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OFFICE OF  
INSPECTOR GENERAL

MEMORANDUM

Date: March 31, 2009

To: Thomas N. Cooley, Director and Chief Financial Officer  
Office of Budget, Finance, & Award Management (OD/BFA)

Dr. Larry H. Weber, Acting Office Director  
Office of International Science and Engineering (OD/OISE)

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

Subject: NSF OIG Report Number 09-1-007  
Audit of the U.S. Civilian Research and Development Foundation

Attached is the final report on the audit of the U.S. Civilian Research & Development Foundation's (CRDF) incurred costs to ensure that Federal funds were being used appropriately. Specifically, the audit was conducted on CRDF award costs and administrative controls for the fiscal year (FY) ended December 31, 2006. CRDF's comments to the draft report have been summarized after the recommendations for each audit finding and the auditor's response has been provided to these comments. NSF indicated that it was unable to provide comments on the audit findings and recommendations because there was insufficient information at the time to render such a position without the benefit of first-hand interaction with CRDF and cognizant NSF program staff. However, NSF did comment on the factual accuracy of certain sections of the report. To the extent we considered appropriate, we made revisions to the report to address both CRDF and NSF comments. The full text of both the CRDF and NSF comments is attached as Appendices C and D, respectively, to the audit report.

The audit found significant internal control weaknesses in CRDF's processes to oversee its subrecipients. CRDF's subrecipients are foreign grantees that received approximately \$6.7 million, or 71 percent, of total direct costs charged to the NSF award in FY 2006. Specifically, we identified internal control weaknesses over approximately \$3 million of Individual Financial Support (IFS) payments to foreign researchers and \$2 million in Institutional Building (IB) support payments to four grant-making organizations established

by CRDF. These weaknesses create substantial risk for potential fraudulent and unallowable costs to be charged to the NSF award.

Our audit also disclosed that CRDF incorrectly included unallowable and unallocable costs in calculating its FY 2006 indirect cost rate, which resulted in \$191,696 of indirect costs being overcharged to the NSF grant. Specifically, CRDF charged public relations and advertising costs as indirect costs, although they are unallowable per Federal cost principles. In addition, CRDF improperly charged \$7,230 of unallowable direct costs to the NSF award for items such as alcohol, food, and party expenses for business meetings and marketing costs.

We consider CRDF's internal control procedural weaknesses identified in the audit findings to be significant, thus NSF needs to ensure appropriate corrective actions are taken to implement the audit recommendations. We request that NSF provide its position regarding each recommendation along with its proposed corrective action plan within 120 days from the date of this memorandum. Milestone dates for implementation should be provided as part of corrective action plan. In accordance with OMB Circular A-50, *Audit Followup*, this timeline will allow NSF and the OIG to work out any differences and reach mutual agreement on the plan within the six month resolution period.

We appreciate the cooperation that was extended to us during our review. If you have any questions, please feel free to call me at 703-292-4985 or Michael Kuklok at 703-292-4975.

Enclosure

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**U. S. Civilian Research & Development Foundation  
Arlington, Virginia**

**Audit of CRDF's Costs and Administrative Controls  
For the Fiscal Year Ended  
December 31, 2006**

**National Science Foundation  
Office of Inspector General**

**March 31, 2009**

**OIG 09-1-007**



## EXECUTIVE SUMMARY

In 1995, the NSF established the U.S. Civilian Research and Development Foundation (CRDF) as authorized by the Freedom Support Act. The Act provided for creating a nonprofit foundation to provide: i) research and development opportunities to former Soviet Union weapons scientists and engineers, ii) conversion of defense to civilian collaborative research and development projects, and iii) assistance in the establishment of a market economy in newly independent states of the former Soviet Union.

Although, NSF is responsible for overseeing and managing the CRDF award, other Federal agencies primarily funded the award through NSF. CRDF also receives funding from corporations and foundations. In response to a request from the NSF Director, the NSF Office of Inspector General (OIG) initiated an audit in 2007 to determine whether CRDF had adequate internal control policies and procedures to properly account for and manage Federal funds provided by the NSF award, which cumulatively totaled \$140 million since 1995. The audit also determined whether \$14.8 million of Fiscal Year (FY) 2006 costs claimed by CRDF were allowable, allocable and reasonable in accordance with Federal grant policies.

The audit found that CRDF lacked adequate administrative and financial internal control policies and procedures to ensure proper use of Federal funds. We noted several material internal control weaknesses in CRDF's monitoring of its individual principal investigators (PI) and subaward organizations that if not addressed could increase the risk for fraud and unallowable costs being charged to the NSF award. Since these costs represent approximately \$6.7 million or 71 percent of the direct costs CRDF claimed in FY 2006, it is imperative that CRDF have an effective internal control oversight process in place. Specifically, CRDF did not:

- Consistently enforce internal control procedures related to Individual Financial Support (IFS) payments. IFS payments are provided to individual scientists in the former Soviet Union doing research under the CRDF program. Our review disclosed that about 40 percent of the approximately \$3 million in FY 2006 IFS payment requests were not adequately supported by labor effort reports.
- Establish and/or enforce controls over approximately \$2 million of funds provided in FY 2006 to CRDF's Institutional Building (IB) organizations. Specifically, required annual audits of these organizations were not consistently conducted, payments were made without reviewing supporting documentation, and the cost allocation methodology for administrative service contracts was subjective.

In addition, we identified internal controls weaknesses in CRDF's indirect cost allocation practices. As a result, CRDF charged \$376,199 of questioned costs to its indirect cost accounts. A breakdown of the questioned costs is as follows:

- \$297,090 of proposed administrative labor charges and related fringe benefits and space occupancy costs for unallowable fundraising and public relations activities conducted by [REDACTED];

- \$53,871 of unallowable charges for entertainment, alcohol, meals and travel expenses; and,
- \$25,238 of direct costs for meetings and conferences incorrectly charged as indirect expenses.

The questioned costs identified above resulted in CRDF's indirect rate for FY 2006 being overstated by 2.04 percent and \$191,696 of indirect costs being overcharged to the NSF award. Through FY 2009, we estimate that \$1,153,497 of funds could be put to better use government wide by applying a lower indirect rate to all of CRDF's Federal awards. This figure includes \$401,231 related to other Federal agencies' awards. We also found that CRDF charged \$7,230 in unallowable costs directly to the NSF award for alcohol, entertainment, and marketing and public relation activities.

These weaknesses generally occurred because CRDF either failed to adequately enforce established policies and procedures or in some instances had not established adequate controls. Specific to the questioned indirect costs, CRDF had not established guidance and procedures to ensure that its employees properly identify and record unallowable and unallocable activities. Moreover, CRDF employees at the time of the audit, were not aware of Federal cost principles and had not received training on these principles.

During the audit, CRDF management provided training on Federal cost principles to its staff. Such training should be conducted on a periodic basis in order to institutionalize and impart change in practice. Furthermore, we believe additional controls are needed to strengthen CRDF's grant management processes. Therefore we recommend NSF management direct CRDF to establish and implement: i) stronger controls over grantee and subrecipient monitoring; ii) written policies over the appropriate charging of allowable, unallocable, direct and indirect costs; and, iii) periodic mandatory training courses for CRDF staff on grant charging practices. In addition, we recommended NSF recover \$198,926 for overcharges.

