



National Science Foundation

4201 Wilson Boulevard
Arlington, Virginia 22230

Office of Inspector General

MEMORANDUM

DATE: **MAR 26 2012**

TO: Jeffrey Lupis, Division Director
Division of Acquisition and Cooperative Support (DACS)

FROM: Dr. Brett M. Baker
Assistant Inspector General for Audit

A handwritten signature in black ink, appearing to read "Brett M. Baker", written over the printed name in the "FROM" field.

SUBJECT: NSF OIG Audit Report No. OIG-12-3-001, Review of Specific Cost Information Related to Contingencies on Consortium for Ocean Leadership's (COL) Ocean Observatories Initiative Cost Proposal

The Defense Contract Audit Agency (DCAA), Chesapeake Bay Branch Office, evaluated how contingency costs were estimated in COL's \$386.42 million proposed budget for the Ocean Observatories Initiative (OOI).¹ DCAA performed this additional work to determine if there would be any effect on its original position to question COL's \$88.1 million of proposed contingency costs. The questioned contingency costs were reported in NSF-OIG Audit Report No. OIG-10-1-012, *Audit of Proposed Budget for the Ocean Observatories Initiative*, dated September 30, 2010, which transmitted DCAA's Audit Report No. 6171-2009J21000001 (same subject) dated September 14, 2010 (Attachment II). The results of DCAA's additional work are contained in the attached DCAA memorandum, entitled *Request of Specific Cost Information Related to Contingencies on COL's Proposal*, dated February 8, 2012 (Attachment I).

Background

In the original audit report on COL's \$386.4 million proposed budget cited above, DCAA questioned the entire amount of COL's proposed \$88.1 million in contingency costs based on federal cost principles in 2 CFR Part 230, Appendix B, Paragraph 9, Contingency Provisions (formerly OMB Circular A-122) for non-profit organizations. This cost principle states, "Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable." COL did not agree with the audit finding and maintained that the incorporation of contingencies in the proposed budget was directed by NSF.

In a written response to DCAA's findings on COL, NSF raised concerns about the correctness of DCAA's interpretation and application of the OMB regulations. DCAA responded to NSF's

¹ COL submitted the OOI Proposal (NSF Proposal No. 0957938) under NSF Solicitation No. 09-29.

concerns in its attached response dated November 30, 2010² (Attachment III), affirming that DCAA's interpretation and application of the OMB regulations are correct. Further, DCAA stated in its response that:

- While contingencies may be included in Government developed budgets, awardees are not allowed to include contingency costs in the proposal they submit to the Government per OMB Circular A-122, Appendix B, and NSF's Proposal and Award Policies and Procedures Guide.
- There is a difference between Government estimates for budgeting purposes (wherein contingency costs are used to provide more realistic costs) and proposed costs (wherein OMB Circular A-122, Appendix B provides that contingency costs are unallowable).
- Awardees must comply with OMB Circular A-122 cost principles for non-profit organizations with respect to their pricing, administration, and settlement of awards; and there is no exception to how the applicable cost principles are determined for an awardee.

The issue of an NSF awardee proposing unallowable contingency costs in construction budgets was also found in DCAA's audits³ of:

- Association of Universities for Research in Astronomy's (AURA) proposed budget for the Advanced Technology Solar Telescope (as reported in NSF OIG Audit Report No. OIG-11-1-001 dated March 11, 2011), which included \$62 million of contingencies, and in
- National Ecological Observatories Network's (NEON) proposed budget for the NEON (as reported in NSF OIG Audit Report No. OIG-11-1-021 dated September 30, 2011), which included \$74 million of contingencies.

On September 21, 2011, NSF OIG held a meeting between DCAA, NSF management, and Clifton Gunderson (NSF's financial statement auditors), wherein DCAA agreed to perform additional work on COL's proposed \$88.1 million of contingencies as well as on AURA's and NEON's proposals including proposed contingencies. This report transmits the outcome of DCAA's additional work at COL.

Results of DCAA's Additional Work at COL

DCAA verified its understanding of how COL's \$88.1 million of proposed contingency costs were calculated. DCAA noted that contingencies were additional costs added to COL's base cost estimates. As for COL's base cost estimates, DCAA noted no exceptions. As for contingencies, DCAA found that COL estimated these costs using two different methods. For the first method (a bottom-up approach), COL judgmentally calculated the contingency costs using NSF-provided tables. For the factors that did not warrant a bottom-up approach, COL used a separate top-down approach to calculate a contingency amount again based on unsubstantiated judgment. COL's contingency estimates were not based on evidence derived from COL's data.

