



National Science Foundation
4201 Wilson Boulevard
Arlington, Virginia 22230

Office of Inspector General

MEMORANDUM

Date: MAF 28 2008

To: Mary F. Santonastasso, Director
Division of Institution and Award Support

From: *Deborah H. Cureton*
Deborah H. Cureton
Associate Inspector General for Audit

Subject: Audit Report No. OIG-08-1-006
SRI International

Attached is the final audit report, prepared by Mayer Hoffman McCann P.C., an independent public accounting firm, on the audit of NSF Cooperative Agreement No. ATM-0121483 awarded to SRI International (SRI). The audit covered NSF-funded costs claimed from August 1, 2003 to December 31, 2006 aggregating to approximately \$30 million of NSF direct funded costs. There were no cost sharing requirements for this award.

Overall, the auditors determined that the costs claimed by SRI appear fairly stated and are allowable, allocable, and reasonable for the NSF award. The auditor also found that SRI's financial reporting system, including reporting subaward costs, equipment and property, is adequate to administer its awards. However, the auditors identified one instance of reportable noncompliance with the Nunavut Territorial law and the terms and conditions of the NSF cooperative agreement.

Specifically, the audit disclosed that SRI had not requested and/or maintained all annual licensing renewals to conduct scientific research activities at the Resolute Bay Observatory, as required by the Nunavut Territory authorities, on a timely basis. In addition, SRI did not keep the authorities fully apprised of the scientific research activities performed on the Advanced Modular Incoherent Scatter Radar (AMISR) project through its annual license renewal reporting requirement or obtain NSF review and approval of all agreements with the Canadian authorities, as required by its agreement. The noncompliance was caused by SRI's lack of a written policy and procedure for obtaining scientific license renewals and its misunderstanding of the license renewal process and requirements. As a result, if SRI is publicly cited for failure to report scientific activity and failure to renew the required license in a timely manner, SRI and NSF run the risk of poor government relations with Nunavut Territorial government and the local community of Resolute Bay; loss of property rights to the AMISR project; and continued AMSIR project delays and increased project costs.

To address this compliance deficiency, we recommend that your office direct SRI to (1) establish and implement written license renewal policies and procedures; (2) obtain and maintain the required international Scientific Research License renewals needed for all NSF projects and, (3) coordinate the license application process with NSF as required in the award agreement.

SRI concurred with the report finding and indicated that it was taking corrective actions to ensure that the required licenses are renewed and maintained for all NSF projects. The finding should not be closed until NSF determines that all recommendations have been adequately addressed and the proposed corrective actions have been satisfactorily implemented.

We are providing a copy of this memorandum to the Division Director and Program Director of GEO/ATM. The responsibility for audit resolution rests with the Division of Institution and Award Support, Cost Analysis and Audit Resolution Branch (CAAR). Accordingly, we ask that no action be taken concerning the report's findings without first consulting CAAR at 703-292-8244.

OIG Oversight of Audit

To fulfill our responsibilities under Government Auditing Standards, the Office of Inspector General:

- Reviewed Mayer Hoffman McCann'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 Mayer Hoffman McCann and NSF officials, as necessary, to discuss audit progress, findings, and recommendations;
- Reviewed the audit report, prepared by Mayer Hoffman McCann to ensure compliance with Government Auditing Standards and the NSF Audit Guide; and
- Coordinated issuance of the audit report.

Mayer Hoffman McCann is responsible for the attached auditor's report on SRI International and the conclusions expressed in the report. We do not express any opinion on the Schedule of Award Costs, internal control, or conclusions on compliance with laws and regulations.

We thank your staff for the assistance that was extended to our auditors during this audit. If you have any questions regarding this report, please contact me at 703-292-4985 or Jannifer Jenkins at 703-292-4996.

Attachment

cc: Richard A. Behnke, Division Director (Acting), GEO/ATM
Robert M. Robinson, Program Director, GEO/ATM

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NATIONAL SCIENCE FOUNDATION AWARD NUMBER
ATM-0121483

FINANCIAL AUDIT OF FINANCIAL SCHEDULES AND
INDEPENDENT AUDITORS' REPORT
AUGUST 1, 2003 TO DECEMBER 31, 2006

MAYER HOFFMAN McCANN P.C.
Conrad Government Services Division
Certified Public Accountants
12761 Darby Brooke Court, Suite 201
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**THE RELOCATABLE ATMOSPHERIC OBSERVATORY: A GLOBAL
INCOHERENT SCATTER RADAR**

SRI INTERNATIONAL

TABLE OF CONTENTS

	<u>Page</u>
Executive Summary:	
Background	1
Audit Objectives, Scope, and Methodology	1
Summary of Audit Results	2
Exit Conference	4
Compliance and Internal Controls:	
Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance with Government Auditing Standards	5
Scientific Research License Not Renewed Timely, Scientific Activity on AMISR Project Not Reported on Annual Reports to the Nunavut Territory Authorities, and Licensing Process Not Coordinated with NSF	8
Financial Schedules and Supplemental Information:	
Independent Auditors' Report on Financial Schedules	15
Schedule A – Schedule of Award Costs (Award No. ATM-0121483)	17
Schedule B – Summary Schedules of Award Audited and Audit Results	18
Notes to Financial Schedules	19
Appendix A - Awardee's Comments to Report.....	21

EXECUTIVE SUMMARY

BACKGROUND

We audited funds awarded by the National Science Foundation (NSF) to SRI International (SRI) under Cooperative Agreement No. ATM-0121483 for the period August 1, 2003 to December 31, 2006. SRI, as a Federal awardee, is required to follow the cost principles specified in Federal Acquisition Regulations Part 31, *Contract Cost Principles and Procedures*, and the Federal administrative requirements contained in OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*. (OMB Circular A-110 has been incorporated into 2 CFR 215).