In response to the draft report, CRDF indicated that while it did not agree with the overall audit conclusions or basic premise of the findings, it did acknowledge that additional subrecipient monitoring controls were needed and has implemented corrective actions to address the report recommendations. With regard to the questioned costs, CRDF disagreed and stated that such costs were allowable because of either longstanding CRDF practice or inclusion of the costs in its Business Plan submitted to NSF. However, the legal binding Funding Arrangement between NSF and CRDF clearly states that grant costs allowability will be based on the Federal cost principles used during our audit. Therefore, we continue to disagree with CRDF on the allowability of these costs and reaffirm our audit conclusions and recommendations.

After incorporating CRDF comments, the draft report was issued to NSF requesting its comments and management position on the audit findings and recommendations. In its response to the draft report, NSF provided suggestions for report clarification, but stated that there was insufficient information available for rendering its management's position on the audit findings and recommendations without interaction with CRDF and cognizant NSF program officials.

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<b>ACRONYMS</b>	
CEO	Chief Executive Officer
CRDF	Civilian Research Development Foundation
FSA	Freedom Support Act
FY	Fiscal Year
IB	Institutional Building
IFS	Individual Financial Support
NSF	National Science Foundation
OIG	Office of Inspector General
OMB	U. S. Office of Management and Budget
PI	Principal Investigator

# INTRODUCTION

## Background

Pursuant to the “Freedom Support Act (FSA) of 1992,” NSF established the U.S. Civilian Research and Development Foundation (CRDF) in 1995. It was chartered as a private nonprofit entity to promote and support opportunities for collaborative research and development projects for peaceful purposes between U.S. researchers and scientists in the newly independent States of the former Soviet Union. CRDF is based in Arlington, Virginia, and it has foreign offices in Russia, Ukraine and Kazakhstan. A Board, appointed by NSF’s Director, oversees CRDF’s activities and sets direction for the organization.

The NSF award to CRDF was first made on September 29, 1995. As of May 1, 2008, the award to CRDF totaled \$140 million, of which 69 percent has been provided by the Department of State, 11 percent has been provided by NSF, and the remaining amount provided from five other Federal agencies and a private foundation. The major Federal contributors in 2006 included the Department of State providing \$8 million, NSF contributing \$1 million, and the National Institutes of Health contributing over \$750,000 to CRDF. In addition to the above funding being provided under the NSF award, CRDF receives additional funds under private grants from non-Federal sources and performs contract work for both the private and Federal sectors. Currently, the NSF award makes up the largest source of funds to CRDF.

Under the Individual Financial Support (IFS) program, CRDF funded individual foreign grantees and sub-recipients. This program constitutes CRDF’s largest expense category. In 2006, CRDF’s IFS program paid almost \$3 million (31 percent) of its 2006 direct costs to individuals and institutions that employed scientists and researchers in the former Soviet Union countries to supplement their salaries and to encourage these individuals to engage in non-weapons related research. In addition, Institutional Building support payments made to foreign grantees and sub-recipients comprise CRDF’s second largest expense category totaling \$2 million (21 percent) of its FY 2006 direct costs. The purpose of the Institutional Building program is to help build peer review, grant making organizations in the newly independent States of the former Soviet Union, with an infrastructure similar to NSF. To this end, CRDF helped establish four Institutional Building organizations in Armenia, Azerbaijan, Georgia, and Moldova.

CRDF recently began expanding its grant support programs to promote the collaboration of scientific projects not only in the former Soviet Union, but also in the Middle East and North Africa. As such, CRDF is now receiving and managing grants for other Federal agencies as well as other private organizations. The additional services that CRDF is providing to the other institutions include purchasing, shipping and customs assistance for equipment, travel assistance, accounting support, oversight of research projects, logistical support, and contract and intellectual property guidance. With the increase in non-FSA related grant activities, the need for reliable cost accounting systems to properly segregate and track expenses by funding sources becomes even more important for CRDF. NSF requested the OIG to conduct an audit of CRDF operations due to the large government grant amounts awarded to CRDF since 1995 and because CRDF has not been audited by the OIG since its inception.

## **Objectives, Scope, and Methodology**

### **Audit Objective**

The purpose of the audit was to determine whether CRDF had adequate internal control policies and procedures to properly account for and manage funds provided by Federal agencies through NSF. The audit also included determining whether \$14.8 million of FY 2006 costs claimed on NSF awards by CRDF were allowable, allocable and reasonable in accordance with Federal cost principles and award terms and conditions.

### **Scope and Methodology**

The audit was performed from May 25, 2007 to May 15, 2008 at CRDF and NSF in Arlington, Virginia. The audit covered FY 2006 CRDF expenditures, which covered the period January 1, 2006 through December 31, 2006. To accomplish the audit objective, we reviewed the adequacy of CRDF internal control procedures and accounting practices for charging costs to Federal awards to determine whether they have been implemented, are functioning as prescribed, and are being effectively monitored internally by CRDF. We reviewed CRDF's accounting records and source documentation to ensure that grant expenditures were allowable, allocable, and reasonable. Specifically, we:

- Obtained and reviewed laws, regulations, policies and procedures relevant to CRDF to gain an understanding of CRDF and its operations;
- Interviewed key CRDF officials, including the Chief Executive Officer (CEO), Chief Financial Officer, Director of Global Operations, and Director of Development to gain an understanding of CRDF's operations. We also interviewed officials from NSF's Office of International Science and Engineering, Cost Analysis and Audit Resolution Branch, and Division of Grants and Agreements to gain an understanding of NSF's requirements for the award provided to CRDF;
- Interviewed officials from the U.S. Department of State and National Institutes of Health to seek an understanding about any of their concerns regarding CRDF operations;
- Reviewed recent single audits conducted by CRDF's external auditors and CRDF's own site visit reports to determine whether any issues should be incorporated into our audit;
- Reviewed CRDF timekeeping procedures to determine if they provided reasonable assurance of accurate recording, distribution, and payment of labor. We judgmentally selected timesheets for two pay periods for three employees who performed direct activities, two employees who performed indirect activities, and three employees who performed award administration<sup>1</sup> activities to determine if their labor hours were accurately recorded, and subjected to supervisory review in accordance with CRDF's policy;

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<sup>1</sup> CRDF has a separate award administration rate.

