



National Science Foundation • Office of Inspector General
4201 Wilson Boulevard, Suite I-1135, Arlington, Virginia 22230

MEMORANDUM

Date: June 16, 2016

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

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

Subject: Report No. 16-6-008, National Science Foundation's (NSF) Negotiation, Award, and Management of Management Fees Awarded to AURA and NEON

This memo transmits the Cotton & Company LLP letter that the NSF Office of Inspector General (OIG) requested to gain greater insight into NSF's process for negotiating, awarding, and managing management fees. The NSF OIG engaged Cotton & Company to conduct performance audits of management fees that NSF had awarded to the Association of Universities for Research in Astronomy (AURA) and the National Ecological Observatory Network (NEON) from October 1, 2011, through September 30, 2014.

The auditors found that NSF did not have policies and procedures on negotiating reasonable management fee rates at the time NSF awarded AURA's and NEON's cooperative agreements. As a result, the only guidance NSF had at the time to make determinations on the amount of AURA's and NEON's management fee was based on prior awards and what the awardee stated that it needed. NSF, therefore, approved the awardees' initial requests for management fees based on the amounts the awardees proposed, rather than obtaining and reviewing any supporting documentation to determine the awardee's need for additional funding. Furthermore, NSF did not review actual management fee expenditures to ensure that awardees were using the fee to cover ordinary and necessary business expenses consistent with those proposed, or that awardees needed the additional funds, but rather continued awarding management fees based on the initial proposed amounts.

The auditors included five recommendations in the letter for NSF concerning management fees. NSF provided its response to the letter and recommendations on May 13, 2016, which is attached in its entirety in the letter. In accordance with Office of Management and Budget Circular A-50, *Audit Followup*, please provide a written corrective action plan to address the recommendations. In addressing the recommendations, this corrective action plan should detail specific actions and associated milestone dates. Please provide the action plan within 60 calendar days of the date of this letter.

OIG Oversight of the Review

To fulfill our oversight responsibilities, the Office of Inspector General:

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

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

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

Attachment

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June 13, 2016

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Subject: NSF’s Negotiation, Award, and Management of Management Fees Awarded to AURA and NEON

In response to congressional inquiries made in 2014 regarding the use of management fees on National Science Foundation (NSF) cooperative agreements (CAs), the NSF Office of Inspector General (OIG) sought to gain greater insight into NSF’s process for authorizing management fees. It engaged Cotton & Company LLP (referred to as “we”) to conduct performance audits of management fees that NSF had awarded to the Association of Universities for Research in Astronomy (AURA) and the National Ecological Observatory Network (NEON) from October 1, 2011, through September 30, 2014. Specifically, we examined [REDACTED] in management fees awarded over the three-year audit period as follows:

Awardee	Fiscal Year 2012	Fiscal Year 2013	Fiscal Year 2014	Total
AURA	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
NEON	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

The objectives of this audit included:

- Identifying and assessing NSF’s process for negotiating, awarding, and managing management fees.
- Determining whether the charging and use of management fees was in accordance with the awardees’ NSF proposals, federal regulations, NSF policy, any negotiation memoranda, and awardee policies.
- Evaluating whether these fees were used for ordinary and necessary expenses (that were not otherwise reimbursable) to facilitate basic business operations.

As part of our procedures, we reviewed relevant documentation regarding the proposal and award of management fees and met with NSF Grants Officers (GOs) and Program Officers (POs) to discuss the process of negotiating, awarding, and managing these fees at AURA and NEON. The NSF OIG requested that we summarize our observations regarding this process, including how NSF determined whether a management fee was warranted.¹

¹ The NSF OIG requested that this information be summarized in a letter to NSF management rather than included in the audit reports we will be issuing to NEON and AURA regarding the use of the management fees.

We found that NSF did not have policies and procedures in place regarding the negotiation of reasonable management fee rates during the period in which it awarded the large facility CAs in question. As a result, NSF's only guidelines in making these determinations were prior award determinations and the awardees' stated requirements. NSF therefore approved the awardees' initial requests for management fees based on the amounts the awardees proposed rather than obtaining and reviewing supporting documentation to determine the awardees' need for additional funding. Furthermore, NSF did not review actual management fee expenditures to ensure that awardees were using the fee to cover ordinary and necessary business expenses consistent with those proposed, or that awardees needed the additional funds; instead it continued awarding management fees based on the initial proposed amounts.