SRI International (SRI), located in Menlo Park, CA, was originally founded as Stanford Research Institute in 1946 by the trustees of Stanford University as a center of innovation to support economic development in the Palo Alto area. In 1970, Stanford Research Institute separated its ties with the University and became SRI International (official not-for profit status) in 1977. SRI's main purpose is to perform client-sponsored research and development for government agencies, commercial business, and private foundations. In addition to performing research and development, SRI also licenses its technologies, forms strategic partnerships, and creates spin off companies, which SRI operates as subsidiary companies.

NSF awarded Cooperative Agreement ATM-0121483, The Relocatable Atmospheric Observatory: A Global Incoherent Scatter Radar (aka, Advanced Modular Incoherent Scatter Radar [AMISR]) to SRI for the period August 1, 2003 through July 31, 2007 for the amount of \$43,999,996. The purpose of the award was to utilize NSF funds to design, construct, and deploy modular phased-array radar that can be assembled and disassembled easily and at a low cost to provide upper atmospheric and ionospheric observing capabilities at different locations. The antenna of the phased array radar will consist of three segments (faces), with each face capable of being operated independently as an incoherent scatter radar. The first face will be deployed at the Poker Flat Research Range in Alaska. The second and third faces will be deployed at Resolute Bay in the Canadian Arctic. SRI will have the primary responsibility for the award and will issue and monitor subcontracts for the design and manufacturing of the various components. Cumulative disbursements for award number ATM-0121483 reported to NSF through December 31, 2006 were \$30,033,100. There was no cost sharing requirement for this award.

AUDIT OBJECTIVES, SCOPE & METHODOLOGY

The objectives of our audit were to:

1. Determine whether the Schedule of Award Costs (Schedule A) of SRI International presents fairly, in all material respects, the costs claimed on the *Federal Cash Transactions Reports (FCTR)* and the costs claimed are in conformity with Federal and NSF award requirements.

2. Determine whether the costs incurred under subcontracts awarded by SRI to Sanmina-SCI Corporation, Comtech PST Corporation, and VECO Alaska, Inc., were documented and allowable under the terms and conditions of the subcontract agreements, NSF, and Federal regulations.
3. Verify that SRI is accounting for property purchased and/or constructed under the NSF award in accordance with the terms and conditions of the cooperative agreement.
4. Identify matters concerning instances of noncompliance with laws, regulations, and the provisions of the award agreement pertaining to the NSF award and weaknesses in SRI's internal control over financial reporting that could have a direct and material effect on the Schedule of Award Costs and SRI's ability to properly administer, account for, and monitor its NSF awards.
5. Determine whether SRI has obtained and is complying with the requirements for international permits and/or other approvals necessary to construct, assemble, and deploy the Advanced Modular Incoherent Scatter Radar at Resolute Bay in accordance with the terms and conditions of the NSF cooperative agreement.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* (2007 revision), issued by the Comptroller General of the United States; and guidance provided in the *National Science Foundation Audit Guide* (December 2004 amended), as applicable. These standards and the NSF Audit Guide require that we plan and perform the audit to obtain reasonable assurance about whether the amounts claimed to NSF as presented in the Schedule of Award Costs (Schedule A) are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Schedule of Award Costs. An audit also includes assessing the accounting principles used and the significant estimates made by SRI, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

SUMMARY OF AUDIT RESULTS

An audit was performed on the costs claimed on the financial reports submitted to NSF by SRI on NSF award number ATM-0121483. These costs are shown in the Schedule of Award Costs (Schedule A) and are summarized as follows.

<u>NSF Award No.</u>	<u>Award Budget</u>	<u>Claimed Costs</u>	<u>Questioned Costs</u>
ATM-0121483	\$ 43,999,996		\$0

We determined that the costs claimed by SRI, including subawards, for NSF award No. ATM-0121483 for the audit period August 1, 2003 to December 31, 2006, appear fairly stated and are allowable, allocable, and reasonable for the NSF award. We also noted that SRI is accounting for property purchased and/or constructed under the NSF award and is submitting property records to NSF that identify the full description and cost of the equipment, in accordance with the terms and conditions of the cooperative agreement. We did not identify any internal control weaknesses in SRI's financial reporting process that could have a direct and material effect on the Schedule of Award Costs or SRI's ability to administer its NSF awards. However, we identified one reportable noncompliance with Nunavut Territorial law and the NSF agreement that could hinder SRI's ability to obtain and maintain the necessary permission from the territory of Nunavut to conduct its scientific research and thereby could interrupt or delay the completion of the Advanced Modular Incoherent Scatter Radar and other scientific projects at the Resolute Bay Observatory.