- Reviewed salaries of CRDF's [REDACTED] to determine whether CRDF was properly charging allowable type activities and allocating those costs to the appropriate direct and indirect accounts. To test the appropriateness of the allocation of the [REDACTED] salaries, we reviewed position descriptions; analyzed survey questionnaires for employee positions completed in 2006, and interviewed selected employees in these positions to obtain an overview of their activities. We used the data gathered to estimate the labor hours individual employees expended on unallowable type activities and related labor costs associated with these activities;
- Performed a complete nomenclature review of journal entries to determine if there were unusual entries that required further review. We also judgmentally selected high dollar entries and high risk accounts and examined the source documents such as vendor invoices, payment receipts, purchase orders, trip reports, and timesheets supporting the amounts and disclosures in the accounting records. We tested approximately \$404 thousand out of \$9.4 million in total direct costs incurred and charged to the award in FY 2006, and \$879,477 out of \$ [REDACTED] of total indirect costs charged to the indirect cost pool in FY 2006. Because we used a non-statistical sampling plan, questioned costs in this report may not represent total costs that may have been questioned had all the reported FY 2006 expenditures been tested;
- Judgmentally selected and reviewed 30 IFS payments to determine whether established policies and procedures and requirements in the grant agreements were followed and claimed costs were supported by adequate documentation;
- Determined reasonableness of CRDF's methodology for allocating administrative support contracts to Federal versus non-Federal projects. We selected two contract billings from each of the four IB organizations and evaluated the reasonableness of the cost allocation methodology and basis for charges to the NSF award; and,
- Reviewed the methodology CRDF used to calculate its FY 2006 indirect cost rates, including indirect, administrative, fringe benefits, and occupancy rates to determine their reasonableness. Finally, we reviewed all cost categories in the indirect cost and administrative cost pools, as well as all costs in the fringe benefits and occupancy cost pools for Virginia, Moscow and Kyiv, in order to identify potential unallowable costs or high risk items requiring further review and testing.

We conducted our audit in accordance with the Comptroller General's government auditing Standards, July 2007. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions. Because our review was limited to the scope and methodology described above, it may not necessarily disclose all internal control deficiencies that may have existed at the time of the audit.

## Findings and Recommendations

### I. CRDF Needs to Significantly Improve Its Oversight of Subrecipient Funds

We found significant internal control weaknesses in CRDF's processes to oversee its subrecipients. CRDF's subrecipients are foreign grantees that received approximately \$6.7 million, or 71 percent, of total direct costs charged to the NSF award in FY 2006. Specifically, we identified internal control weaknesses over approximately \$3 million of Individual Financial Support (IFS) payments and \$2 million in Institutional Building (IB) support. These weaknesses create substantial risk to CRDF and NSF for potential fraudulent and unallowable costs to be charged to the NSF award.

#### 1. Incomplete or Missing Labor Effort Reports to Support IFS Salary Charges

CRDF award agreements with its subrecipients include a requirement for the Principal Investigators (PIs) to review and approve labor effort reports for all staff working on the subrecipient awards, and to make those records available to CRDF upon request for its review. In turn, CRDF, as the primary grant recipient, is responsible for overseeing and monitoring its subrecipients to ensure compliance with this effort reporting requirement and the propriety of subrecipient labor effort charged to NSF awards.

However, our review disclosed significant weaknesses over CRDF's processes for monitoring the approval of effort reports supporting IFS payments. For 13 (43 percent) of 30 sampled IFS transactions listed in the general ledger, we found that effort reports to support the payments were either not properly completed or unavailable. Specifically, three PIs prepared and dated their effort reports after we requested the effort reports during the course of our audit, which was one and a half years after the work was performed. Another five effort reports were not dated, and one was not signed or dated. Therefore, it was unclear whether these effort reports were prepared at the time the work was actually performed or who prepared them. Moreover, four payments had no supporting effort reports and CRDF could not locate the responsible PIs to obtain the missing reports.

CRDF found similar problems with subrecipient labor effort. CRDF site visits conducted during a two year period, found that approximately 40 percent of grantees did not maintain an effort reporting system as required. If this rate of missing effort reports exists throughout the IFS program, as much as \$1.2 million of the \$3 million in FY 2006 IFS salary payments may be at risk.

Although CRDF had established requirements for subrecipient effort reporting, it did not consistently enforce those requirements. Subrecipients received their IFS payments regardless of whether or not they completed timesheets or effort reports. CRDF management indicated that the concept of preparing labor effort reports by foreign grantees was new and efforts to train foreign grantees and gain their acceptance of this requirement had been slow. While cultural

differences at the onset of the program are understandable, the IFS program has been in existence for more than 10 years.

## 2. Inadequate Oversight of IB Organization Costs

We also identified three significant weaknesses in CRDF's oversight of its four IB organizations which receive approximately \$2 million annually in NSF funds. CRDF did not ensure that: i) required annual audits of IB organizations were consistently conducted, ii) staff reviewed supporting documentation from its IB organizations before making payments, and iii) a reasonable basis was established for allocating the costs of its administrative service contracts to the NSF award. Further explanation of each of these weaknesses follows.

- a. Required Annual Audits for IB Organizations Not Conducted. CRDF audit guidelines require annual audited financial statements. The policy also requires an audit of all grants at an institution for the last two years if unaudited grant funds total \$50,000 or more during the life of the organization. The policy requires independent audit reports to cover, at a minimum: i) a financial statement that presents the IB organization's revenues, expenses, and the cash balance of funds provided by CRDF; and ii) a report on the IB organization's compliance with the project grant agreement and applicable laws and regulations. This report should identify material instances of noncompliance, the amounts questioned as a result of the noncompliance, and material weaknesses in the control system that contributed to the noncompliance.

CRDF did not ensure that its IB organizations have met the annual audit requirement. Although all four IB organizations were required to have an annual audit, none was conducted or completed in accordance with established CRDF guidelines. For example, the initial audit report for the Azerbaijan IB organization that included FYs 2002 through 2004 was not issued until May 1, 2006. Similarly, the Moldova IB organization did not conduct the required annual financial audit in FY 2004. Rather, they conducted an audit of FYs 2004 and 2005 and issued the audit report on July 22, 2006. At the time of our review, the FY 2006 audit for Moldova had not been completed. Furthermore, of the audits that were completed, the scope was limited to a review of financial statements and did not include assessing the organizations' compliance with grant terms and conditions of the CRDF award agreement or the adequacy of their internal controls over compliance.

Timely and complete audits are critical to the identification and correction of material internal control weaknesses that can lead to unallowable costs and potential fraud, waste and abuse.

- b. Supporting Documentation Not Reviewed Before Making IB Payments. CRDF's subaward agreements require that IB organizations submit receipts and invoices to support their requests for reimbursement of award expenditures. Moreover, CRDF, in accordance with OMB Circular A-110, *Uniform Administrative Requirements for Grants and Other Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations*, is required to have written procedures to help ensure that costs charged to the NSF award for the IB organizations are allowable, allocable and

reasonable in accordance with cost principles contained in OMB Circular A-122, *Cost Principles for Non-Profit Organizations*.

However, CRDF did not have established procedures to ensure that supporting documents were consistently reviewed before making IB payments. During the audit, CRDF officials stated that the individual who performed this oversight function left CRDF employment and that they were not diligent in requesting and reviewing supporting documentation. In fact, management could not provide documentary evidence that would support any reviews ever occurred in FY 2006. Further, CRDF's own site visits to the IB organizations did not include reviewing actual expenditures charged to the grant to ensure their propriety and allowability. Finally, CRDF did not assess the adequacy of the subrecipients' internal controls over award expenditures to ensure the IB organizations grant accounting and management controls were adequate. Instead, CRDF's site visits only focused on whether the IB organizations and their PIs were achieving the scientific program goals of the awards.

