of the audit;
- Evaluated the qualifications and independence of the auditors;
- Monitored the progress of the audit at key points;
- Coordinated periodic meetings with Cotton & Company and NSF officials, as necessary, to discuss audit progress, findings, and recommendations;

- Reviewed the audit report, prepared by Cotton & Company, to ensure compliance with generally accepted government auditing standards; and
- Coordinated issuance of the audit report.

Cotton & Company is responsible for the attached auditor's report on NEON and the conclusions expressed in the report. We do not express any opinion on the conclusions presented in Cotton & Company's audit report.

We thank your staff for the assistance that was extended to the auditors during this audit. If you have any questions regarding this report, please contact Elizabeth Goebels at 703-292-8483.

Attachment

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NATIONAL ECOLOGICAL OBSERVATORY NETWORK (NEON)

PERFORMANCE AUDIT OF MANAGEMENT FEES AWARDED ON

NATIONAL SCIENCE FOUNDATION

COOPERATIVE AGREEMENTS

FOR THE PERIOD OCTOBER 1, 2011, TO SEPTEMBER 30, 2014

NATIONAL SCIENCE FOUNDATION

OFFICE OF INSPECTOR GENERAL

TABLE OF CONTENTS

I.	EXECUTIVE SUMMARY	1
II.	BACKGROUND	1
III.	MANAGEMENT FEE HISTORY	2
IV.	NEON MANAGEMENT FEE AWARD HISTORY	4
V.	NEON’S POLICIES AND PROCEDURES FOR CHARGING, ACCOUNTING FOR, AND DRAWING DOWN MANAGEMENT FEES AND RELATED EXPENDITURES	5
VI.	AUDIT RESULTS	6
	APPENDIX A: SUMMARY OF EXPENSES PAID USING MANAGEMENT FEES	8
1.	<i>Consulting and Outsourced Services</i>	<i>10</i>
2.	<i>Overhead.....</i>	<i>10</i>
3.	<i>Employee Welfare & Team Building.....</i>	<i>10</i>
4.	<i>Rent.....</i>	<i>11</i>
5.	<i>Legal Services</i>	<i>11</i>
6.	<i>Salaries & Wages and Other Compensation.....</i>	<i>12</i>
7.	<i>Business Meals.....</i>	<i>12</i>
8.	<i>Relocation Expense</i>	<i>12</i>
9.	<i>Fringe Benefits.....</i>	<i>13</i>
10.	<i>Travel.....</i>	<i>13</i>
11.	<i>Internet & Communications.....</i>	<i>13</i>
12.	<i>Conferences/Seminars</i>	<i>14</i>
13.	<i>Board-Related Fees</i>	<i>14</i>
14.	<i>Office/Program Equipment & Supplies</i>	<i>14</i>
15.	<i>Late Fees.....</i>	<i>15</i>
16.	<i>Furniture, Fixtures & Supplies and Leasehold Improvements (<\$5k).....</i>	<i>15</i>
17.	<i>Printing, Copying, Postage and Freight.....</i>	<i>15</i>
18.	<i>Dues/Subscriptions</i>	<i>15</i>
19.	<i>Equipment Rental.....</i>	<i>16</i>
20.	<i>Participant Support Costs.....</i>	<i>16</i>
21.	<i>Recruiting</i>	<i>16</i>
22.	<i>Bank Services Fees</i>	<i>16</i>
	APPENDIX B: OBJECTIVES, SCOPE, AND METHODOLOGY	17
	APPENDIX C: NEON MANAGEMENT’S RESPONSE	20

**NATIONAL SCIENCE FOUNDATION
PERFORMANCE AUDIT OF MANAGEMENT FEES
NATIONAL ECOLOGICAL OBSERVATORY NETWORK**

I. EXECUTIVE SUMMARY

Cotton & Company LLP (referred to as “we”) conducted a performance audit of management fees awarded by the National Science Foundation (NSF) to the National Ecological Observatory Network (NEON) for the period from October 1, 2011, to September 30, 2014. We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS).

The audit objectives included determining whether NEON’s method of charging and using management fees was in accordance with its NSF proposals, evaluating whether these fees were used for ordinary and necessary expenses (that were not otherwise reimbursable) to facilitate basic business operations at NEON, and comparing the amount of management fees received to the amount of unallowable expenses identified.

We found that NEON’s use of management fees was not in accordance with its NSF proposals, and that a significant portion of the fees were not used for ordinary and necessary expenses to facilitate basic business operations. Funds provided as management fees were used to pay for lobbying, alcohol, and entertainment, among other things. We also noted that NEON’s budget proposals to NSF included management fees under a category of allowable cost (Other Direct Costs) instead of under a separate line item, which would have increased transparency.

II. BACKGROUND

The National Science Foundation (NSF) is an independent federal agency whose mission is to promote the progress of science; to advance the national health, prosperity, and welfare; and to secure the national defense. Through grant awards, cooperative agreements, and contracts, NSF enters into relationships with non-federal organizations to fund research and education initiatives and to gain assistance in supporting its internal financial, administrative, and programmatic operations. One such organization receiving funding from NSF is the National Ecological Observatory Network (NEON).