Specifically, we found that SRI has obtained the Multi-Year Scientific Research License required to conduct science research activities at the Resolute Bay Observatory (RBO) but has not requested and/or maintained all annual licensing renewals on a timely basis. In addition, SRI has not reported any activities concerning the Advanced Modular Incoherent Scatter Radar (AMISR) project in annual reports to the Nunavut Territory authorities or obtained NSF review and approval of some agreements between SRI, Nunavut Territory authorities, and the Canadian Government. The lack of a written policy and procedure for obtaining scientific license renewals and SRI's misunderstanding of the license renewal process and requirements, have contributed to SRI's failure to maintain timely license renewals; report complete information in its annual report to the Nunavut territorial government; and obtain required approvals from NSF. Therefore, NSF did not have the opportunity to ensure that SRI's and its property rights were protected or that SRI's scientific licensing renewal process was adequate. Ultimately, SRI could have lost its permission from the Nunavut territorial government to conduct any scientific research at the RBO as a consequence of the failure to promptly renew the required license. Moreover, none of the planned activities for the AMISR project have been approved under the license because they have not been reported to the Nunavut territorial government in the annual report. If SRI is publicly cited for failure to report scientific activity and failure to renew the required license in a timely manner, SRI and NSF run the risk of poor government relations with Nunavut territorial government and the local community of Resolute Bay; loss of property rights to the AMISR project; and continued AMSIR project delays and increased project costs. Once SRI realized that its annual scientific license had lapsed it obtained assurance from the Nunavut Territory authorities that its immediate operations would not be affected because it's multi-year license was still in effect.

To address this compliance deficiency, we recommend that NSF's Director of the Division of Institutional and Award Support (DIAS) ensure that SRI: 1) establish and implement written license renewal policies and procedures to ensure that the proper licenses are obtained and scientific activity is included in annual reports in a timely, accurate, and thorough manner; 2) obtain and maintain the required international Scientific Research License renewals needed for all NSF projects including the AMISR at the RBO; and 3) coordinate the license application process with NSF as required in the award agreement, which would ensure that all of NSF's and

SRI's property rights are protected, complete scientific activity is reported, and licenses are renewed timely.

SRI responded to the draft report on March 21, 2008. In its response, SRI concurs with the finding and states that it has included all of the license renewal, scientific reporting and NSF review requirements in its project deliverables reporting and tracking system. This will allow for proper reporting and tracking of due dates and status of the project deliverables and/or reporting requirements under each of SRI's contracts.

The finding in this report should not be closed until NSF has determined that all the recommendations have been adequately addressed and the proposed corrective actions have been satisfactorily implemented. SRI's response has been summarized in the report and is included in its entirety in Appendix A attached to this report.

For a complete discussion of audit findings, refer to the Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance with Government Auditing Standards.

EXIT CONFERENCE

We conducted exit conferences on November 15, 2007 and February 29, 2008 via telephone. We discussed the preliminary findings and recommendations noted during the audit. Representing SRI was the following individuals:

- [REDACTED]
- [REDACTED]

Representing Mayer Hoffman McCann P.C. – Conrad Government Services Division were:

Name	Title
[REDACTED]	[REDACTED]

**COMPLIANCE AND INTERNAL
CONTROLS**



Mayer Hoffman McCann P.C.

An Independent CPA Firm

Conrad Government Services Division

**INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL SCHEDULES
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

National Science Foundation
Office of Inspector General
4201 Wilson Boulevard
Arlington, Virginia 22230

We have audited the costs claimed as presented in the Schedule of Award Costs (Schedule A), which summarizes the financial reports submitted by SRI International (SRI) to the National Science Foundation (NSF) for the award listed below and have issued our report thereon dated March 27, 2008.

Award Number	Award Period	Audit Period
ATM-0121483	08/01/03 – 7/31/07	08/01/03 – 12/31/06

We conducted our audit of the Schedule of Award Costs as presented in Schedule A in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* (2007 revision), issued by the Comptroller General of the United States; and the guidance provided in the *National Science Foundation Audit Guide* (December 2004 amended), as applicable.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the Schedule of Award Costs (Schedule A) for the period August 1, 2003 to December 31, 2006, we considered SRI's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial schedule, but not for the purpose of expressing an opinion on the effectiveness of SRI's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of SRI's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of SRI's financial schedule that is more than inconsequential will not be prevented or detected by SRI's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial schedules will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be significant deficiencies or material weaknesses, as defined above.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether SRI's financial schedule is free of material misstatements, we performed tests of SRI's compliance with certain provisions of applicable laws, regulations, and NSF award terms and conditions, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of compliance disclosed one instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and the *National Science Foundation Audit Guide* and which are described in Finding No. 1.

SRI's response to the finding identified in our audit is described after the finding and is included in its entirety in Appendix A. We did not audit SRI's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of SRI's management, the National Science Foundation, SRI's Federal Cognizant Agency, the Office of Management and Budget,

and the Congress of the United States and is not intended to be and should not be used by anyone other than these specified parties.