- c. Costs for IB Administrative Contracts Allocated without Adequate Support. CRDF did not have a reasonable basis for allocating its administrative service contract costs to its individual IB awards. Administrative contracts were awarded to the IB organizations to provide general administrative support services for CRDF's grant and project administration activities, such as logistics, dissemination of non-IB grantee payment requests, local currency handling, and dissemination of program information in the local scientific communities in Armenia, Azerbaijan, Georgia, and Moldova. OMB Circular A-122 requires that costs be allocated to a particular cost objective in reasonable proportion to the relative benefits received. However, CRDF only requested the IB organizations to submit monthly progress reports and the payment authorization for the total administrative services costs was subjectively allocated to its various projects and awards. For example, while contract employees work on multiple projects, the amount of time spent on each project is not recorded separately for costing purposes. As a result, CRDF cannot appropriately allocate costs charged to the Federal awards. The absence of cost accounting systems to segregate the administrative services costs by award and provide verifiable supporting documentation, such as effort reports, may result in an inequitable apportionment of these contract costs to the NSF award. There is also a risk of duplicate charging of the same administrative costs to more than one Federal award.

These internal control weaknesses occurred because CRDF did not have a system in place to enforce its annual audit requirement for the IB organizations. It also did not provide the resources necessary to consistently review and validate the costs for payment or ensure proper allocation to the NSF award. In addition, CRDF did not provide proper subrecipient oversight by ensuring that the IB organizations had implemented adequate accounting systems that could segregate and accumulate costs by project or award, or equitably allocate costs to awards based on the benefits derived. As a result of these weaknesses, CRDF cannot fully ensure that \$2 million of annual subaward costs for IB organizations' activities benefited the award to which they were charged, or were spent on valid and allowable award costs.

## **Recommendations**

We recommend that the NSF Director of the Division of Grants and Agreements and the Director of the Division of Institution and Award Support require CRDF to:

- 1.1 Fully implement and enforce a labor effort reporting system for IFS subrecipients and properly validate effort reports for completeness, accuracy and appropriateness prior to disbursing IFS payments.
- 1.2 Enforce its established annual audit requirement of all IB organizations, and adequately monitor these subawardees to ensure compliance.
- 1.3 Develop and implement a policy to obtain and review all documents supporting IB payment requests prior to making any disbursements for reasonableness, allowability and allocability. CRDF's review process should also include regular financial site visits to ensure the adequacy of IB organizations' grant accounting and management practices.
- 1.4 Develop an effective and documented methodology for allocating costs incurred by IB organizations for administrative service contracts to the Federal award in proportion to the benefits received.

## **CRDF Comments:**

CRDF did not agree with the overall audit conclusions regarding oversight of subrecipient funding and the amount of funding that was identified as being at risk. However, CRDF did acknowledge that additional subrecipient monitoring controls were needed and stated that it had already implemented corrective actions that meet the intent of recommendations 1.1 through 1.4. Specifically, management stated:

1. The IFS system did not lack payment controls and took exception to our estimation of \$1.2 million in IFS payments being at risk based on our sample. Management did however agree that controls were not consistently applied and monitoring needed improvement. Management stated they have implemented a number of controls and are in the process of testing a new system to improve the monitoring of subrecipients. These include: (i) implementation of daily timesheet system by project participants, and must be reviewed and approved by the responsible PI; and, (ii) CRDF project managers conducting regular desk reviews on a monthly basis to reconcile timesheets to payment requests submitted.
2. They recognized in 2004 that they needed to enhance controls to ensure annual audits were conducted at IB organizations, but felt they had instituted some compensating controls. Again, management stated they have taken numerous steps to improve the current system. CRDF also disagreed with our conclusion that \$2 million in IB subaward costs were at risk under the NSF award.
3. The wording for the cost allocation process was misleading and that part of the breakdown was due to the individual in charge of this process not maintaining adequate

records. Nevertheless, CRDF acknowledged that a more objective methodology for allocating administrative contract costs to its various awards and projects was appropriate and have instituted procedures to collect the necessary data.

**OIG Response:**

We have reviewed CRDF's comments and made changes to the report where appropriate for clarification and accuracy. We disagree with CRDF's comment that our overall conclusion indicates an absence of controls. Rather, the conclusion states there were significant internal control weaknesses primarily due to the lack of CRDF enforcement of existing policies and procedures and subrecipient monitoring. CRDF acknowledges a lack of consistency in the application of controls in their comments to the report. Thus, we stand by our report. Regarding the dollars at risk, the report does not state that funds were misspent or used inappropriately, but rather the risks for the potential misuse of these funds increases when there is a weak internal control system in place. As stated in the report, the dollars at risk were based on estimates from audit results and in some instances corroborated by prior CRDF reviews. Thus, we believe the dollars at risk are fairly stated. Finally, we believe CRDF's proposed actions will be responsive to the recommendations when fully implemented.

**NSF Comments:**

NSF only provided minor comments or suggestions on clarification of the the audit finding. Management stated that there was insufficient information available for rendering a NSF position on the audit finding and recommendations at this time.

**OIG Response:**

We considered NSF comments and have incorporated appropriate suggestions for report clarification. However, after NSF has had the opportunity to discuss and obtain additional information from CRDF and cognizant NSF program staff, as previously requested, management needs to provide a formal position on the audit finding and its agreement or disagreement with each audit recommendation.

## II. CRDF Lacks a Full Understanding of Cost Principles Related to Identification and Segregation of Unallowable and Unallocable Costs

OMB Circular A-122 states that non-profit organizations receiving Federal grant funds may only claim costs that are allowable, allocable and reasonable. Specifically, the Circular stipulates that advertising and public relations costs, fundraising, social club memberships, entertainment, alcohol and first-class airfares, are generally unallowable as indirect or direct costs. Also, when calculating indirect costs, the grantee must include the cost of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission in the direct cost pool for the purposes of calculating its indirect cost rate whether or not these costs are allowable.

However, our audit disclosed that CRDF incorrectly included unallowable and unallocable costs in calculating its indirect rate for FY 2006. In addition, CRDF charged unallowable costs directly to the NSF award. Specifically, CRDF charged public relations and advertising costs as indirect costs, although they are unallowable per OMB Circular A-122, Attachment B. The [REDACTED] staff stated they frequently briefed congressional staffers and other intermediaries of the foreign relations committees on CRDF grant efforts. Under Attachment B, paragraph (1)(f)(4) of OMB Circular A-122, costs of public relations designed solely to promote the organization are unallowable. According to CRDF, these meetings were all initiated by CRDF and were not in response to specific requests for testimony or information from a congressional committee. CRDF also provided the auditors with a legal opinion on "lobbying costs," versus public relations. Regardless, CRDF also does not meet the OMB Circular A-122, Attachment B, paragraph 25(b)(1) exception to the general prohibition for charging lobbying costs which states that costs associated with "providing a technical and factual presentation of information on a topic directly related to the performance of a grant, contract or other agreement through hearing, testimony, statements or letters to the Congress or a State legislature, or subdivision, member, or cognizant staff member thereof, must be in response to a documented request [*emphasis added*] (including a Congressional Record notice requesting testimony or statements for the record at a regularly scheduled hearing) made by the recipient member, legislative body or subdivision, or a cognizant staff member thereof."