NEON was conceived as an instrument to advance scientists’ ability to examine and understand the interactions between life and the environment at the scale of an entire continent. NEON is currently in the construction phase, which initially involved building 95 field sites and implementing the information infrastructure needed to gather data from sensors and field samples, ensure data quality, process the information into data products, and deliver those products to users via an online portal.

In September 2014, Senators Charles Grassley and Rand Paul sent a letter to NSF's Director regarding the preliminary draft results of an audit of NEON's accounting system performed by the Defense Contract Audit Agency (DCAA) at the request of the NSF Office of Inspector General (OIG), which provides independent oversight of NSF's programs and operations. The draft audit found that federal grant money NSF provided to NEON in the form of a "management fee" had been used to pay for expenses that could be considered unallowable under NSF awards. Specifically, DCAA found that NEON was using management fees to cover expenses for Christmas parties, premium coffee services, Board of Directors (BOD) dinners, and other costs that were not part of the entity's official business.

In response to Congressional inquiries, the NSF OIG engaged Cotton & Company LLP to conduct a performance audit of management fees that NSF awarded to NEON from October 1, 2011, to September 30, 2014. Our audit of NEON encompassed [REDACTED] in expenses that NEON had paid using NSF management fees. The purpose of this audit was to: (1) determine whether NEON's charging and use of management fees was in accordance with NSF proposals, federal regulations, NSF policy, any negotiation memoranda, and NEON's internal policies; (2) evaluate whether these fees were used for ordinary and necessary expenses (that were not otherwise reimbursable) to facilitate basic business operations at NEON; and (3) compare the amount of management fees received to the amount of unallowable expenses identified and draw any conclusions that arise from this comparison.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS), issued by the Government Accountability Office (GAO). We communicated the results of our audit and the related findings and recommendations to NEON and the NSF OIG.

III. MANAGEMENT FEE HISTORY

According to the NSF OIG's *White Paper on Management Fees*, issued on November 24, 2014, the concept of providing management fees to non-profit entities was established shortly after World War II as part of the development of Federally Funded Research and Development Centers (FFRDCs). The FFRDCs' mission was to perform research and development for the government that the government was unable to provide itself. The FFRDCs were typically non-profit entities and were almost wholly dependent upon government funding; however, they would necessarily incur costs that could not be reimbursed under federal cost principles. As a result, the government created management fees to bridge the gap between what could be reimbursed under an award as a direct or indirect cost, and what could not be reimbursed as such but was still needed. A 2003 Congressional Research Report¹ summed up this practice as follows:

While Centers are not-for-profit entities, they are allowed to charge the government fees above and beyond the cost of carrying out their responsibilities. Some Centers charge fees to cover ordinary and necessary costs of doing business that are not otherwise reimbursable, but that the government recognizes must be incurred. These fees can also

¹ *Department of Homeland Security: Issues Concerning the Establishment of Federally Funded Research and Development Centers (FFRDCs)* (November 13, 2003).

be used by an FFRDC to conduct independent research. The [Federal Acquisition Regulation (FAR)] acknowledges the legitimacy of such fees.

While the FAR, which does not apply to NSF cooperative agreements, acknowledged the legitimacy of these fees, the government did not issue any guidance regarding how the fees should be monitored or justified, which led to many concerns regarding what types of expenses the fees should cover. After a number of Government Accountability Office (GAO) reports² found that FFRDCs were using management fees to pay for expenses such as holiday parties, receptions, and personal use of company-furnished cars, GAO recommended adopting government-wide guidelines to identify appropriate restrictions on the use of the fees and to precisely define what constitutes an ordinary and necessary expense. No such guidelines were ever published, however.

Before June 2015, the only³ NSF policy that addressed management fees was its Proposal and Award Policies and Procedures Guide (PAPPG). Specifically, PAPPG Part II Chapter V, Section E states that “payment of fees (profit) are allowable only if specifically permitted by a program solicitation and only to the extent that it does not exceed the amount negotiated by the Grants and Agreements Officer and specified in the award letter.” This document does not include any specific guidance regarding how the fee amount should be determined, how it should be monitored, or what types of expenses should be reimbursable using these fees.

In June 2015, NSF issued an updated Large Facilities Manual, NSF 15-089. This updated document contains specific guidance addressing the definition, award, and use of management fees under NSF awards. The manual defines management fees as an amount of money paid to a recipient in excess of a cooperative agreement’s allowable costs and states that the following expense categories will be used in the negotiation and award of management fees:

- Working capital necessary to fund operations under an award.
- Facilities capital necessary to acquire assets for performance.
- Other ordinary and necessary expenses for business operations that are not otherwise reimbursable under the governing principles.

NSF 15-089 also states that awardees will be required to report to NSF annually regarding their actual use of the management fees. Furthermore, the policy specifically identifies types of expenses that are not appropriate uses of management fees awarded. These unallowable expenses include lobbying, alcoholic beverages, tickets to concerts or sporting events, and meals or social activities for non-business purposes or for business purposes that are so extravagant as to constitute entertainment.