Margie Hoffman McCarver, P.C.

Woodbridge, Virginia
March 27, 2008

Finding 1. Scientific Research License Not Renewed Timely, Scientific Activity on AMISR Project Not Reported on Annual Reports to the Nunavut Territory Authorities, and Licensing Process Not Coordinated with NSF.

SRI has obtained the Multi-Year Scientific Research License required to conduct science research activities at the Resolute Bay Observatory (RBO) but has not requested and/or maintained all annual licensing renewals on a timely basis. In addition, SRI has not reported any activities concerning the Advanced Modular Incoherent Scatter Radar (AMISR) project in annual reports to the Nunavut Territory authorities or obtained NSF review and approval of some agreements between SRI, Nunavut Territory authorities, and the Canadian Government. The lack of a written policy and procedure for obtaining scientific license renewals and SRI's misunderstanding of the license renewal process and requirements, have contributed to SRI's failure to maintain timely license renewals; report complete information in its annual report to the Nunavut territorial government; and obtain required approvals from NSF. Therefore, NSF did not have the opportunity to ensure that SRI's and its property rights were protected or that SRI's scientific licensing renewal process was adequate. Ultimately, SRI could have lost its permission from the Nunavut territorial government to conduct any scientific research at the RBO as a consequence of the failure to promptly renew the required license. Moreover, none of the planned activities for the AMISR project have been approved under the license because they have not been reported to the Nunavut territorial government in the annual report. If SRI is publicly cited for failure to report scientific activity and failure to renew the required license in a timely manner, SRI and NSF run the risk of poor government relations with Nunavut territorial government and the local community of Resolute Bay; loss of property rights to the AMISR project; and continued AMISR project delays and increased project costs. Once SRI realized that its annual scientific research license had lapsed it obtained assurance that its immediate operations would not be affected because its multi-year license was still in effect.

SRI's Cooperative Agreement No. ATM-0121483, Section I. Special Conditions, C.2.d) requires that SRI "Work with officials of the Canadian government, and/or officials for the government of the territory of Nunavut, to obtain the permits or other approvals necessary for the construction, assembly and deployment of AMISR at Resolute Bay, on the site of the existing NSF facility located at Nunavut airport. All agreements between SRI and Canadian officials, or between NSF and Canadian officials, are subject to prior review and approval by NSF. All such agreements should address future obligations to NSF for land leases, site remediation, or any other long-term obligation associated with the installation of the AMISR facility at Resolute Bay. All such agreements must reserve the rights of the awardee and/or NSF to remove AMISR equipment from Canada in the event of a future relocation and preserve the U.S government's title to the equipment. All agreements must also contain assignment provisions that will allow NSF to transfer the operations and maintenance of the AMISR installation to another award."

The RBO, where the AMISR will be constructed at the Resolute Bay Airport, is located on Inuit-owned land in the Nunavut Territory. The Scientists Act, R.S.N.W.T, 1988, C.s-4, requires all scientific researchers to obtain a license for research activities in Nunavut territory. The Nunavut Research Institute (NRI) part of the Nunavut Arctic College, is responsible for approving and administering these scientific research licenses.

The Nunavut Scientific Research License is important because the Inuit have significant concerns and reservations about how research is conducted and about the impact of scientific activities on their communities. Specific concerns include whether projects involve technological innovations for which the effects are unknown or whether projects may have significant adverse effects on the ecosystem, wildlife habitat or Inuit harvesting activities. NRI's scientific research approval and licensing process is designed to protect and promote the existing and future well-being of the residents and communities of the Nunavut Settlement Area. NSF is also concerned that the proper licenses are maintained in order to comply with Nunavut Territorial and Canadian Government requirements, foster good international and scientific relationships, and protect SRI's property rights.

Organizations that desire to conduct research at the RBO must comply with NRI's regulatory requirements to obtain proper approval. First, all requestors are required to submit an application to the NRI for the specific type of research activity that will be undertaken. Once the application is submitted it is forwarded by NRI for review by several different organizations depending on the extent and nature of the project (i.e. Hamlet Community, Hunters and Trappers Associations, Nunavut Impact Review Board, Nunavut Wildlife Management Board, Department of Fisheries and Oceans, other various Inuit organizations). These review committees provide the NRI with comments or questions regarding the project. These comments and questions are forwarded by NRI to the requestor who is responsible for providing explanations and answering any questions regarding the proposed research activities. The requestor's responses and application are then reviewed by the Nunavut Impact Review Board (NIRB). Once the NIRB approves the application it is forwarded to the NRI Executive Director who provides final approval and issues the license to the requestor. The license is subject to the terms conditions determined by the Nunavut Impact Review Board and the NRI Executive Director. Under the provisions of the Scientists Act, the NRI requires the requestor to submit a 500 - 1000 word non-technical annual summary of their research activities and findings in English and Inuktitut or Inuinaqtun format. The translation ensures maximum accessibility of the research results to Nunavut residents. The annual report is required to describe research activities performed during the current calendar year and expected research activities for the following calendar year, which is the effective period of the requested license. The NRI requires a minimum 45-day processing time frame for the renewal process and the license renewals are usually issued for a one-year calendar period from January 1 to December 31. The Scientists Act, R.S.N.W.T, 1988, C.S-4, Section 7, states that "Every person who contravenes this Act or the regulations or a condition of a license issued under this Act is guilty of an offence and liable on summary conviction to a fine not exceeding \$1,000 or to imprisonment for a term not exceeding six months or to both."