The following sections provide background information regarding the original purpose of the management fees, as well as specific supporting details regarding the negotiations that NSF held with NEON and AURA when awarding management fees.

Background Information

Management fees were initially designed as a tool to ensure that Federally Funded Research and Development Centers (FFRDCs)² could obtain funding for, among other things, "ordinary and necessary" but otherwise non-reimbursable business expenses.³ FFRDCs are typically non-profit entities that are almost wholly dependent upon government funding; however, they necessarily incur costs that are unallowable under federal regulations and that therefore cannot be reimbursed under federal cost principles as direct or indirect costs attributable to a specific agency or project.⁴ The government instituted management fees awarded as a means to pay these non-reimbursable "ordinary and necessary" expenses to enable the research centers to continue to operate in a business environment.

These management fees were controversial at first, as they appeared to be awarded to research centers as profit. As a result, the Government Accountability Office (GAO) issued a 1982 report in which it differentiated management fees from profit, noting that "fees paid to nonprofit organizations are considered necessary to provide required operating capital and to cover certain non-reimbursable expenses."⁵ While the legitimacy of these fees was further acknowledged by many federal agencies, as well as within the Federal Acquisition Regulation (FAR), no government-wide guidance was ever issued regarding how these fees should or could be negotiated, justified, awarded, or managed.

² FFRDCs are independent non-profit entities sponsored and funded by the U.S. Government to meet specific long-term technical needs that cannot be met by another single organization.

³ Non-reimbursable business expenses are those deemed unallowable under federal regulations.

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 *Fee Guidelines Still Needed for Government-Sponsored Non-Profit Organizations*.

While NSF did have several policies in place during our audit period that related to the payment of management fees,⁶ it did not issue specific guidance regarding the issuance, oversight, or allowable and unallowable use of management fees until 2015. From fiscal year (FY) 2012 through FY 2014, the NSF guidance regarding management fees could be found in NSF's Proposal and Award Manual (PAM), which contained the following language related to fees:

NSF policy permits the payment of fees for performance of Government-supported work to organizations that have made legitimate requests in response to formal program solicitations where the payment of fees is permitted.

The amount of any fee provided by NSF is negotiated with the organization by DGA⁷ or DACS⁸ in consultation with the responsible program. The fee may not exceed 15 percent of the total project costs provided by NSF (excluding the fee). In most cases, the fee is lower. In determining the fee to be paid, consideration should be given to the following: the degree of difficulty or complexity of the work to be performed, the potential public benefits as a result of the work, the level of investment in the work being performed, the performer's past performance record, and the extent of any subcontracting.

For awards resulting from proposals that were not submitted in response to formal solicitations that permitted appropriate fees, the payment of fees may be authorized on a case-by-case basis by the Director of DGA or DACS, as appropriate. In order for such authorization to be given, the Foundation must have an especially strong interest in having the work performed because of substantial potential public benefits. Such exceptions, however, rarely will be made.

In November 2014, the NSF OIG issued the memorandum *White Paper on Management Fees*, which described the origin of management fees for research centers, as well as NSF's policy and practice with regard to awarding these fees. The paper concluded federal agencies have awarded management fees to FFRDCs to cover ordinary and necessary, but otherwise nonreimbursable, business expenses; however, absent explicit government-wide or agency-specific guidelines, questions will continue to be raised regarding how the fees are awarded and used, and the risk of misuse will remain.

In response to a need for agency-specific guidelines, NSF issued an updated Large Facilities Manual (LFM), NSF 15-089, in June 2015. The updated document contained 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 CA'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.

⁶ See *Manual 10, Proposal and Award Manual (PAM)*, Chapter VI.E.3 and *NSF's Proposal and Award Policies and Procedures Guide (PAPPG)* Part II, Chapter V.E.

⁷ Division of Grants and Agreements

⁸ Division of Acquisition and Cooperative Support

- 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 expenses considered not appropriate include alcoholic beverages, tickets to concerts or sporting events, meals or social activities for non-business purposes or for business purposes that are so extravagant as to constitute entertainment, and lobbying. This updated LFM policy was implemented by NSF's Standard Operating Guidance (SOG),⁹ NSF 15-1, issued on August 31, 2015.