² Transmitted to NSF on January 5, 2011 and via OIG Audit Report No. 11-1-001, Audit of AURA's Cost Book Proposal for the ATST, dated March 31, 2011.

³ Neither of the two audits (ATST and NEON) could be completed because, in both cases, DCAA found that the proposals were unacceptable for audit and consequently issued inadequacy memos. However, for both awardees' proposals, DCAA reported that the proposed contingency costs were unallowable.

Of primary importance, DCAA found no evidence that COL can support contingencies “with certainty as to time, intensity, or with an assurance of their happening” as required by the OMB cost principle previously cited. DCAA therefore reaffirmed its prior audit position that COL’s proposed contingency costs are unallowable per the OMB cost principle.

DCAA concluded its memo by stating that unallowable costs should not be proposed (as allowable costs) or awarded. DCAA based its conclusion on the OMB cost principles, which NSF has incorporated into its grant policies and procedures to NSF awardees.

Based on DCAA’s aggregate findings on COL’s proposed contingencies, NSF needs to internally control, and not award, contingency funds until a demonstrated need arises that is predicated on known events, the occurrence of which can be foretold with certainty as to time, intensity, and with an assurance of their happening.

Recommendations

With regard to COL’s proposed contingencies in the budget provided to NSF, we continue to recommend that the NSF Director of the Division of Acquisition and Cooperative Support:

1. Require COL to remove unallowable contingency provisions from its proposed budgets for OOI and discontinue NSF’s practice of funding contingencies. Instead, NSF should require its awardee to submit proposed budgets supported by auditable, current, accurate and complete cost data, request independent audits of the awardee’s proposed budgets prior to funding, and base NSF funding on the results of audit⁴.
2. Implement policies and procedures that require that NSF internally control, and not award, contingency funds until a demonstrated need arises that is predicated on known events the occurrence of which can be foretold with certainty as to time, intensity, and with an assurance of their happening⁵.

Both of these recommendations are currently being resolved by DACS under OIG Report Nos. OIG-10-012 and OIG-11-001, in accordance with OMB Circular A-50. Therefore, no further action is necessary under this report number OIG-12-3-001.

We are providing a copy of this memorandum to the OOI Program Director and the Director of Large Facilities Projects. The responsibility for audit resolution rests with DACS. Accordingly, we ask that no action be taken concerning the report’s findings without first consulting DACS at (703) 292-8242.

⁴ This recommendation was originally made in NSF OIG Report No. OIG-10-1-012, *Audit of Proposed Budget for the Ocean Observatories Initiative*, dated September 30, 2010, recommendation no. 4.

⁵ This recommendation was originally made in NSF OIG Report No. OIG-11-1-001, *Audit of Association of Universities for Research in Astronomy, Inc.’s (AURA) Cost Book Proposal for the Advanced Technology Solar Telescope (ATST)*, dated March 31, 2011, recommendation no. 3.

OIG Oversight of DCAA's Additional Work at COL

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

- Reviewed DCAA's approach and planning of the additional work;
- Evaluated the qualifications and independence of the auditors;
- Monitored the progress of the additional work at key points;
- Coordinated periodic meetings with DCAA and NSF officials as necessary to discuss audit progress, findings and recommendations;
- Reviewed the memorandum prepared by DCAA to ensure compliance with Government Auditing Standards and Office of Management and Budget Circulars; and
- Coordinated issuance of the memorandum.

DCAA is responsible for the attached memorandum and the conclusions expressed in the memorandum. NSF OIG does not express any opinion on COL's proposed contingency costs or the conclusions presented in DCAA's memorandum.

We thank you and your staff for the assistance extended to us during the audit. If you have any questions about this report, please contact Jannifer Jenkins at (703) 292-4996 or David Willems at (703) 292-4979.

Attachments:

I. DCAA memorandum, *Request of Specific Cost Information Related to Contingencies on Consortium for Ocean Leadership's (COL) Proposal*, dated February 8, 2012.

II. NSF OIG Audit Report No. OIG-10-1-012 dated September 30, 2010 transmitting DCAA Audit Report No. 6171-2009J21000001, *Report on Audit of Proposed Budget for the Ocean Observatories Initiative for Consortium of Ocean Leadership, Inc.*, dated September 14, 2010.

III. DCAA *Response to National Science Foundation's Concerns Regarding Assignment Number 6171-2009J21000001*, (the Audit of the Consortium of Ocean Leadership Proposed Budget for the Ocean Observatories Initiative, OIG Report No. 10-1-012) dated November 30, 2010

cc: Martha Rubenstein, CFO and Director BFA
Mary Santonastasso, Division Director, DIAS
Jean McGovern, OOI Program Director, Division of OCE
Mark Coles, Director Large Facilities Projects