Specifically, for the AMISR project, SRI's [REDACTED] is responsible for ensuring compliance with the terms and conditions of NSF's cooperative agreement and its requirement to maintain proper approvals and licenses with the Nunavut and Canadian Governments for the RBO. The [REDACTED] the Nunavut Scientific Research License compliance responsibility to the [REDACTED] and provides oversight of the [REDACTED] compliance efforts. The Nunavut Scientific Research License is only one of the licenses required by the Nunavut and Canadian governments. Other licensing requirements associated with the AMISR project have

been completed. Further licensing will be required once construction of the AMISR begins at the RBO.

Annual Scientific Research License Not Renewed Timely

In 2003, SRI renewed the Multi-Year Scientific Research License, valid through 2013, from NRI. The license provides SRI permission to conduct scientific research at the RBO. Even though the Multi-year Scientific Research license has been obtained, the license must be renewed annually by the NRI to ensure continued permission to conduct specific research activities for each calendar year period of time at the RBO. The Scientific Research License was properly renewed in 2004 and 2005, however, SRI failed to comply with the annual renewal requirement for the license for part of 2006 and most of 2007. Instead of submitting the 2005 annual report to NRI by November 15, 2005, to comply with the 45-day minimum processing requirement, SRI submitted the annual report late to NRI in January 2006. NRI did not take immediate action to approve the annual report, which further delayed the approval process. The delays resulted in the 2006 license being issued on June 30, 2006. As a result, the renewal period only covered a six-month period for June 30 – December 31, 2006.

The problems encountered for the 2006 license renewal had a negative effect on SRI's 2007 renewal efforts. SRI failed to realize that the renewal period for 2006 ended on December 31, 2006. SRI officials mistakenly thought the renewal for 2006 was valid for a 12-month period starting June 30, 2006 ending on June 29, 2007, even though the effective period was indicated on the license. Based on this assumption, SRI submitted the annual report to NRI in February 2007, with the intentions of complying with NRI's processing time frame for the license renewal. Again, NRI did not take immediate action to approve the report and renew the license. NRI did not issue the 2007 license to SRI until November 2007.

The [REDACTED] was unaware of licensing remedies available to SRI in situations when license renewals are pending or overdue for a specific period of time. In 2006, SRI was issued a license that did not include the January 1 – June 29, 2006 time period. The [REDACTED] was unaware that SRI could have requested a temporary "official" license for the January 1 through June 29, 2006 time period. NRI advised the [REDACTED] that NSF operations would not be affected because the Multi-Year Scientific Research License was still in effect even though the 2006 license renewal was only for a six-month period of time.

SRI's failure to maintain timely license renewals occurred because of a lack of a written policy and procedure for obtaining license renewals and SRI's misunderstanding of the license renewal process and requirements. SRI does not have a routine and systematic process for determining when due dates for approvals and licensing requirements must be complied with to ensure the continuity of operations. In addition, NRI has constantly changed licensing requirements over the years that has also caused confusion to the [REDACTED] and has contributed to SRI's misunderstanding of requirements. SRI's [REDACTED], who is responsible for compliance with licensing requirements contacts the NRI on a random basis to determine the current license compliance requirements for the RBO. The [REDACTED] regarding the approval process and the importance of timing regarding the submission of the required documents to the NRI for approval.

A formalized license renewal process would help SRI comply with regulatory licensing requirements and ensure that the proper personnel are aware of the requirements and expiration dates. When appropriate, SRI should be required to provide a plan for acquiring licenses so that NSF officials are aware of which research activities should be included in the required applications and what approvals are mandatory for research projects.

Scientific Activity on AMISR Project Not Reported on Annual Reports to the Nunavut Territory Authorities

SRI did not report the status of any scientific activities concerning the AMISR project in its annual reports that were submitted to the NRI with SRI's scientific research license renewal applications. SRI only reported on scientific projects that are deployed or in operation in its annual plan. However, according to NRI, it is interested in all phases of scientific activity performed on a project. The annual report is required to describe research activities performed during the current calendar year and expected research activities for the following calendar year, which is the effective period of the requested license.

In 2004, SRI properly started to apply for and obtain the necessary approvals needed for the AMISR that was originally scheduled for deployment in 2006. One of the requirements included conducting an environmental assessment for use of the land at the RBO. SRI completed the assessment in 2006, and received NSF's and NRI's approval in 2006. However in 2005, SRI postponed the AMISR deployment until 2008 because of delays in the final Resolute AMISR configuration and prime power distribution methods.