NSF's Negotiation of Management Fees with AURA

AURA is a consortium of 40 U.S. institutions and 4 international affiliates. It currently operates four astronomical facilities that receive management fee funding from NSF, including:

- The Gemini Observatory (Gemini)
- The National Optical Astronomy Observatory (NOAO)
- The National Solar Observatory (NSO)
- The Large Synoptic Survey Telescope (LSST)

AURA received more than \$760 million dollars from NSF during the three-year audit period, including ██████████ in management fees.

Prior to 1998, AURA was exempt from the requirements established by Office of Management and Budget (OMB) Circular A-122¹⁰ and was therefore not required to prepare an indirect cost submission, instead receiving a fixed fee each year to cover indirect costs incurred under NSF awards. After OMB removed AURA from the list of exempt entities, NSF became responsible for applying the provisions of OMB Circular A-122 to AURA. As a result, NSF determined that it required greater oversight of AURA's expenses when awarding future CAs. OMB Circular A-122 provided NSF with the authority to require that AURA account for its indirect costs, and so when AURA submitted its proposals for new CAs in 2002, NSF requested that AURA calculate and report its indirect costs as part of its proposals.

In calculating its indirect cost rate, AURA determined that it had expenses that could not be covered under NSF awards either directly or indirectly, as they were unallowable under OMB Circular A-122. To ensure that it could continue to operate, AURA met with NSF Program Officers (POs) to request an annual management fee to cover possible unreimbursable cost items that AURA might encounter in operating its business in the future.

⁹ The SOG describes NSF's method for internally processing the LFM directions to the awardee.

¹⁰ The June 1998 revision of OMB Circular A-122 specifically stated that AURA had been removed from the exemption list because it "either no longer exist[s] or [is] no longer exempted from complying with Circular A-122."

The NSF POs responsible for the CAs issued to Gemini and NOAO/NSO¹¹ met in July 2003 to discuss AURA’s proposed management fee structure. Specifically, the POs met with AURA personnel to discuss the rationale for the payment of the management fees and, “in some detail,” the types of corporate expenses that the fee might cover. Based on this discussion, the POs sent a memorandum to NSF’s Division of Grants and Agreements (DGA) that recommended providing AURA with a management fee of [REDACTED] per annum for the duration of each CA. At the time of this recommendation, NSF DGA had neither examined nor requested a written justification of need (considering all sources of revenue) or support for AURA’s actual expenses, because NSF DGA did not require, and AURA did not provide, that level of detail.

Subsequent to the NSF POs’ recommendations, on September 15, 2003, AURA sent DGA a memorandum officially requesting that NSF DGA award management fees under CAs proposed to fund operations at the NOAO/NSO and Gemini facilities. This memorandum clarified that the term “management fee” was not currently intended to, nor would it ever, represent profit. Specifically, AURA explained the principal purpose of the management fees as follows:

AURA management fees are to permit the continuing operation of the corporate office, to provide for the unreimbursable expenses of the corporation, and to enable AURA to use its funds in furtherance of the corporate mission. The management fee is not part of the costs of performing a contract, grant or Cooperative Agreement and hence is neither an “allowable” cost under cost reimbursement regulations nor otherwise subject to “allowable cost” principles.

AURA’s memorandum also included a “table of possible unreimbursable cost items and events” that identified potential costs that would require the use of management fees, as follows:

Description	Amount
Directors’ discretionary funds for use at the Centers	[REDACTED]
Third-party contributions	[REDACTED]
Meals and entertainment costs (corporate staff)	[REDACTED]
Meals and entertainment costs (professional meetings)	[REDACTED]
Special projects (unplanned workshops)	[REDACTED]
Insurance premiums (for non-approved risks)	[REDACTED]
Exhibits (unplanned- at professional societies)	[REDACTED]
Award programs (incentives for performance)	[REDACTED]
Shortfalls on projected program expenditures	[REDACTED]
Total	[REDACTED]

The memorandum concluded that, based on this list of potential expenditures, AURA believed its management fee request of [REDACTED] annually [REDACTED] per facility) to be “fair and reasonable.”