In fact, the CRDF Business Development Group's primary function is promoting and marketing CRDF to its funding stakeholders. For example, position descriptions for CRDF Business Development Group Senior Staff Associates state that their duties include identifying opportunities to broaden CRDF's base of support through attending and tracking congressional hearings, meeting with congressional staff members to educate them about CRDF's capabilities and activities, and organizing or participating in events that offer CRDF an opportunity to showcase its successes. In addition, they "act on opportunities to utilize CRDF's grants and other activities within individual U.S. states and districts to garner support for CRDF among congressional members and staff."

For FY 2006, we estimate that CRDF's CEO and the Business Development Group incorrectly charged the indirect cost pool \$ [REDACTED] for indirect salaries and associated fringe benefits and occupancy costs to carry out unallowable fundraising, public relations and promotional activities.

This estimate reflects the percentage of time that CRDF employees self-reported as being spent on public relations, marketing and outreach activities.<sup>2</sup>

In addition, we found that CRDF incorrectly claimed \$53,871 of other indirect costs that were not allowable under Federal and NSF award requirements. Some examples of unallowable charges include:

- \$10,121 for entertainment and alcoholic beverage costs for a holiday party on a dinner cruise;
- \$4,575 for a farewell cocktail reception for the former CEO;
- \$10,022 in additional costs for first and business class airfares; and,
- \$3,056 for a dinner organized by the U.S.-Russian Business Council in San Francisco for the governor of St. Petersburg, Russia.

CRDF also incorrectly charged \$25,238 of direct costs as indirect costs. These costs included subscriptions, meetings, and conferences that directly supported CRDF's research mission. Therefore, these costs are allowable as direct costs and should not have been allocated through the indirect cost rate.

Finally, CRDF charged certain unallowable expenses directly to the NSF award. These include \$5,563 in alcohol, food and party expenses charged to business meetings and \$1,667 for marketing.

As a result of charging these unallowable and unallocable costs to the award, CRDF's indirect cost rate charged to NSF for FY 2006 is overstated. Adjusting for these inaccuracies, we calculated CRDF indirect cost rate to be [REDACTED] percent rather than the [REDACTED] percent claimed in FY 2006. Accordingly, we are questioning \$191,696 in overstated indirect costs and \$7,230 of unallowable direct costs charged to the NSF award for FY 2006. This methodology of calculating a lower indirect cost rate should significantly reduce claimed indirect costs on future NSF and other Federal agency awards. In addition to the questioned costs above, we estimate that approximately \$1,153,497 of federal funds could be put to better use from applying lower indirect rates in FY 2005 – 2009.<sup>3</sup> This figure includes \$401,231 related to other Federal agencies' FY 2005 - 2009 awards. This reduction in costs could be used to fund additional grants. Differences in the amounts proposed compared to the audit determined amounts along with detailed explanations on the costs we questioned and the impact on the indirect cost rate are summarized in Appendices A and B.

Although CRDF has been receiving Federal funds since its inception, neither CRDF management nor its staff were fully aware of the Federal OMB and grant requirements and thus had not developed written procedures or provided training to employees responsible for classifying and charging award costs. Specifically, CRDF did not have guidance and procedures to help employees properly identify allowable and unallowable activities. Additionally, we

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<sup>2</sup> This information came from position description questionnaire CRDF employees completed in a survey conducted in FY 2006 by a consulting firm hired by CRDF.

<sup>3</sup> At the time of audit, the State Department was finalizing CRDF's indirect cost rate for FY 2005. The FY 2004 indirect rate is already negotiated.

determined that CRDF had not trained their employees in this area. For example, CRDF officials believed that because Congress approved the legislation creating CRDF and approved annual funds for its operations, their grant from NSF covered costs of providing regular briefings to Congress. They did not understand that Federal cost principles governing the NSF award considers such briefings as unallowable promotional and public relations activities. As such, the briefings do not support the research purpose of the NSF award and the costs are not allowable charges to the grant.

Since our audit, CRDF has appropriately moved to address this weakness by providing training to all staff concerning the allowability and allocability of costs and charging to the appropriate accounts.

### **Recommendations**

We recommend that the NSF Director of the Division of Grants and Agreements and the Director of the Division of Institution and Award Support direct CRDF to:

- 2.1 Establish written accounting policies and procedures for calculating and charging indirect cost rates that ensure only reasonable, allowable and allocable costs are charged to Federal awards as required by OMB Circulars A-110 and A-122 standards for financial management systems. The policies and procedures should specifically direct staff not to include costs for promotional and marketing activities (such as briefings to Congress) in the indirect cost rates.
- 2.2 Train staff on the accurate classification and proper allocation of costs as direct or indirect, and allowable versus unallowable. The training should be provided to all new hires with periodic refresher courses provided to existing employees.
- 2.3 Require supervisors to review timesheets to ensure that unallowable activities are charged to the appropriate cost account.

We recommend that the NSF Director of the Division of Grants and Agreements and the Director of the Division of Institution and Award Support:

- 2.4 Work with CRDF to correct the indirect cost rate for other years prior to and after FY 2006 to remove and/or reclassify the types of unallowable and unallocable costs identified in the audit and seek recovery of all improper NSF charges.
- 2.5 Resolve the \$191,696 in unallowable indirect costs and \$7,230 in direct costs improperly charged to the NSF award in FY 2006.

### **CRDF Response:**

CRDF disagreed with the basic premise of this finding. It stated that, rather than CRDF lacking an understanding of OMB Circulars A-110 and A-122, CRDF has a fundamental disagreement

with the OIG's interpretation of the regulations. In particular, CRDF disagreed with our determination that briefing of members of Congress and their staff are unallowable public relations costs. CRDF stated NSF requested to update the Business Plan in 2005 and that Sec. III.B of the NSF Funding Arrangement explicitly calls for CRDF to conduct its activities in accordance with the Business Plan which calls for advancing its mission through various means including communicating its successes to external stakeholders and Congressional members and staff among others. Thus, CRDF disagrees with the audit conclusion that the labor charges for t [REDACTED] personnel were, in part, unallowable public relations type activities. CRDF also believes the basis on which we considered the costs unallowable was flawed. Simply relying on position description questionnaires provided to CRDF's independent consultant as a basis for estimating potentially unallowable public relations costs is too unreliable according to CRDF. Based on CRDF's own post hoc determinations, which included two training sessions on Federal cost principles and its 2006 revised position description questionnaires, the amount of unallowable costs CRDF believes were charged to the Federal award were \$13,857 instead of the \$173,910 the audit identified (the CRDF number did not include the associated fringe benefits and occupancy costs). Also, CRDF only partially agreed with the \$79,109 of other questioned costs in the report because they disagreed with the audit conclusion and in some cases because charging these costs were long standing CRDF practices which NSF had never questioned.