² *Use of Contract Fee by the Aerospace Corporation*, GAO/NSIAD-95-174 (Sept.1995) and *Use of Fee by the MITRE Corporation*, GAO/NSIAD-96-26 (Nov.1995).

³ NSF’s Proposal and Award Manual (PAM) also contained language regarding the payment of fees; however, the PAM is an internal NSF document that is only accessible to NSF personnel.

IV. NEON MANAGEMENT FEE AWARD HISTORY

NEON began receiving cooperative agreement funding from NSF in April 2007; however, it did not request management fees until December 8, 2008, under NSF Award No. 0752017. This request described NEON’s need for discretionary funds to cover incurred expenses that were deemed to be unallowable under Office of Management and Budget (OMB) Circular A-122.⁴ NEON explained that because NSF was its primary source of income,⁵ almost all of funding that it received was subject to federal cost principles; therefore, without either additional sources of income or management fees, it did not, and would not, have any funds available to cover “necessary or unavoidable costs” that were unallowable under OMB Circular A-122. Specifically, NEON requested [REDACTED] in management fees to cover the following expenses, which NSF approved:

Expense Category	Amount
Vender Conference Cancellation	[REDACTED]
General Unallowable Costs- Meals, Meetings	[REDACTED]
Future Building & Site Study	[REDACTED]
Government Outreach Events	[REDACTED]
Lease Cancellation Expense	[REDACTED]
Risk Management – Losses, Termination Fees	[REDACTED]
Total	[REDACTED]

In fiscal year (FY) 2010, NEON used supplemental budget proposals submitted under the same NSF award to request an additional [REDACTED] in management fees; NSF approved these requests as well. The supplemental requests did not specify what the fees would be used for, nor did they include a justification for why NEON required additional management fee funding.

In June 2011, NEON submitted a budget proposal for NSF Award No. 1029808 in which it requested management fee funding at [REDACTED] percent of total award funds. NEON claimed that it had been incurring unallowable costs, funded by management fees, at approximately [REDACTED] percent of total spending since FY 2009, and that it expected these unallowable expenditures to remain at approximately [REDACTED] percent of total spending. Specifically, NEON’s proposal for management fees under this award requested discretionary funding to cover the following types of expenses:

⁴ OMB Circular A-122 established principles for determining costs of grants, contracts, and other agreements with non-profit organizations; it has now been replaced by 2 Code of Federal Regulations (CFR) 230, *Cost Principles for Non-Profit Organizations*.

⁵ NEON also receives revenue through annual membership fees. During the audit period, these membership fees represented [REDACTED] percent of its total revenue, or [REDACTED].

Expense Category	Request	Actual Expense
Contract Termination & Losses	██████	██████
Outreach Activities	██████	██████
Personnel-Related*	██████	██████
Business Meals/Other	██████	██████
Total	██████	██████

* *Travel, training, employee welfare, teambuilding, relocation*

NSF approved the requested management fees and incrementally awarded the fees as a percentage of total spending through NSF award amendments. Total management fees awarded to NEON under NSF Award No. 1029808 for each fiscal year are summarized below:

FY Awarded	Fee Awarded ⁶
2011	██████
2012	██████
2013	██████
2014	██████
Total Fees	██████

NSF also awarded NEON ██████ in management fees under NSF Award No. 1247476 in FY 2012. The management fee amount approved under this award was determined based on cost review discussions held with the NSF Grants Officer.

V. NEON’S POLICIES AND PROCEDURES FOR CHARGING, ACCOUNTING FOR, AND DRAWING DOWN MANAGEMENT FEES AND RELATED EXPENDITURES

NEON’s Cost Policy Statement states that approved management fees are “used only for legitimate costs of doing business to cover costs that are not chargeable to federal agencies and are to be used at the discretion of NEON management for unallowable costs.” The policy does not include any guidance or criteria for determining whether an expense is ordinary and necessary to facilitate basic operations before it is charged to the management fee pool. NEON’s current policy is therefore to charge all incurred expenses to NSF, either as direct or indirect costs on NSF awards or through management fees, including costs that NSF disallowed during its indirect cost rate reviews.

NEON’s accounting system accumulates all management fee costs within an established management fee pool, or “project.” According to NEON’s Cost Policy Statement, approved management fees under cooperative agreements and related discretionary spending are recorded in a specific project/charge code, separate from the direct costs of other projects. NEON then draws down funds under its awards as it incurs expenses. During the period from October 1, 2011, to September 30, 2014, NEON drew down ██████ for expenditures charged to its management fee pool.

⁶ As a result of the inquiries into NEON’s spending of management fees, NSF has suspended the awarding of management fees to NEON since May 2014.

VI. AUDIT RESULTS

NEON provided a summary by general ledger account code and fiscal year for the [REDACTED] in costs that it charged to its management fee pool during the audit period. We also obtained transaction-level detail reports supporting the costs charged and judgmentally selected and tested a sample of transactions totaling [REDACTED] which represented 67 percent of the costs claimed as management fee expenses. We reviewed supporting documentation to determine the types of expenses that NEON charged to each general ledger account within the management fee pool. When necessary, we requested additional supporting documentation and obtained explanations and justifications from knowledgeable NEON personnel. We provide the summary of NEON's management fee pool costs in Appendix A, along with our notes regarding descriptions and examples of the types of expenditures that NEON charged to each general ledger account within the management fee pool.