¹¹ AURA operated NOAO and NSO under the same CA until January 2009.

DGA concluded that the cost items requested appeared to be ordinary and necessary for the operation of AURA's facilities and determined that the [REDACTED] per year rate appeared reasonable when compared to the [REDACTED] of reported potential scenario expenditures. It therefore approved management fees of [REDACTED] per facility per year for the duration of the two CAs, as requested. At the time of this approval, DGA personnel performed only a high-level review of the types of expenses for which AURA requested funding and neither examined nor requested a written justification of need (considering all sources of revenue) or support for AURA's actual expenses.

After the initial award, NSF's Division of Acquisition and Cooperative Support (DACs)¹² continued to provide AURA with [REDACTED] per year on each of the CAs funding operations at NOAO and Gemini without examining actual expenditures or evaluating AURA's current need for management fees. NSF DACs never requested additional justifications for these fees, questioned if any additional revenues were received that would cover unreimbursable expenses, or examined how the fees had been, or would be, spent on each award. Specifically, NSF DACs believed that an additional examination of the amount requested was unnecessary because AURA continued to request management fees at the previously approved amount of [REDACTED] per year for each facility. Accordingly, NSF DACs neither examined nor requested a written justification of need (considering all sources of revenue) or support for AURA's actual expenses during this time.

The NOAO CA originally included the NOAO and NSO facilities; however, in 2009, AURA established NSO as a separate facility. In its proposal for a new CA to operate NSO independently, AURA proposed a budget for NSO that included management fees of [REDACTED] in the base year, escalating to [REDACTED] in subsequent years, for a total of [REDACTED] for the original five-year audit period from October 1, 2009, to March 31, 2014.¹³ NSF DACs personnel were unable to locate any documentation related to the negotiation of the NSO management fee amounts, but stated that it likely awarded the fees as proposed rather than performing negotiations, because the requested funding was less than the amount previously approved under NSF's prior and current CAs with other AURA facilities. Accordingly, NSF DACs neither examined nor requested a written justification of need (considering all sources of revenue) or support for AURA's actual expenses.

In 2012, AURA established a CA to fund LSST as a sponsored facility. In its original proposal for the CA, AURA stated that management fees would be negotiated under each Cooperative Support Agreement (CSA) awarded under the CA. The CSA proposal that AURA submitted to support the final design phase of LSST requested a total of [REDACTED] in management fees for the

¹² In 2004, NSF reorganized its Office of Budget, Finance and Award Management and transferred all large facility awards to DACs; DGA was therefore no longer involved with the AURA CAs.

¹³ NSF DACs personnel were unable to remember how the amount was calculated; however, it appears that DACs noted that the award period proposed was for 54 months (4.5 years) rather than 60 months (5 full years) and therefore awarded a prorated amount of [REDACTED] for the first year of the award.

36-month period of performance.¹⁴ NSF DACS approved this budget when awarding the CA; however, it only approved the initial two-year period of performance, designating the final year as an option year. NSF DACS therefore awarded only [REDACTED] of the [REDACTED] proposed for the period from October 1, 2012, to September 30, 2015. When calculating the annual management fee, however, NSF DACS personnel erroneously awarded the fees at [REDACTED] per year based on the initial proposed period of three years. NSF DACS personnel were unable to locate any documentation related to the negotiation of the LSST management fee amounts, but again stated that DACS likely awarded the fees as proposed rather than performing negotiations, as the request appeared reasonable and was relatively low compared to the management fees awarded under other AURA CAs. Accordingly, NSF DACS neither examined nor requested a written justification of need (considering all sources of revenue) or support for AURA’s actual expenses.

NSF’s Negotiation of Management Fees with NEON

NEON is a continental-scale ecological observation facility that gathers and synthesizes data on the impacts of climate change, land-use change, and invasive species on natural resources and biodiversity. It is a non-profit entity that is financed solely by NSF;¹⁵ it began receiving funding in April 2007. NEON received more than \$196.4 million from NSF during the three-year audit period, including more than [REDACTED] in management fees.