SRI did not include a discussion of the activities involving AMISR in the annual reports for 2005 through 2007 that supported the scientific license renewal applications, because the AMISR was not scheduled for deployment until 2008. Specifically, the annual reports for 2005 through 2007 should have explained that steel for the AMISR platforms was purchased in 2005, shipped to RBO in 2006 and is being stored at the Resolute Bay port for the expected deployment in 2008. The annual reports should have explained how this material would be stored at the port until the radar was assembled and constructed to ensure that NRI was fully informed and that it would provide the proper approvals for issuance of the license renewals. The failure to include the status of the AMISR in the annual reports occurred because of SRI's misunderstanding of NRI's license requirements to report all scientific activity on a project in the years in which the license is effective and is being renewed. Including this activity in the annual reports would also be necessary to protect the U.S. Government's rights and access to the property being stored at the Resolute Bay port.

Having proper licenses and reporting all scientific activity could prevent further delays to the AMISR project. Due to the geographical location of the RBO, materials and supplies can only be shipped during the late summer (usually in August) to the Canadian Arctic when the waterways are ice-free and shipping to RBO is possible. Shipping by means of sealift to the Canadian Arctic is the most cost effective method of shipping to the RBO. If scheduled shipments are not made during this time frame the materials and supplies will have to remain at SRI and/or in storage at some other designated location until late summer in the following year

for shipment to occur. Shipping delays will lead to interruptions in construction, missed project completion milestones, and, inefficient use of staff and contractor time during periods when materials are not available for assembly and construction at the RBO. The AMISR project has already been subject to a significant cost increase in 2007 when the NSF extended the project's period of performance to fall 2008 and funded an additional \$4 million to complete the project. This action was based on unforeseen delays, and, increased costs of materials and equipment. The lack of proper licenses from NRI could cause the project to be delayed beyond 2008 and be subject to additional shipping, storage, and costs to complete the project. In 2008, the assembly and construction of the AMISR is scheduled to take place and the majority of the AMISR's equipment, and, materials and supplies are scheduled for shipment to the RBO. Therefore, it is essential to have the proper license and report the proper activity to NRI to protect the NSF's and SRI's rights and interests in AMISR property at the RBO and meet the AMISR deployment schedule.

Licensing Process Not Coordinated with NSF

NSF has not been provided the opportunity to review and approve SRI's Scientific Research Licensing Process during the AMISR project. SRI coordinated with NSF during the earlier application for licensing of the RBO that was valid until 2003. SRI provided the environmental assessment of the AMISR project to NSF for review and approval before submission to the Nunavut and Canadian governments. However, SRI does not obtain NSF's review and approval of the Scientific Research License application or the annual reports submitted to NRI. The terms of the cooperative agreement require that SRI obtain NSF's review and approval of all agreements before they are entered into with the Nunavut and Canadian governments and will ensure the agreements protect NSF's and SRI's property rights at the RBO. NSF wants to ensure that provisions are made to protect NSF's and SRI's ownership rights, assignment and transfer rights to other NSF projects, and the right to remove equipment from Canada at the end of the project.

The lack of a written policy and procedure for identifying NRI's and other regulatory requirements for obtaining licenses and approvals have contributed to SRI's failure to obtain approvals from NSF. A written policy and execution plan would ensure that all of NSF's and SRI's property rights are protected, complete scientific activity is reported, and licenses are renewed timely.

Summary

Compliance with Nunavut's and Canada's regulatory requirements is critical to ensure the success of all NSF research activities and the timely completion of the AMISR project in 2008. If SRI is publicly cited for failure to report scientific activity and failure to renew the required license in a timely manner, SRI and NSF run the risk of poor government relations with Nunavut territorial government and the local community of Resolute Bay; loss of property rights to the AMISR project; and continued AMSIR project delays and increased project costs. SRI could be

subject to penalties and fines imposed by the NRI for failure to maintain the proper license under provisions of the Scientists Act.

The NSF and the U.S. Government could also be subject to negative publicity, public criticism, and embarrassment for not complying with Nunavut and Canadian regulatory requirements that are designed to protect the territorial environment and protect the safety of its citizens. Compliance with regulatory statutes prevents infractions from occurring that increase Nunavut's risks to its environment and increase SRI's risk of environmental liabilities. It will also reduce the risk of lost trust of the Nunavut and Canadian governments and possible lost opportunities for future approvals of research and scientific projects in the territory.

Recommendation 1:

We recommend that NSF's Director of the Division of Institutional and Award Support (DIAS) ensure that SRI establish and implement written license renewal policies and procedures to ensure that the proper licenses are obtained and scientific activity is included in the annual reports in a timely, accurate, and thorough manner. We also recommend that these written policies and procedures include provisions where SRI develop a tracking and notification mechanism for identifying expiration dates for regulatory requirements at the RBO and provide direct notification to NSF program officials to alert them of expiring requirements.

Recommendation 2:

We recommend that NSF's Director of DIAS ensure that SRI obtain and maintain the required international Scientific Research License renewals needed for all NSF projects including the AMISR at the RBO.

Recommendation 3:

We recommend that NSF's Director of DIAS ensure that SRI coordinate the license application process with NSF as required in the award agreement, which would ensure that all of NSF's and SRI's property rights are protected, complete scientific activity is reported, and licenses are renewed timely.