We noted that a significant portion of the expenses charged to the management fee pool were not consistent with the types of expenditures identified by NEON in its grant proposals and negotiations with NSF, and that the actual expenses do not appear to be ordinary and necessary expenses to facilitate basic operations. Specifically, within our audit sample, we found that the management fee expenses included:

- [REDACTED] for lobbying/fundraising services provided by consultants.
- [REDACTED] for coffee services at NEON's headquarters.
- [REDACTED] for alcohol purchased for various dinners, parties, and other events.
- [REDACTED] for entertainment provided during company parties.
- [REDACTED] for equipment and mirror walls for an employee fitness room.
- [REDACTED] for the painting of a wall mural.

While specific NSF guidance regarding the types of expenses that could be charged as management fees did not exist prior to June 2015, expenses incurred for lobbying, alcohol, social activities, and entertainment would not have been allowable under the current guidance in NSF 15-089.

As described above, NEON had no significant sources of income aside from NSF for the years audited, and it did not believe that there were any restrictions on the types of expenses that could be paid using management fees. Its current policy is therefore to charge all incurred expenses to NSF, either as direct or indirect costs on NSF awards or through management fees. NEON does not currently have policies or procedures in place for reviewing expenses; determining whether they are ordinary and necessary to facilitate basic operations; and, if they are not ordinary and necessary, using non-NSF funds to pay the expenses.

Recommendations

If NSF continues to award management fees in its grants or cooperative agreements, we recommend that NSF's Director of the Division of Institution and Award Support request that NEON:

1. Update NEON's Cost Policy Statement to include guidance that ensures the negotiation, award, and uses of management fees are consistent with the criteria established in NSF 15-089.
2. Develop administrative and internal controls and processes to ensure that it does not use management fees to pay costs identified as inappropriate per NSF 15-089 (e.g., lobbying costs).
3. Develop policies and procedures for reporting to NSF annually regarding its actual use of management fees, including a reconciliation of the amount of fees provided to actual management fee expenditures.
 - a. In instances where the amount awarded exceeds total expenditures, NEON should quantify the difference and report how it proposes to handle the excess fees awarded. (e.g., carry forward to future years or submit a refund to NSF).
4. Propose management fees as a separate line item in its future NSF proposals, rather than including them under a category of allowable cost.
5. In all future proposals to NSF, include a complete justification for the need for management fees, including a full disclosure of all of NEON's financial resources and other sources of income available to cover the expenses in question.

Summary of NEON's Response

NEON agreed with the facts contained within the audit report. Specifically, as discussed in the draft report, NEON noted that NSF guidance regarding the types of expenses that could be charged under management fees was not in place during the period covered by the audit.

NEON's full response is located in Appendix C of this report.

Auditor's Comments on NSF Management's Response

While NSF guidance regarding the appropriate use of management fees was not available during the audit period, NEON used NSF management fees to cover expenses that do not appear ordinary and necessary to facilitate basic business operations, such as lobbying, alcohol, and entertainment.

Cotton & Company LLP



[Redacted], CPA, CFE

Partner

June 15, 2016

APPENDIX A: SUMMARY OF EXPENSES PAID USING MANAGEMENT FEES

SUMMARY OF EXPENSES PAID USING MANAGEMENT FEES

Account Descriptions	FY 2012	FY 2013	FY 2014	Total	Note
Consulting & Outsourced Services					1
Overhead					2
Employee Welfare & Teambuilding					3
Rent					4
Legal Services					5
Salaries & Wages & Other Compensation					6
Business Meals					7
Relocation Expense					8
Fringe Benefits					9
Travel					10
Internet & Communications					11
Conferences/Seminars					12
Board Related Fees					13
Office & Program Equipment & Supplies (<\$5k)					14
Late Fees					15
Furniture, Fixtures & Supplies & Leasehold Improvements (<\$5k)					16
Printing, Copying, Postage, & Freight					17
Dues & Subscriptions					18
Equipment Rental					19
Participant Support Costs					20
Recruiting					21
Bank Service Fees					22
Prepaid Expenses					
Repairs & Maintenance					
Total Management Fee Expenses					

Notes to Appendix A

1. Consulting and Outsourced Services

NEON retained three contractors for services that were not directly related to the scope of any of its awards. The services provided by two of the contractors could be considered lobbying, and the services provided by the third included personal tax services, both of which are unallowable costs under NSF awards. NEON therefore charged costs incurred for these services to the management fee pool instead. For example, NEON spent:

- ██████████ to hire a consulting company to provide a comprehensive set of government relations services designed to assist in advocating for NEON before Congress and relevant federal agencies that were in a position to influence NEON's success and long-term future. NEON stated that this company served as its eyes and ears in Washington, DC, and that the consultants helped NEON stay informed on the topics currently under discussion, as well as the types of funding decisions being made at the time.
- ██████████ to hire a consulting company to assist NEON's Chief Executive Officer (CEO) in reaching out to key corporations and developing new partnerships, using the NEON observatory as the launching point for catalyzing new opportunities and financial resources. NEON stated that the purpose of this contract was to determine how it could leverage its available infrastructure to impact citizens in their daily lives.
- ██████████ to hire a professional tax consulting company to prepare a personal tax return for a NEON employee. NEON stated that it had agreed to pay a professional to complete the employee's personal tax return as part of the employee's employment contract; however, NEON was unable to provide any documentation to support this assertion.