According to NEON officials, NEON did not request funding for “unallowable” costs in its initial proposals to NSF, as it had been established as a new entity and was initially unaware of the types of unallowable expenses that it might incur. After a year of operations, however, NEON determined that it was incurring costs that could not be charged directly or indirectly to NSF CAs and that it had no other method of paying these costs, because it received all of its funding, except for membership fees, from NSF. In an attempt to obtain funding to cover incurred and future unallowable expenses, NEON submitted a proposal for management fees under an active CA, *Organizational & Project Management Support to complete the NEON Construction-Ready Design and Project Execution Plan*, in December 2008. The proposal specifically identified the types of expenses that NEON had incurred and additional costs that it was likely to incur that would require the use of management fees, as follows:

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]

¹⁴ AURA’s revised budget requests [REDACTED] for a 36-month period of performance; however, the narrative description supporting this amount requests [REDACTED] per year for management fees, or a total of [REDACTED] AURA did not provide an explanation for the additional [REDACTED]

¹⁵ Less than 0.1 percent of NEON’s funding comes from outside, non-federal sources. This funding is provided through one-time membership fees assessed by NEON.

An NSF Business Oversight Team (BOT) met to discuss NEON’s proposed management fee expenses and determined that, while some of the expenses were unallowable per federal regulations, they appeared to be ordinary and necessary for operations at NEON. Before awarding the management fees, NSF DACS sent an e-mail to NEON regarding the identified anticipated costs:

Does this fee allow NEON the freedom to move these fees around? You are pretty specific in his requests on what the fee will fund, but we don’t want to limit the fee to these amounts should something else arise. Does this amount allow you enough flexibility should some unexpected otherwise unallowable costs arise.

NEON responded that it anticipated that the [REDACTED] proposed for risk management would cover expenses not initially proposed and did not update its proposal. Based on these discussions and the amount requested, DACS ultimately determined that “[t]he fee seems to be an acceptable amount, as it represents less than [REDACTED] of the total funding provided to NEON.” NSF DACS therefore approved management fees of [REDACTED] under the CA, as requested. At the time of this approval, DACS personnel performed only a high-level review of the types of expenses that NEON requested funding for and neither examined nor requested a written justification of need (considering all sources of revenue) or support for NEON’s actual expenses.

In July 2010, NEON used supplemental budget proposals submitted under the same CA to request an additional [REDACTED] in management fees to cover project expenses from May 2010 through June 2011. NSF DACS again awarded the fees at the amounts proposed by NEON and neither examined nor requested a written justification of need (considering all sources of revenue) or support for NEON’s actual expenses.

In February 2010, NEON requested additional management fees of [REDACTED] per year for a proposed five-year period of performance) in a CSA proposal under a CA issued to support the construction and operation of the NEON Observatory. In response to this proposal, NSF DACS requested a brief justification for the requested amount. Rather than supporting the amount requested in its initial proposal, NEON’s justification, submitted in June 2011, stated that it had been incurring unallowable costs at approximately [REDACTED] percent of total spending since inception, and that it anticipated that it would continue to incur unallowable costs at approximately [REDACTED] percent of total costs in the future, as follows:

Expense Category	Request	Actual Experience
Contract Termination & Losses	[REDACTED]	[REDACTED]
Outreach Activities	[REDACTED]	[REDACTED]
Personnel-Related*	[REDACTED]	[REDACTED]
Business Meals/Other	[REDACTED]	[REDACTED]
Total	[REDACTED]	[REDACTED]

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

NSF DACS determined that the amount of this request was reasonable, as NEON only requested [REDACTED] percent of total funding proposed, and therefore awarded management fees under this CSA as requested without examining or requesting a written justification of need (considering all sources

of revenue) or support for NEON's actual expenses. The original award document for this CSA awarded management fees of [REDACTED] for FY 2011, which represented [REDACTED] percent of the [REDACTED] awarded under this CSA for direct and indirect costs for the fiscal year. NSF DACS established a not-to-exceed amount of [REDACTED]¹⁶ for management fees under this CSA and only incrementally awarded additional management fees based on total spending in FYs 2012 through 2014. As of the end of our audit period, or September 30, 2014, NSF DACS had only awarded NEON [REDACTED] of this not-to-exceed amount.