**OIG Response:**

We do not consider CRDF's comments responsive to the finding. We stand by the facts and conclusions presented in the report, as discussed below:

1. CRDF stated it had a fundamental disagreement with the OIG concerning the Federal cost principles contained in the OMB Circulars. However, CRDF first trained its staff on these cost principles after the auditors brought questions of cost allowability to the attention of CRDF during the audit. CRDF did not argue the presentation of this fact in the report and in effect affirmed it through their comments.
2. CRDF further states NSF asked it to update its Business Plan in 2005. Based on the cover memorandum to NSF, dated May 9, 2005, it was CRDF's initiative to update the Business Plan instead of NSF's. According to CRDF, the funding arrangement explicitly calls for CRDF to conduct its activities in accordance with the Business Plan. The Business Plan does call for advancing its mission through various means including communicating its successes to external stakeholders and Congressional members and staff, among others. However, the Business Plan does not address specific funding issues and financial responsibility. Rather CRDF lists this issue as an "opportunity" to communicate CRDF's successes. We recognize that CRDF has both Federal and non-Federal funding and some of these expenses may be allowable for non-Federal funding, but are not allowed to be charged to Federal funding either, directly or indirectly. Further, the 1996 Funding Arrangement, signed by NSF and CRDF, states the allowability of costs shall be determined in accordance with OMB Circular A-122 cost principles and that funds for the discretionary account (unallowable costs) will come from the interest earned by CRDF investments, except for the initial year of operation.

Finally, neither NSF nor the State Department (the primary funding agency) were aware of any documentation overturning the Funding Arrangement.

3. In addition to CRDF's disagreement on our interpretation of Federal cost principles, it disagreed with our conclusion and analysis of the [REDACTED] labor allocation costs. Our analysis and conclusion was not based solely on the independent position description questionnaires, as indicated by CRDF. We also interviewed several CRDF personnel including [REDACTED] who confirmed the reasonableness of the marketing and public relations level of effort reported in the questionnaires. Since it was CRDF that hired the consultant to collect this information, we consider this information objective and reliable. Only after CRDF learned, from our audit, about the Federal prohibition on charging some public relations costs to Federal awards, did it make known any concerns about the reliability of its consultant's work. Therefore we do not consider CRDF's post hoc review to be objective.
4. CRDF also partially disagreed with the questioned costs for other charges in part because it has been a long standing practice of CRDF to charge these costs and which NSF has never challenged. However, as with CRDF's Business Plan, long standing practices do not override Federal cost principles and requirements. Therefore, we stand by the questioned amounts in the report.

#### **NSF Comments:**

NSF management stated that there was insufficient information available for rendering an opinion on the audit findings and recommendations at this time, but provided minor suggestions for improving clarity in the audit finding and recommendations.

#### **OIG Response:**

Based on NSF's comments, we have clarified our audit recommendations by combining two recommendations and revising the wording of a third recommendation. Specifically, in lieu of recommending additional incurred cost audits of NSF grants to CRDF, we have clarified recommendation 2.4 to ensure that NSF will be reimbursed for any improper grant charges for other years prior to and after FY 2006. Further, we clarified a third recommendation to seek recovery of both questioned direct and indirect FY 2006 grant costs.

However, as previously stated, NSF needs to provide its formal management position on the audit findings and its agreement or disagreement with each audit recommendation after it has had the opportunity to discuss and obtain additional information from CRDF and cognizant NSF program staff.

**CIVILIAN RESEARCH & DEVELOPMENT FOUNDATION**  
National Science Foundation Award Number OISE – 9531011  
Audit of Incurred Costs and Administrative Controls  
January 1, 2006 – December 31, 2006

Schedule of Indirect Costs

<u>Cost Category</u>	<u>Cost Claimed</u>	<u>QUESTIONED Costs</u>	<u>Adjusted Cost</u>	<u>NOTES</u>
Admin Labor- VA		173,910		1
Admin labor - Moscow				
Admin labor - Kyiv				
Temporary Help				
Parking/Local Transport				
Business Meetings & Events		32,155		2
Dues & Subscriptions		8,365		3
DataBase				
Purchase Equipment				
Purchase Furniture				
Equipment Rental				
Maintenance & Repair				
Telephone				
Internet Services				
Accounting, audit, Tax				
Legal				
Payroll				
Other				
Training				
Business Insurance - D&O				
Other Taxes, Miscellaneous				
Bank Cahrges				
Bank Monthly Fees				
Marketing		17,211		4
Rent				
Office Supplies				
Printing & Reproduction				
Postage & Deliveries				
Consulting Services		1,235		5
Computer Services				
Travel - Board				
Travel - Staff		10,022		6
Travel - Advis				
Miscellaneous		10,121		7
Currency Exchange Gain/Loss				
Fringe Allocation		86,068		8
Occupancy Allocation		37,112		9
Total		376,199		
Allocation Base:		(346,285)		10
Overhead Rate *				

\* Base for the indirect rate is total direct costs. Slight arithmetic differences may exist due to computer rounding.

Note: The accompanying notes to explain adjustments and eliminations are an integral part of this financial schedule.

Explanatory Notes for Questioned indirect costs:

**1. Administrative Labor Costs**

The audit of CRDF indirect labor charges disclosed that the CEO and Development Group staff frequently briefed congressional staffers and other intermediaries of the foreign relations committees on CRDF award efforts and engaged in public relations, fundraising, marketing, and promotional activities.

We tested the allocation of Development Group employees, the CEO and former CEO's (retired in April 2006) salaries to determine whether these employees allocated their time appropriately to the proper cost category. We focused on unallowable activities like fundraising, public relations, and marketing to determine how employees allocated the time spent on these activities. We found that many of employees did not allocate, or under-allocated fundraising, public relations, and marketing type activities to the unallowable accounts, and instead, charged these unallowable activities to the indirect pool. Table 1 lists a summary of testing of unallowable indirect salaries for the development group and CEO.

**Table 1: Unallowable Indirect Salaries for [REDACTED]**

Position	% Charged by CRDF to unallowable	% Unallowable per audit	Additional % to adjust into unallowable	Total \$ to adjust into unallowable
[REDACTED]	[REDACTED]	25%	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	25%	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	25%	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	75%	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	60%	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	50%	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	50%	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	50%	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	50%	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	50%	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	50%	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	40%	[REDACTED]	[REDACTED]
<b>TOTAL</b>				[REDACTED]

**2. Business Meeting & Event:**

We questioned \$32,155 of the proposed business meeting and event expenses because they were either unallowable (\$9,917) per OMB Circular A-122 cost principles or unallocable to the indirect costs pool because costs (\$22,239) were related specifically to the NSF award and did not benefit all projects. A breakdown and explanation of the questioned costs is shown below:

<b>Costs Questioned</b>	<b>Description</b>
<u>Unallowable</u> \$3,056*	The questioned amount is the cost of meals and alcohol at a US-Russian Business Council dinner party in honor of the Governor of St. Petersburg in Russia. CRDF considers the event essential for business development. However, under OMB Circular A-122 cost principles, this type of amusement or social event is an unallowable entertainment expense.
\$695*	The questioned business meeting cost comprise of \$580 for groceries, and \$115 for flowers, which are considered unallowable entertainment costs, because they were not necessary to conduct the business meetings.
\$946*	The questioned amount is the cost of alcohol at a CRDF Board meeting held on May 4, 2006. Costs of alcohol are expressly unallowable per Federal cost principles.
\$3,470	The questioned amount is the cost for promotional items such as insulated mugs and luggage tags labeled by CRDF as “George Brown Award and Event Giveaway.” Of the total expense of \$5,721 for the items, CRDF booked \$2,251 as unallowable and \$3,470 as allowable. However, we consider the entire cost of \$5,721 as unallowable because under OMB Circular A-122, costs of promotional items and memorabilia, including models, gifts, and souvenirs are unallowable advertising and public relations costs. Therefore, we have questioned the difference (\$5,721 - \$2,251) accordingly.
\$1,750	The questioned amount was the rental cost of exhibit booth space at an international technical conference in Dallas, Texas that was recorded as business meeting expense. However, per OMB Circular A-122, the cost of displays, demonstrations and exhibits are unallowable advertising and public relations costs.