2. Overhead

NEON did not identify overhead (OH) as a necessary expense in its requests for management fee funding; however, NEON applied its NSF-approved indirect cost rates to management fee expenses each year. The management fees were included in the indirect cost rate allocation base used to calculate the approved indirect cost rates, the application of which resulted in ██████████ of OH expenses being charged to the management fee pool.⁷

3. Employee Welfare & Team Building

NEON hosts a variety of events aimed at increasing employee morale, including holiday parties, picnics, and other team-building activities. NEON initially charged all expenses associated with these events to the indirect cost pool (with the exception of alcohol), as it believed that they were allowable as employee welfare expenses; however, NSF's indirect cost rate review found that these expenses appeared to be entertainment costs rather than employee morale, and that the costs were therefore unallowable. As a result of these findings, NEON transferred the disallowed expense from prior years and began charging all expenses incurred for employee morale functions to the management fee pool instead. In addition, NEON charged the management fee pool for costs incurred for employee welfare expenses that were considered personal in nature, or

⁷ NEON applied the indirect OH rate to all costs charged to management fees during our audit period, with the exception of ██████████ related to professional services and participant support costs.

that were otherwise unallowable under 2 Code of Federal Regulations (CFR) 230. For example, NEON spent:

- [REDACTED] on coffee services at its headquarters.
- [REDACTED] on its 2012 holiday party, including \$2,592 for alcohol.
- [REDACTED] on its 2011 holiday party, including \$1,448 for alcohol.
- [REDACTED] on exercise equipment for its fitness room.
- [REDACTED] on an employee's going-away party, including \$931 for alcohol.
- [REDACTED] on casino entertainment services for a holiday party.
- [REDACTED] on a team-building scavenger hunt.
- [REDACTED] on "Island Music and Polynesian Show w. Fire Dance" for a company picnic.
- [REDACTED] on t-shirts provided to NEON employees during an employee morale function.
- [REDACTED] on face paint for its 2012 summer picnic.
- [REDACTED] on alcohol served at its 2011 summer picnic.

4. Rent

In January 2008, NEON moved into temporary headquarters near the municipal airport in Boulder, Colorado. NEON's lease for this location did not expire until FY 2014; however, at the beginning of FY 2011, NEON was required to move its main headquarters to a larger facility due to the corporation's rapid growth. While NEON was able to sublet its initial headquarters building for the remaining years of its lease, the market value of the property had significantly declined, causing NEON to rent the property at a loss. NEON discussed this situation with NSF, and in August 2012, NSF issued Amendment No. 31 to NSF Award No. 0752017. The amendment identified how much of the sublease loss was allowable on the NSF award in each fiscal year. The amount allowable on the NSF award was lower than the actual incurred loss on the sublease, and NEON therefore charged the total dollars in excess of the allowable amount, or [REDACTED] to the management fee pool as follows:

- FY 2013: [REDACTED]
- FY 2014: [REDACTED]

5. Legal Services

Legal expenses for attorney-related services that are associated with project activities are charged directly to projects, while costs not directly associated with project activities are generally charged to the indirect pool; however, NEON also incurred a variety of attorney-related costs that it deemed non-reimbursable under NSF awards and therefore charged them to the management fee pool instead. For example, NEON spent:

- [REDACTED] for employee visa expenses from FY 2012 through FY 2014. NEON initially charged employee visa application expenses as direct or indirect costs; however, NSF's review of NEON's indirect cost rate found that these expenses were unallowable. NEON therefore began charging all visa application expenses to the management fee pool instead.
- [REDACTED] for attorney fees related to a discussion of invention rights with a NEON employee.
- [REDACTED] for attorney fees related to work performed on an age discrimination claim filed against NEON.

6. Salaries & Wages and Other Compensation

The majority of NEON's employees charge their work-related salary and wage costs directly to a specific project, as their work is assignable to direct programs supported by NEON grants and cooperative agreements. However, certain NEON employees charged salary expenses to the management fee pool to cover work that may have been considered lobbying, or that otherwise could not be charged directly or indirectly to NSF awards. For example:

- An employee spent time performing tasks related to “NSF Advocacy.”
- NEON employees spent time working on NSF proposals outside the scope of NEON's current NSF awards.