While NEON was receiving management fees under the new CSA, it submitted a proposal for an additional CSA in June 2012, for the period from September 1, 2012, to August 31, 2013. NEON's initial proposal did not request funding for management fees; however, NSF DACS approved management fees of [REDACTED] or [REDACTED] percent of the total award value, under this one-year award based on cost review discussions that NEON held with an NSF GO. NSF DACS awarded management fees at the rate previously approved for NEON and neither examined nor requested a written justification of need (considering all sources of revenue) or support for NEON's actual expenses.

While NEON continued to receive management fee funding under its construction and operation CA as identified above, in May 2013 it submitted a supplemental request to increase the rate at which it received management fees for the duration of the CA. The request stated that "the current rate of [REDACTED] has not really been sufficient to cover even the bare minimum of costs that are typically disallowed per regulation..." and that it required a fee "of around [REDACTED]" In July 2013, NSF DACS denied this request, as it concluded that some of the expenses requested may be reimbursable (at least in part) under NSF awards, and that the fees requested for non-reimbursable expenses would not benefit NSF.

Conclusion

The following is a summary of our observations related to NSF's processes for negotiating, awarding, and managing management fees for AURA and NEON for FYs 2012 to 2014, including how NSF determined whether a management fee was warranted:

1. NSF approved awardees' initial requests for management fees based on the amounts that the awardees proposed. NSF did not obtain any supporting documentation to determine either the need (considering other sources of revenue) or the reasonableness of the amounts requested.
2. NSF did not review actual expenditures that awardees paid using management fees to determine if the expenditures were consistent with the amounts proposed and were for ordinary and necessary business expenses.

¹⁶ The not-to-exceed amount was established at [REDACTED] percent of the total anticipated funding amount under the CSA of \$433,789,935.

3. NSF approved amounts for management fees in subsequent years based on the amounts originally proposed, rather than on the awardees' current need based on actual ordinary and necessary business expenses.
4. NSF approved amounts for management fees in subsequent years without determining whether awardees had other sources of revenue that could be used for unallowable costs and whether a management fee was no longer warranted.
5. NSF approved management fees as an item under other direct costs in proposed NSF grant budgets, rather than requiring the awardees to specifically identify management fees as a separate budget activity.
6. NSF's new management fee policy does not require awardees to submit a justification of need (considering other sources of revenue), nor does it require NSF to evaluate the need and the reasonableness of the fee to determine if the fee is necessary to maintain the awardees' financial viability.

Recommendations

We recommend that NSF:

1. Duly consider the December 2015 National Academy of Public Administration (NAPA) recommendations concerning management fees included in its report *National Science Foundation: Use of Cooperative Agreements to Support Large Scale Investment in Research* and make a determination as to whether it will still continue to award management fees based on necessity for financial viability.

In the event that NSF decides to continue awarding management fees, we recommend that these fees should be limited to maintaining an awardee's financial viability. Specifically, NSF should:

2. Revise its management fee policy to require that awardees submit a written assertion of need that details all sources of revenue, and examine all federal and non-federal sources of revenue for each awardee in making a determination as to whether a management fee is necessary and warranted. Specifically, the policy should ensure that awardees only receive management fees based on a demonstrated need for additional funding to maintain financial viability.
3. Update and revise its administrative and management controls and processes over the negotiation, award, and management of management fees to ensure compliance with its newly updated management fee policy established in the LFM, NSF 15-089.
4. Develop guidelines and procedures for reviewing the information that awardees must provide each year regarding their actual use of management fees. In addition, NSF should require that the evaluators use the results of this review to determine whether fees are still warranted, and, if so, the amount of management fees that should be awarded for the next year.

5. Restructure NSF Summary Proposal Budget Form 1030 for CAs to include a separate line item for management fees.

Summary of NSF Management's Response

While this letter noted a number of conclusions regarding NSF's process for negotiating, awarding, and monitoring management fees at AURA and NEON, NSF's response only addressed one of the report conclusions; specifically, NSF management agreed that, prior to December 2014, its practice had been to make fee determinations based on awardees' proposals specifying their planned use of fees. The remainder of NSF's response focused on replying to each of the letter recommendations, which discussed how NSF should negotiate, award, and monitor management fees in the future.