Awardee's Comments

SRI concurs with the finding and recommendations. Since the audit, SRI states that it has added all of the license renewal and scientific reporting requirements of the Canadian or Provincial government agencies and NSF's review and approval requirements into SRI's project deliverables reporting and tracking system. This system allows for the reporting and tracking of due dates and status of the project deliverables and/or reporting requirements under each of SRI's contracts.

Auditor's Response

SRI's comments are responsive to the finding and recommendations. Tracking all of the license renewal, scientific reporting, and NSF review and approval requirements in SRI's project deliverables reporting and tracking system, in connection with adequate NSF review and approval, should correct the noncompliance finding. However, the finding should not be closed until NSF determines that proposed corrective actions have been satisfactorily implemented.

**FINANCIAL SCHEDULES AND
SUPPLEMENTAL INFORMATION**



Mayer Hoffman McCann P.C.
An Independent CPA Firm
Conrad Government Services Division

INDEPENDENT AUDITORS' REPORT ON FINANCIAL SCHEDULES

National Science Foundation
Office of Inspector General
4201 Wilson Boulevard
Arlington, Virginia 22230

We have audited the costs claimed by SRI International (SRI) to the National Science Foundation (NSF) on the Federal Cash Transactions Reports (FCTRs) for the NSF award listed below. The FCTRs, as presented in the Schedule of Award Costs (Schedule A), are the responsibility of SRI's management. Our responsibility is to express an opinion on the Schedule of Award Costs (Schedule A) based on our audit.

Award Number	Award Period	Audit Period
ATM-0121483	08/01/03 – 7/31/07	08/01/03 – 12/31/06

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* (2007 revision), issued by the Comptroller General of the United States and the guidance provided in the *National Science Foundation Audit Guide* (December 2004 amended), as applicable. These standards and the *National Science Foundation Audit Guide*, require that we plan and perform the audit to obtain reasonable assurance that the amounts claimed to NSF as presented in the Schedule of Award Costs (Schedule A) are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Schedule of Award Costs (Schedule A). An audit also includes assessing the accounting principles used and the significant estimates made by SRI's management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the Schedule of Award Costs (Schedule A) referred to above presents fairly, in all material respects, the costs claimed on the FCTRs for the period August 1, 2003 to December 31, 2006 in conformity with the provisions of the *National Science Foundation Audit Guide*, *NSF Grant Policy Manual*, terms and conditions of the NSF award and on the basis of accounting

described in the Notes to the Financial Schedule, which is a comprehensive basis of accounting other than generally accepted accounting principles. This schedule is not intended to be a complete presentation of financial position in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, and provisions of the *National Science Foundation Audit Guide*, we have also issued a report dated March 27, 2008, on our tests of SRI's internal control over financial reporting and on compliance and other matters. The purpose of that report is to describe the scope of our testing over internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

This report is intended solely for the information and use of SRI's management, NSF, SRI's cognizant Federal audit agency, Office of Management and Budget, and the Congress of the United States, and is not intended to be, and should not be used by anyone other than these specified parties.

A handwritten signature in blue ink that reads "Margie Hoffmann McConry, P.C." The signature is written in a cursive style.

Woodbridge, Virginia
March 27, 2008

SCHEDULE A

SRI INTERNATIONAL
 National Science Foundation Award Number ATM-0121483
 Schedule of Award Costs
 August 1, 2003 – December 31, 2006
 Interim

<u>Cost Category</u>	<u>Approved Budget</u>	<u>Claimed Costs (A)</u>	<u>Questioned Costs</u>	<u>Schedule Reference</u>
Direct costs:				
Salaries and Fringe Benefits	██████████	██████████	-	
Travel	██████████	██████████	-	
Other direct costs:				
Equipment	██████████	██████████	-	
Material and supplies	██████████	██████████	-	
Publication Costs	██████████	██████████		
Consulting	██████████	██████████	-	
Subcontracts	██████████	██████████	-	
Computer	██████████	██████████	-	
Total direct costs	██████████	██████████	-	
Indirect costs	██████████	██████████	-	
Total	██████████	██████████	-	
Cost sharing	<u>\$ -</u>	<u>\$ -</u>	<u>-</u>	

(A) - The total claimed costs agrees with the total expenditures reported by SRI on the Federal Cash Transaction Report - Federal Share of Net Disbursements as of the quarter ended December 31, 2006. Claimed costs reported above are taken from the awardee's books of accounts.

See Accompanying Notes to this Financial Schedule.

SRI International

Summary Schedules of Award Audited and Audit Results
From August 1, 2003 to December 31, 2006

Summary of Award Audited

<u>Award Number</u>	<u>Award Period</u>	<u>Audit Period</u>
ATM-0121483	08/01/2003 to 07/31/2007	08/01/2003 to 12/31/2006

<u>Award Number</u>	<u>Type of Award</u>	<u>Award Description</u>
ATM-0121483	Cooperative Agreement	To design, construct, and deploy modular phased-array radar that can be assembled and disassembled easily and at a low cost to provide upper atmospheric and ionospheric observing capabilities at different locations.