In addition, NEON transferred other salary and wage expenses to the management fee pool after NSF disallowed the expenses during its review of NEON's indirect cost rate. For example, NEON transferred:

- ██████ paid to NEON employees as signing bonuses; NSF disallowed the amount because NEON's compensation policies do not include guidance related to signing bonuses.
- ██████ of a 12-week severance package; NSF disallowed the amount because NEON's policy only allowed for a 3-week severance payment.

7. Business Meals

Business meals are an allowable expense when they are an integral and necessary part of a conference, workshop, or other meeting. NEON generally charged expenses incurred for business meals to the management fee pool if the business purpose of the meal was not clearly defined, if the event was held as a dinner, or if the expenses were expressly unallowable. For example, NEON spent:

- ██████ on catering services for an “all-hands” meeting with NEON's incoming CEO, followed by a meet-and-greet reception with the CEO and BOD members; \$1,619 of these expenses were related to the purchase of alcohol.
- ██████ on dinner for a Science Technology Engineering Advisory Committee (STEAC) meeting.⁸
- ██████ on alcohol for a BOD dinner.
- ██████ on alcohol for a celebration held after NEON finished a business system review.
- ██████ on alcohol purchased during a team morale happy hour.

8. Relocation Expense

Costs associated with relocating new or existing employees, either as part of a hire agreement or to relocate existing employees as authorized by management, are typically considered allowable costs and are charged to NEON's indirect cost pool; however, 2 CFR 230 requires institutions to refund or credit the federal government for recruitment costs if the newly hired employee resigns within 12 months of hire. As a result, if an employee that received relocation funds leaves NEON

⁸ STEAC serves as NEON's scientific BOD.

within 12 months of hire, NEON withholds funds from their final paycheck to recover those costs. If the amount of the final paycheck does not cover all of the relocation funds provided to the employee, however, NEON charges the remaining relocation expenses to the management fee pool. For example, an employee that received [REDACTED] for relocation expenses left NEON after only working at the organization for 5 months. NEON was unable to recover any of the relocation expenses from the employee's final paycheck, as the employee had been on an extended period of leave and their final paycheck did not contain any salary. NEON therefore transferred the [REDACTED] to the management fee pool to comply with 2 CFR 230 regulations.

NEON also transferred other expenses to this general ledger account within the management fee pool after NSF disallowed the expenses during its review of NEON's indirect cost rate. For example, NEON transferred [REDACTED] in rent expenses associated with four excess months of rent for which NEON had reimbursed an employee as part of their relocation to Boulder, Colorado. NEON reimbursed six months of the employee's rent; however, its policy at the time of the expense only allowed it to reimburse rent for a maximum of two months. The expense had therefore been disallowed by NSF.

9. Fringe Benefits

NEON applied fringe benefit expenses of [REDACTED] to salary costs accumulated in the management fee pool.

10. Travel

The purpose of a trip determines whether employee travel expenses are charged to a specific contract as direct costs, to an account common to all programs as indirect costs, or to the management fee pool as unallowable costs. NEON generally charges travel expenses to the management fee pool if the trip does not have a defined business purpose, or if the expenses are expressly unallowable. For example, NEON spent:

- [REDACTED] on travel expenses for two NEON employees to fly to France for one week to meet with members of the international scientific community to discuss an NSF proposal involving international collaboration.
- [REDACTED] on excess rent expenses incurred for the CEO. NEON's relocation policies at the time this expense was incurred indicated that it would pay one to two months of rent when an employee relocated to Boulder. In FY2012, when the newly appointed CEO decided to stay in the apartment for a second month, NEON determined paying for the second month of rent was in excess of the amount that NEON's policy typically allows, therefore, NEON charged the excess costs to management fees.
- [REDACTED] on no-show room expenses incurred because NEON employees neglected to cancel their hotel reservations when their travel plans changed.

11. Internet & Communications

Costs associated with general internet and communications expenses are usually included in the facilities pool and allocated to direct programs on the basis of gross assignable square feet of space occupied by the function. During FY 2012, however, NEON determined that costs incurred on a communications contract were expressly unallowable under 2 CFR 230, and NEON therefore charged the costs to the management fee pool instead. Specifically, NEON

charged to the management fee pool [REDACTED] in penalties associated with early termination assessed on a communications contract. Due to NEON's extreme growth, the company was required to move to a larger building at the end of FY 2011. NEON terminated its communications contract when it left its initial headquarters building, 11 to 13 months before the communications contract ended. The communications company therefore assessed a penalty for each of the cancelled lines.

12. Conferences/Seminars

NEON hosts business-related conferences and sends employees to attend off-site workshops that are directly related to the scope of NEON projects. NEON generally charges expenses incurred for attending or hosting these conferences directly to the associated project; however, it also incurred costs associated with hosting banquets and receptions and arranging for child care required due to conferences that it deemed non-reimbursable on NSF awards. NEON charged these costs to the management fee pool instead. For example NEON spent:

- [REDACTED] on food and beverages served at banquets/receptions held during a NEON scaling workshop in June 2012.⁹
- [REDACTED] on child care costs incurred while a NEON employee was attending a grant-sponsored conference in San Francisco.