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\* Questioned cost is not includable in the base. Please see Note 10 of Appendix A for explanation.

Costs Questioned	Description
<u>Unallocable</u>	<p>CRDF organized several business meetings and conferences that in our opinion were directly related to specific projects or activities under the NSF cooperative agreement. Therefore, the costs for the activities should have been charged as direct costs in their entirety in accordance with OMB Circular A-122. According to A-122, the cost of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization’s mission must be treated as direct costs. Also, paragraph 29 of Attachment B of the Circular stipulates that to the extent that costs associated with the conduct of meetings and conferences are identifiable with a particular cost objective (the NSF award), they should be charged direct to that objective. Below is the list and description of costs questioned as unallocable to the indirect cost pool.</p>
\$1,678	<p>The questioned amount is the portion of catering costs for a luncheon at the International AIDS conference in Toronto, Canada. The audit disclosed that of the total catering cost of \$3,356, CRDF charged half of the expenses as direct and the other half as indirect. We questioned the half that was charged as indirect expense.</p>
\$3,000	<p>The questioned amount is for an International AIDS Conference Satellite symposium. Our review disclosed that of the total cost of \$4,000 for the symposium, \$1,000 was recorded as direct costs and the balance of \$3,000 as indirect expense. We therefore questioned the balance as unallocable to the indirect cost pool.</p>
\$2,037	<p>The questioned amount is the Events department share of meetings and conferences expenses in Amman, Jordan.</p>
\$4,994	<p>The questioned indirect expense was for catering at a business meeting and conference event in Ohio.</p>
\$4,661	<p>The questioned costs are the total expenses for catering and table decorations at an event during the XVI International AIDS conference in Toronto, Canada.</p>
\$5,869	<p>Questioned amount is the cost of meals to clients at an “Industry Event” at the Cleveland Clinic Foundation.</p>

**3. Dues & Subscriptions Expenses:**

We questioned \$8,365 of the proposed dues and subscriptions expenses as unallowable per OMB Circular A-122. A breakdown of the questioned costs follows.

**Costs Questioned      Description**

Unallowable

\$7,865      The questioned amount is for the renewal of the VOCUS Public Relations software, which we consider as unallowable. Based on CRDF’s own description of the functionalities of the software, it appears CRDF uses the web-based software to manage the way it communicates with the media and the public to promote the organization. Since the software is used primarily for public relations and marketing activities, the cost is unallowable per OMB Circular A-122.

\$500\*      The questioned amount is the United Airlines Red Carpet club annual membership renewal fees for the CRDF CFO. Per the A-122, Attachment B, costs of membership in any social or dining club or organization is unallowable. The United airlines Red Carpet club, in our opinion, falls under the category of such organizations.

**4. Marketing Expenses:**

We questioned \$17,211 of the proposed marketing, advertising and public relations expenses, because they are unallowable (\$14,211) or unallocable (\$3,000) per OMB Circular A-122. A breakdown and explanation of the questioned costs follows.

**Costs Questioned      Description**

Unallowable

\$1,667      The questioned amount is the portion of total flyer sponsorship costs of \$5,000 at an International AIDS conference that was recorded as allowable indirect expense.

\$1,950      The questioned amount is the cost for exhibit space at the American Association of Advance Science (AAAS) annual meeting which we consider as advertising and public relations expenses.

\$894      The questioned amount is the cost of CRDF logo lapel pins recorded as allowable program marketing expense. A logo lapel pin is a memorabilia or promotional item and the costs are unallowable per A-122.

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\* Questioned cost is not includable in the base. Please see Note 10 of Appendix A for explanation.

<b>Costs Questioned</b>	<b>Description</b>
\$5,125	The questioned amount is the total cost for the design and construction of a tradeshow booth recorded as allowable indirect program marketing and consulting services costs. Per A-122, tradeshow exhibits and demonstrations are broadly targeted selling and marketing efforts and are unallowable costs.
\$4,575*	The questioned amount is the cost for a farewell cocktail reception for the former CRDF CEO that was booked as allowable marketing expense. However, in our opinion, the event was an entertainment and amusement activity which is unallowable per A-122.
<u>Unallocable</u> \$3,000	The questioned amount is the portion of the CRDF cost charged as indirect expense for the sponsorship of Nanotech 2006 Conference and Tradeshow. Of the total cost of \$7,000 for the event, \$3,000 was charged as indirect and the balance as direct expense. Since the event relates to the NSF award, the total cost should have been charged as direct costs to the award in accordance with the provisions of OMB Circular A-122.

**5. Consulting Services:**

We questioned \$1,235 of the proposed consulting services costs. The questioned amount was for the design and manufacture of 7ft. banners, which we consider as unallowable advertising and public relations costs per A-122.

**6. Travel:**

We questioned \$10,022 of the proposed travel costs as unallowable airfare expenses. The questioned amount is the difference between first-class and coach airfares. Detailed descriptions follow.

<b>Costs Questioned</b>	<b>Description</b>
<u>Unallowable</u> \$6,000*	The questioned amount is the difference in cost between business class and our estimated coach fares from Redmond, Oregon to Moscow, Russia. The roundtrip business class fare was \$9,359 versus our estimated coach fare of \$3,055. Questioned cost rounded down to \$6000.
\$1,500*	The questioned amount is the difference between first class and estimated coach roundtrip fares from San Jose, California to Dallas, Texas.

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\* Questioned cost is not includable in the base. Please see Note 10 of Appendix A for explanation.

<b>Costs Questioned</b>	<b>Description</b>
\$1,522*	The questioned amount is the difference between first class and estimated coach roundtrip fares from Redmond, Oregon to Washington, DC.
\$1,000*	The questioned amount is the difference between first class and estimated coach roundtrip fares from San Jose, California to Salt Lake City, Utah.

**7. Miscellaneous:**

We questioned \$10,121\* of the proposed miscellaneous expenses as unallowable entertainment and amusement expenses. The questioned amount was the entertainment and alcohol cost for a holiday dinner party on the Potomac River.

**8. Fringe Benefits Allocation:**

We questioned [REDACTED] of the proposed fringe allocation due to the questioned base administrative labor costs for Virginia [REDACTED].

**9. Occupancy Allocation:**

We questioned [REDACTED] of the proposed occupancy allocation due to the questioned base administrative labor costs for Virginia [REDACTED].