As a general response to the letter recommendations, NSF noted that it had published and implemented a new management fee policy in December 2014 that addresses appropriate and prohibited uses of fees and includes a requirement for awardees to verify actual uses of fees during the performance of CAs. NSF believes that the newly implemented policy "largely addresses" the concerns reported in the letter, and that the policy has provided NSF with increased oversight and assurance regarding awardees' use of management fees.

Specifically, NSF agrees with recommendations one, three, and four, and is also considering making adjustments to budget form 1030 as suggested in recommendation five. However, it appears that NSF is disagreeing with recommendation two that NSF revise its management fee policy to ensure awardees only receive management fees based on need for additional funding for financial viability.

NSF's full response is located in the attachment to this letter.

Auditor's Comments on NSF Management's Response

NSF's December 2014 management fee policy provides guidance regarding items that should be considered when NSF is negotiating and awarding management fees, as well as examples of appropriate and prohibited uses of fees; however, this policy does not address our recommendations to require awardees to submit a written assertion of need detailing all sources of revenue and to restructure the proposal budget form to include a separate line item for management fees. Ensuring that awardees only receive management fees based on a demonstrated need for additional funding would provide NSF with a more thorough understanding of an entity's resources available to cover expenses, and ensure that NSF has a sufficient basis for evaluating the appropriate amount of management fee necessary to cover ordinary and necessary business expenses that an awardee could not otherwise pay for with other sources of revenue.

COTTON & COMPANY LLP



[REDACTED], CPA, CFE

Partner

May 18, 2016

Attachment: NSF Management Response

ATTACHMENT: NSF MANAGEMENT'S RESPONSE



National Science Foundation

4201 Wilson Boulevard, Arlington, Virginia 22230

Memorandum

Date: May 13, 2016

To: Marie A. Maguire
Assistant Inspector General for Audit (Acting)
Office of Inspector General

From: Ms. Martha A. Rubenstein /s/
Office Head and Chief Financial Officer
Office of Budget, Finance and Award Management

Subject: **Response to the Cotton & Company, LLP, Letter Entitled “NSF’s Negotiation, Award, and Management of Management Fees Awarded to AURA and NEON”**

I am writing to provide NSF’s response to a letter prepared by Cotton & Company, LLP, on behalf of the NSF Office of Inspector General (OIG), dated April 18, 2016, the subject of which is “NSF’s Negotiation, Award, and Management of Management Fees Awarded to AURA and NEON.” We appreciate the opportunity to review and respond to the observations and recommendations contained in the subject letter.

With respect to management fee awarded to AURA and NEON for Fiscal Years (FYs) 2012 to 2014, Cotton & Company’s letter makes observations regarding NSF’s past procedures in negotiating, awarding, and managing management fees. While NSF had no formal written management fee policy prior to December 2014, the practice had been to make fee determinations based on awardees’ proposals specifying planned uses of fee. In December 2014, NSF published and implemented a management fee policy addressing appropriate uses of fee, prohibited uses of fee, and requirements for awardees to verify actual uses of management fee during performance of their cooperative agreements (CAs). NSF issued its final management fee policy in June 2015, following consideration of public comments received in conjunction with the December 2014 Federal Register (FR) publication.

As addressed in detail below with regard to Cotton & Company’s recommendations, we believe that the management fee policy implemented in 2015 largely addresses the concerns raised in the letter and has provided increased Agency oversight and assurance regarding awardees’ use of management fee.

Cotton & Company Recommendations:

- 1. Duly consider the December 2015 National Academy of Public Administration (NAPA) recommendations concerning management fees included in its report *National Science Foundation: Use of Cooperative Agreements to Support Large Scale Investment in Research* and make a determination as to whether it will still continue to award management fees based on necessity for financial viability.**

NSF Response: In testimony before the U.S. House of Representatives Committee on Science, Space and Technology Subcommittee on Research and Technology, and the Subcommittee on Oversight on A Review of Recommendations for NSF Project Management Reform on February 4, 2016, Dr. Richard Buckius, Chief Operating Officer (COO), stated the following:

“Recognizing the [NAPA] Panel recommends eliminating the use of management fee in future projects, we are in the process of doing two things: assessing how our updated policies have impacted existing cooperative agreements, and determining if there are other appropriate cost categories to cover some expenditures currently considered under management fee, per the Panel’s recommendation. While many of the Panel’s recommendations are implementable within a relatively short time frame, I would note that we believe this topic will likely take a more thorough analysis on the part of NSF than some of the other recommendations.”