13. Board-Related Fees

NEON holds BOD meetings approximately four times per year to review NEON's current progress and to discuss BOD's goals for NEON's future. NEON initially only charged expenses incurred for BOD meetings to the management fee pool if the expenses were expressly unallowable under 2 CFR 230; however, NSF's review of NEON's indirect cost rate indicated that in some years, NEON charged all meal expenses for these meetings to the management fee pool. For example, NEON spent:

- [REDACTED] on dinner served at a BOD meeting, including \$372 for alcohol.
- [REDACTED] on catering services to provide breakfast and lunch for a two-day BOD meeting.
- [REDACTED] on a gift basket presented to NSF's former Assistant Deputy Director of Biology at a BOD meeting; the gift basket was in honor of her retirement.

14. Office/Program Equipment & Supplies

Office and program equipment and supplies are generally allocated directly or indirectly to projects in accordance with the purpose of the purchase; however, NEON also incurred costs associated with equipment and supplies purchases that it deemed non-reimbursable on NSF awards such as promotional materials, BOD gifts, and breakroom supplies. NEON therefore charged these costs to the management fee pool instead. For example, NEON spent:

- [REDACTED] on reusable grocery bags that NEON's education department purchased to hand out during education outreach events.

⁹ Spatial and Temporal Scaling in Continental Scale Ecology Workshop: <http://www.neoninc.org/updates-events/events/spatial-and-temporal-scaling-continental-scale-ecology-workshop>

- [REDACTED] on mini-replicas of NEON towers that it provided to various BOD members as thank-you gifts.
- [REDACTED] on breakroom supplies that NEON determined were not considered necessary for business purposes, such as coffee cups, coffee creamer, plates, and forks.

15. Late Fees

Penalty fees incurred as a result of payments not being completed properly or on time are expressly unallowable under 2 CFR 230, and NEON therefore charges all such expenses to the management pool. For example, NEON spent:

- [REDACTED] on penalties associated with improper employee tax filings with the Florida Department of Revenue.
- [REDACTED] on late fee penalties assessed by an architect because NEON did not pay an invoice before the due date.
- [REDACTED] on late fee penalties incurred in October 2013, when NEON would not, or could not, pay for expenses as a result of the federal shutdown.

16. Furniture, Fixtures & Supplies and Leasehold Improvements (<\$5k)

Costs associated with the purchase of furniture, fixtures, or other supplies necessary to support the business purpose of NEON operations are typically considered allowable indirect costs; however, NEON also incurred expenses to update the aesthetic features of NEON's headquarters building. These expenses were not necessary for NEON's operations and were therefore deemed non-reimbursable on NSF awards. As such, NEON charged these costs to the management fee pool. For example, NEON spent:

- [REDACTED] to employ an artist to paint a mural on a wall of NEON's headquarters building.
- [REDACTED] to install a mirrored wall in NEON's fitness room.

17. Printing, Copying, Postage and Freight

Printing costs associated with outreach activities that are used to maintain or promote understanding with the community, such as brochure design and conference exhibits, are generally considered direct costs allowable on NEON's NSF awards; however, NEON's education and public engagement department incurred printing costs for promotional/marketing materials that are expressly unallowable per 2 CFR 230. NEON therefore charged these expenses to the management fee pool instead. For example, NEON spent:

- [REDACTED] on graphic design services to create a NEON poster for public outreach events.
- [REDACTED] on NEON-branded sticky note pads to hand out during public outreach events.

18. Dues/Subscriptions

Costs associated with membership dues and subscriptions can generally be charged directly or indirectly to the projects that the dues/subscriptions benefit, in accordance with the purpose of the purchase; however, NEON also incurred additional expenses charged to this account, such as medical exams, tax penalties, and subscriptions for congressional journals that were deemed non-reimbursable on NSF awards. NEON charged these additional expenses to the management fee pool. For example, NEON spent:

- ██████ to reimburse a NEON employee for expenses incurred to perform medical checks necessary to enable the employee and her husband to obtain immigration visas.
- ██████ to provide NEON's Chief of External Affairs with subscriptions to ClimateWire, E&E Daily, Greenwire, and E&E News PM, to enable him to keep up with daily congressional updates.

19. Equipment Rental

Repairs performed on equipment rented for a business purpose are typically considered allowable expenses under normal operations; however, NEON charged ██████ in repair expenses to the management fee pool because it was unable to confirm whether the damage on a rented pickup truck was caused by ordinary business operations.

20. Participant Support Costs

Costs incurred at NEON-sponsored events in which members of the scientific and education communities participate are typically considered allowable participant support costs; however, NEON provided alcoholic beverages during some of these events. Alcohol expenses are expressly unallowable under 2 CFR 230, and NEON therefore charged the costs of these beverages to the management fee pool. For example, NEON spent:

- ██████ on alcohol served at a Board and Member Meeting held in October 2012.
- ██████ on alcohol served at a Board and Member Meeting held in September 2011.

21. Recruiting

Costs associated with employee recruiting fees, such as job postings and travel costs for interviews, are allowable indirect costs; however, NEON also incurred a ██████ expense for alcoholic beverages purchased at a dinner held to discuss the recruitment of a new CEO. Alcohol expenses are expressly unallowable under 2 CFR 230, and NEON therefore charged the costs to the management fee pool.