Summary of Questioned and Unsupported Costs by Award

<u>Award Number</u>	<u>Award Budget</u>	<u>Claimed Costs</u>	<u>Questioned Costs</u>	<u>Unsupported Costs</u>
ATM-0121483			\$0	\$0
Total			<u>\$0</u>	<u>\$0</u>

Summary of Non-Compliance and Internal Control Findings

<u>Findings</u>	<u>Non-Compliance or Internal Control</u>	<u>Material or Reportable</u>
International Permits not maintained	Non-Compliance	Reportable

SRI INTERNATIONAL
Notes to Financial Schedules
From August 1, 2003 to December 31, 2006

Note 1: Summary of Significant Accounting Policies

Accounting Basis

The accompanying financial schedules have been prepared in conformity with National Science Foundation (NSF) instructions, which are based on a comprehensive basis of accounting other than generally accepted accounting principles. Schedule A has been prepared by SRI from the Federal Cash Transactions Reports submitted to NSF and SRI's accounting records. The basis of accounting utilized in preparation of these reports differs from generally accepted accounting principles. The following information summarizes these differences:

A. Equity

Under the terms of the award, all funds not expended according to the award agreement and budget at the end of the award period are to be returned to NSF. Therefore, the awardee does not maintain any equity in the award and any excess cash received from NSF over final expenditures is due back to NSF.

B. Equipment

Equipment is charged to expense in the period during which it is purchased instead of being recognized as an asset and depreciated over its useful life. As a result, the expenses reflected in the Schedule of Award Costs include the cost of equipment purchased during the period rather than a provision for depreciation.

Except for awards with nonstandard terms and conditions, title to equipment under NSF awards vests in the recipient, for use in the project or program for which it was acquired, as long as it is needed. The recipient may not encumber the property without approval of the federal awarding agency, but may use the equipment for its other federally sponsored activities, when it is no longer needed for the original project.

C. Inventory

Minor materials and supplies are charged to expense during the period of purchase. As a result, no inventory is recognized for these items in the financial schedules.

Income Taxes

SRI is a non-profit entity within the state of California and is exempt from income taxes.

SRI INTERNATIONAL
Notes to Financial Schedules
From August 1, 2003 to December 31, 2006

The departure from generally accepted accounting principles allows NSF to properly monitor and track actual expenditures incurred by the Grantee. The departure does not constitute a material weakness in internal controls.

Note 2: Indirect Cost Rates

<u>Award Number</u>	<u>Program Year</u>	<u>Indirect Cost Rate</u>	<u>Base</u>
ATM-0121483	08/01/03 – 07/31/04	██████████	Eng OH
		██████████	G&A
		██████████	Off-Site OH
		██████████	Support Cost
		██████████	Sys OH
ATM-0121483	08/01/04 – 07/31/05	██████████	Eng OH
		██████████	G&A
		██████████	Off-Site OH
		██████████	Support Cost
		██████████	Sys OH
ATM-0121483	08/01/05 – 07/31/06	██████████	Eng OH
		██████████	G&A
		██████████	Off-Site OH
		██████████	Support Cost
		██████████	Sys OH
ATM-0121483	08/01/06 – 07/31/07	██████████	Eng OH
		██████████	G&A
		██████████	Off-Site OH
		██████████	Support Cost
		██████████	Sys OH

**APPENDIX A - AUDITEE'S
COMMENTS TO REPORT**

HOW TO CONTACT
THE OFFICE OF INSPECTOR GENERAL

Internet

www.oig.nsf.gov

Email Hotline

oig@nsf.gov

Telephone

703-292-7100

Toll-free Anonymous Hot Line

1-800-428-2189

Fax

703-292-9158

Mail

Office of Inspector General
National Science Foundation
4201 Wilson Blvd., Suite 1135
Arlington, VA 22230



March 21, 2008

[REDACTED]

Mayer Hoffman McCann, P.C.
12761 Darby Brooke Court, Suite 201
Woodbridge, Virginia 22192

Subject: Draft Report of the SRI International Financial Audit of Financial Schedules and
Independent Auditors' Report

Dear Mr. [REDACTED]

The following information is provided in response to your draft finding/recommendations in the subject audit report.

SRI was granted a multi year (10 year) science license by the Nunavut Research Institute (NRI) in 2003. Due to misunderstandings between SRI, NRI and the Nunavut territorial government and changes to the annual licensing requirements, the annual licensing renewal was not completed on a timely basis for the 2006/2007 time period. Although the annual report was not delivered on time, we were in contact with the NRI routinely and as a result, the NRI graciously allowed the license to continue in spite of our failure to report in a timely manner. We now have a better understanding as to the annual license renewal requirements which will prevent these delays from happening in the future.

To prevent this oversight from happening in the future, we have added all of the license renewal and scientific reporting requirements of the Canadian or Provincial government agencies and NSF's review and approval requirements into SRI's project deliverables reporting and tracking system. This system allows for the reporting and tracking of the due dates and status of the project deliverables and/or reporting requirements under each of SRI's contracts. This will ensure that all of NSF's and SRI's property rights are protected, complete scientific activity is reported and licenses are renewed timely.

If you have any questions or require further information, please call me at [REDACTED]

Sincerely,

[REDACTED]

SRI International

333 Ravenswood Avenue • Menlo Park, California 94025-3493 • 650.859.2000