As also noted by Dr. Buckius in his testimony, “... the NSF Director has created an implementation team to address each of the recommendations ...”

With regard to the issue of management fee, the cross-organizational implementation team continues to evaluate NSF’s past and present use of management fee in order to reach a determination as to the most feasible and sound approach going forward. On May 5, 2016, the National Science Board (NSB) was briefed on the implementation team’s progress to date.

We note that in developing NSF’s management fee policy, NSF benchmarked fee policies at other federal agencies. **The NSF Policy has since been recognized by the Office of Management and Budget (OMB) as an example of an agency best practice.**

Following full and thorough consideration of the NAPA Report’s recommendation, NSF anticipates its next stage in decision-making related to management fee in fall of 2016.

In the event that NSF decides to continue awarding management fees, we recommend that these fees should be limited to maintaining an awardee’s financial viability. Specifically, NSF should:

- 2. Revise its management fee policy to require that awardees submit a written assertion of need that details all sources of revenue, and examine all federal and non-federal sources of revenue for each awardee in making a determination as to whether a management fee is necessary and warranted. Specifically, the policy should ensure that awardees only receive management fees based on a demonstrated need for additional funding to maintain financial viability.**

NSF Response: In general, limiting management fee to the purpose of maintaining an awardee’s financial viability would be more limiting than the current policy, which is based on the Department of Defense (DOD) fee policy for its Federally Funded Research and Development Centers (FFRDCs), and to which NSF added additional, specific prohibitions – arguably the most restrictive in the Federal Government. Further, this issue was examined closely by NSF when drafting the first version of the management fee policy in December 2014. As awardee organizations noted and NSF agreed, information required to assess financial viability is at times business proprietary and more generally not relevant to many expenses incurred as a result of performance on an NSF award. **It is notable that NSF has not been able to identify any other Agency that implements this type of requirement for fee consideration.**

- 3. Update and revise its administrative and management controls and processes over the negotiation, award, and management of management fees to ensure compliance with its newly updated management fee policy established in the LFM, NSF 15-089.**

NSF Response: NSF has completed this requirement. After finalization of the updated management fee policy established in LFM, NSF 15-089, NSF updated internal guidance to implement the policy

through issuance of Standard Operating Guidance (SOG) 15-1, Negotiation, Award, and Payment of Management Fee, issued August 31, 2015.

NSF is committed to promoting uniformity while reducing risk in the negotiation, award, and management of management fees under our current management fee policy. Following the first year of implementation of the 2015 management fee policy, the Division of Acquisition and Cooperative Support (DACS) is reviewing the FY 2015 process in order to implement updated and revised administrative and management controls, as necessary. In the first year of implementation, the policy and review process addressed prior inappropriate uses of management fee. We continue to monitor management fee use this summer as we work to complete our next review of management fee expenses under the limited number of CAs that include management fee.

- 4. Develop guidelines and procedures for reviewing the information that awardees must provide each year regarding their actual use of management fees. In addition, NSF should require that the evaluators use the results of this review to determine whether fees are still warranted, and, if so, the amount of management fees that should be awarded for the next year.**

NSF Response: **We believe we are currently satisfying this recommendation. NSF's 2015 policy requires that awardees provide detailed information regarding actual uses of management fee to inform NSF's future management fee funding decisions.** We are committed to continuous improvement and we are striving to ensure uniformity in procedures as we review first year submissions received and the process for reviewing and approving management fee for subsequent years.

- 5. Restructure NSF Summary Proposal Budget Form 1030 for CAs to include a separate line item for management fees.**

NSF Response: As noted above, the population of awardees receiving management fee is currently limited to seven awardees. We will take this recommendation under consideration. Although "management fee" is currently captured in the "Other" budget category, through procedures implemented with our 2015 management fee policy, we believe that we are uniformly capturing management fee amounts under CAs within the budget justifications, awardee requests, and NSF written approvals.

Thank you, again, for the opportunity to review and respond to Cotton & Company's observations and recommendations.

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