22. Bank Services Fees

Monthly service fees for maintaining checking accounts with Chase Bank are typically considered allowable indirect costs; however, NEON also incurred interest expense on funds drawn down on an unsecured line of credit that NEON maintains with Chase services. Interest expenses are expressly unallowable under 2 CFR 230, and NEON therefore charged these costs to the management fee pool.

APPENDIX B: OBJECTIVES, SCOPE, AND METHODOLOGY

OBJECTIVES, SCOPE, AND METHODOLOGY

The NSF OIG Office of Audits engaged Cotton & Company LLP (referred to as “we” in this report) to conduct a performance audit of management fees awarded under agreements between NSF and NEON for the period from October 1, 2011, to September 30, 2014. The overall objective of the audit was to evaluate how NEON tracked and spent management fees. Specifically, we performed this audit to:

- Determine whether the awardee’s method of charging and using management fees was in accordance with its proposals, federal regulations, NSF policy, any negotiation memoranda, and its own policies.
- Determine if the awardee used management fees for ordinary and necessary expenses (that were not otherwise reimbursable) to facilitate basic operations.
- Compare the amount of management fees received to the amount of unallowable expenses identified and draw any conclusions that arise from this comparison.

Our work required reliance on computer-processed data obtained from NEON. NEON provided detailed general ledger data for all costs that it charged to its management fee pool during our audit period. This resulted in a total audit universe of \$ [REDACTED] in costs claimed through 1,148 transactions charged to the management fee pool.

We assessed the reliability of the data provided by NEON by (1) reviewing NSF award documentation (e.g., grant proposals, awardee correspondence, award amendments) for each NSF award under which NEON claimed costs during our audit period, to verify how much funding NSF provided for management fees, and (2) reviewing NEON’s accounting manual and discussing its accounting policies with NEON staff to determine how NEON tracks management fee expenditures.

Based on our assessment, we found NEON’s computer-processed data to be sufficiently reliable for the purposes of this audit. We did not review or test whether the data contained in, or the controls over, NSF’s databases were accurate or reliable; however, the independent auditor’s report on NSF’s financial statements for FY 2014 found no reportable instances in which NSF’s financial management systems did not substantially comply with applicable requirements.

NEON management is responsible for establishing and maintaining effective internal control to help ensure that federal award funds are used in compliance with laws, regulations, and award terms. In planning and performing our audit, we considered NEON’s internal control solely for the purpose of understanding the policies and procedures relevant to the financial reporting and administration of NSF awards, in order to evaluate NEON’s compliance with laws, regulations, and award terms applicable to the items selected for testing, but not for the purpose of expressing an opinion on the effectiveness of NEON’s internal control over award financial reporting and administration. Accordingly, we do not express an opinion on the effectiveness of NEON’s internal control over its award financial reporting and administration.

To evaluate whether NEON’s use of management fees was in accordance with the intentions outlined in its NSF proposals, we conducted interviews with relevant NSF program officers, NSF

grant officers, and NEON personnel, in which we requested all documentation relevant to the negotiation and award of management fees at NEON. As a result of this research, we gained insight into NSF and NEON's roles in the negotiation process, including both NSF and NEON's understandings of the types of expenses these fees were awarded to cover, as well as the types of reviews that each entity performed to examine how NEON was using these fees.

After determining the types of expenses that NEON had included in its management fee proposals, we evaluated the types of expenses that NEON had actually paid using these fees by judgmentally selecting and testing a sample of transactions that NEON had charged to its discretionary management fee pool during the audit period.

We reviewed the supporting documentation provided to determine if we obtained sufficient, appropriate evidence to support the types of expenses that NEON charged to each general ledger account within the management fee pool. When necessary, we requested additional supporting documentation, reviewed the documentation, and obtained explanations and justifications from knowledgeable NEON personnel to determine whether the costs charged were necessary to facilitate basic operations at NEON, and whether the costs were charged in accordance with its proposals, federal regulations, NSF policy, negotiation memoranda, and its own policies.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX C: NEON MANAGEMENT’S RESPONSE



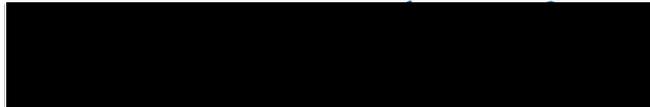
National Ecological Observatory Network

May 19, 2016

Cotton & Company, LLC
635 Slaters Lane, 4th Floor
Alexandria, VA 22314

NEON, Inc. appreciates the opportunity to comment on the draft report of your audit of management fees at the National Ecological Observatory Network (NEON) on National Science Foundation (NSF) Cooperative Agreements for the period October 1, 2011 through September 30, 2014.

We do not dispute the audit or the facts contained therein. As the draft report makes clear, NSF guidance regarding the types of expenses that can be charged under management fees was not in place during the time period covered by the audit, so NEON, Inc. was not in violation of any existing guidance at the time.



Chief Financial Officer