




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

MEMORANDUM

DATE: September 30, 2015

TO: Jeffery M. Lupis
Director, Division of Acquisition and Cooperative Support (DACS)

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

SUBJECT: NSF OIG Report No. OIG 15-6-004, The Defense Contract Audit Agency's Letter of Observations on the Need for NSF to Require the Tracking of Contingency Expenditures on Construction Projects

In conjunction with its ongoing audit of California Technology Institution's (Caltech) fiscal years 2011 and 2012 Advanced Laser Interferometer Gravitational Wave Observatory (ALIGO) incurred direct costs, the Defense Contract Audit Agency (DCAA) provided the attached letter of observations on the \$39 million (19 percent) for contingencies (out of total proposed costs of \$205 million) included in Caltech's ALIGO proposal for FYs 2008-2015.

The auditors provided information on the ability of Caltech's accounting system to track contingency expenditures and presented a series of facts pursuant to contingency, which are detailed in the attached letter. In addition, DCAA recommended that NSF be required to strengthen its award policy to include clear requirements for reporting irregularities or potential irregularities by awardees and awardee employees.

We requested that DCAA examine how contingency was estimated, tracked, and spent because a large body of audit work spanning five years has found that construction budgets for NSF's large facility projects included millions of dollars of contingencies, which lacked adequate supporting documentation. The risk of misuse is heightened because NSF does not retain control over contingency funds and does not require awardees to demonstrate a bona fide need for contingency funds that is supported by verifiable cost data. Finally, because NSF does not require awardees to separately track contingency in their accounting systems, NSF cannot confirm that contingency funds were spent for items requested in change orders.

For example, most recently, our September 2015 alert memo on the potential \$80 million cost overrun for the National Ecological Observatory Network (NEON) project¹ disclosed that NSF

¹ *NSF's Management of Potential \$80 Million Cost Overrun for NEON*, Report #15-3-001, dated September 15, 2015

could not determine whether NEON actually spent any of the \$35 million in contingency. If, as OIG has recommended, NSF held contingency funds until NEON provided sufficient support for their use, NSF would have greater visibility over contingency expenditures and assurance that funds were not spent in advance of NSF approval.

The findings at Caltech related to contingency re-emphasized long-standing accountability weaknesses and risk of misuse related to NSF's contingency practices. Specifically, the DCAA auditors found the following:

- Once authorized, the actual costs covered by the contingency funds are commingled with the other elements of costs in the award.
- Review of approximately 76 percent of total contingency funds requested in FYs 2011 and 2012 found that the approved contingency funds assigned to the Work Breakdown Structure (WBS) may differ from what was originally proposed for each WBS.
- After the project/task was completed, the actual costs covered by the contingency funds could not be uniquely distinguished or identifiable separately as being associated with the contingency funds in the accounting system.
- DCAA traced the contingency funds requested in seven selected change control requests and in found **no** direct correlation between the WBS originally requested for contingencies, in change orders NSF approved and those that were actually funded in six of the seven.

In summary, DCAA found no separate tracking of Caltech's actual use of the contingencies. Specifically, auditors found that \$19.6 million in actual budgeted contingency use differed significantly from what was requested and from what NSF approved in six of the seven cases reviewed. Therefore, NSF cannot tell if awardees are properly accounting for contingency or if contingency funds were used without approval for unauthorized purposes such as cost overruns, scope increases, or other unauthorized use. This occurred because NSF did not require Caltech to separate track contingency costs in its accounting system. Under these circumstances, the risk of taxpayer funds being potentially misused without controls for detection is increased greatly.

Moreover, DCAA concluded that Caltech's budgeted use of contingencies varied often and significantly, to such an extent that there is not a direct correlation between contingency requested and approved by NSF and actual budgeted contingency use. As a result, Caltech did not provide the auditors with a sufficient and meaningful comparison between its budgeted and its actual use of contingency costs.

These findings underscore the importance of tracking how contingency funds are actually spent and the need for NSF, as a steward of federal funds, to require visibility and accountability over contingency costs to properly manage those funds. Visibility of expenditures is the starting point and the key to proper accounting and oversight. This visibility would enable a meaningful comparison between budgeted and actual contingency costs. One potential option could be to make contingency a separate award, to facilitate tracking these funds. Thus, we again urge NSF to strengthen its oversight over awarded contingency funds.

Additionally, DCAA made an observation regarding the NSF Policy on Reporting Fraud, Waste and Abuse. The auditors noted that the NSF Proposal and Award Policy and Procedure Manual does not require an awardee to provide a mechanism for its employees to report suspected fraud, waste, abuse, and noncompliance directly to the NSF-OIG.

As stated in the attached letter, DCAA made the following recommendations:

1. NSF strengthen its Proposal and Award Policy and Guidance to awardees with respect to estimating, monitoring, and accounting for contingency expenditures on construction projects, and that NSF be required to include a contractual requirement (in its construction awards) for an awardee to separately track in detail the use of contingency costs in its accounting system.
2. NSF strengthen the NSF Award Policy to specify requirements for reporting irregularities or potential irregularities by awardees and awardee employees. The policy could be similar to the requirements in FAR 52.203-13, requiring an internal reporting mechanism such as a hotline (which allows for anonymity and confidentiality) by which employees may report irregularities.

DCAA is responsible for the attached letter, and the conclusions and recommendations expressed in that letter.

This memo is related to the work on Caltech's ongoing incurred cost audit (which OIG will issue after we receive DCAA's report), and brings to NSF's attention issues identified during that work that warrant corrective action. In accordance with OMB Circular A-50, NSF and OIG should agree on a corrective action plan for resolution of all findings. Please provide us your proposed corrective plan within 60 calendar days.

We appreciate 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.

Attachment: DCAA Letter of Observations to NSF-OIG on California Technology Institution's Advanced Laser Interferometer Gravitational Wave Observatory, dated June 26, 2015

cc: Martha Rubenstein
Dale Bell
Matthew Hawkins
Christina Sarris
Michael Van Woert
Ruth David
Mark Coles