**10. Direct Costs excluded from Base:**

Based on the costs questioned as explained above, CRDF understated the total direct cost allocation base by \$346,285. This amount is the portion of the total questioned costs that is includable in the indirect cost base in order to bear their pro rata share of indirect costs. OMB Circular A-122, Attachment A, Section B.3 stipulates that even though costs of certain activities are unallowable as charges to Federal awards, they nonetheless must be treated as direct costs (and included in the base) for purposes of determining indirect cost rates and be allocated their share of the organization's indirect costs if they represent activities which (1) include the salaries of personnel, (2) occupy space, and (3) benefit from the organization's indirect costs. A breakdown of the questioned unallowable and unallocable costs includable in the base is as follows:

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\* Questioned cost is not includable in the base. Please see Note 10 of Appendix A for explanation.

Table 2: Unallowable and Unallocable Costs Includable in the Base

<b>Cost Element</b>	<b>Questioned Amount</b>
Administrative Labor	██████████
Allocated Fringe Benefits	██████████
Allocated occupancy Costs	██████████
Business Meetings & Events	██████████
Marketing	██████████
Dues/Subscription	██████████
Consulting	██████████
<b>Total</b>	<b>\$ 346,285</b>

**CIVILIAN RESEARCH & DEVELOPMENT FOUNDATION**

National Science Foundation Award Number OISE – 9531011

Audit of Incurred Costs and Administrative Controls

January 1, 2006 – December 31, 2006

Schedule of Questioned Direct Costs

<b>Cost Category</b>	<b>Claimed Costs</b>	<b>Audit Adjustment</b>	<b>Adjusted Cost</b>	<b>Notes</b>
Business Meetings		5,563		1
Program Marketing		1,667		2
<b>Total</b>	<b>\$ -</b>	<b>\$ 7,230</b>		

CRDF charged \$7,230 of unallowable costs directly to the NSF award. Below is explanation of the questioned direct costs.

**1. Business Meetings**

The questioned Business Meeting cost consists of \$1,938 for alcohol, \$2,935 for food at a baseball game, and \$690 for employee farewell party. These expenses are unallowable alcohol or entertainment expenses.

**2. Program Marketing**

The questioned cost relates to cost of marketing flyer sponsorship (total cost was \$5,000 and it was split three ways - \$1,667 to NSF award, \$1,667 to indirect (we questioned the indirect portion separately under the indirect cost testing) and \$1,667 to CRDF's non-government funds. The direct cost of \$1,667 charged to NSF award is considered unallowable marketing or public relations expense per OMB Circular A-122.



U.S. CIVILIAN RESEARCH &amp; DEVELOPMENT FOUNDATION

November 7, 2008

Michael R. Kuklok  
Senior Audit Manager  
National Science Foundation  
4201 Wilson Boulevard  
Arlington, Virginia 22230

**Subject: NSF Audit Draft of Costs and Administrative Controls for Fiscal Year  
Ended December 31, 2006**

Dear Mr. Kuklok:

The purpose of this memo is to address the draft report dated October 23, 2008. Our responses will be divided between the comments labeled "CRDF's Oversight of Significant Sub recipient Funds was Inadequate" and "CRDF Lacks a Full Understanding of Cost Principles".

Given the special nature of CRDF we request that you expand the Executive Summary of the audit to include more detail on the nature and purposes for which CRDF was authorized under law:

*The establishment of CRDF was required by statute, i.e. Sec. 511 of Title V ("Nonproliferation and Disarmament Programs and Activities"), The Freedom Support Act ("FSA"), P.L. 102-511 (October 24, 1992). In the statement of findings on which the entire statute, including Sec. 511, is premised, Congress states that the activities to be funded under Title V are "in the national security interest of the United States." Sec. 501. The seminal NSF "Funding Arrangement" (INT-9531011, Amendment 03) also expressly states on p. 3 that "The CRDF is to make a direct contribution to U.S. national security."*

We have addressed the specific items cited in the report below in the order they are presented in the document.

## **I: CRDF's Oversight of Significant Sub-Recipient Funds was Inadequate**

### *"Lack of IFS Payment Controls"*

CRDF disagrees with the IG's assertion that CRDF lacked payment controls for Individual Financial Support (IFS) payments (page 4). CRDF controls were based on a number of requirements including:

- (1) Initial IFS payments were advanced to grantees based on a formal request from the Principal Investigator (PI) based on estimated level of effort for the first quarter. CRDF policy required subsequent requests to include actual level of effort for the period in person-days (defined as 8 hours per day, 22 days per month maximum) certified by the PI that the requested payment was in accordance with the CRDF grant agreement. Where necessary, requested amounts were adjusted for overpayment of the prior period advance. Final quarter IFS payments were withheld until after the project had completed and final project reconciliation of IFS paid versus effort reported.
- (2) CRDF policies required the PI to maintain level of effort logs in his/her records to track individual team member hours spent daily on the CRDF project OR to use a similar system with equivalent information. This information was subject to review during CRDF site visits and audits.
- (3) CRDF conducts 40-50 site visits and audits of projects each year and where level of effort record-keeping is inadequate the grantee is instructed to take corrective action.
- (4) CRDF also received and reviewed quarterly technical reports jointly approved by the U.S. Principal Investigator on all projects confirming work was being carried out in accordance with the technical work plan. While not a direct control, the budgets for labor for awards were determined (and in most cases REDUCED prior to award) based on a technical evaluation of the necessary labor effort to accomplish the project's technical objectives.

In 2006 CRDF monitored over 700 awards in over 15 countries involving IFS payments to over 7,000 individual recipients paid directly by CRDF to individual bank accounts designated by CRDF through agreements with the individual banks and required of the grantees. The average payment received by a grantee per month was less than \$500.

While, in discussions with the IG, CRDF concurred that procedures could be enhanced significantly, we disagree with the estimate of \$1.2 million being "at risk of improper payment." These assertions are based on a sample of only 30 out of an estimated 3,000 IFS requests received in 2006 involving over 7,000 individual participants on over 700 discrete projects implemented in numerous countries with different legal and regulatory environments. The assertion also fails to acknowledge any existing controls or compensating controls. While enforcement of these controls was not consistent, it is inaccurate to make the blanket statement that CRDF did not enforce the procedures at all.

CRDF does, however, concur that existing monitoring can be improved and *we have implemented the following enhanced monitoring procedures on a phased basis for all USG-funded projects:*

- All individual project participants must maintain an individual timesheet on a daily basis in a format mandated by CRDF to record all hours worked on CRDF projects.
- Timesheets must be signed and submitted regularly to the Principal Investigator for review and approval. A signed certification of hours from the PI must accompany IFS requests submitted to CRDF.
- IFS requests will be paid solely on a reimbursable basis.
- CRDF Project Managers will conduct regular "desk checks" on a test basis each month by requesting selected individual timesheets to reconcile to payment requests submitted.
- The number of project audits conducted will be significantly increased and individual timesheets will be reconciled and individual interviews enhanced to monitor level of effort record-keeping and reporting. If level of effort issues are identified clear guidelines for corrective actions to be taken in a timely manner have been developed.
- In addition, before the IG audit began CRDF began planning for a web-based system that will include a time-keeping component for project participants and allow for more robust monitoring and analysis of level of effort reporting. That system is now being tested.

*"Lack of IB Organization Requirements and Controls"*

Required Annual Audits for IB Institutions Not Conducted

In 2004, CRDF recognized that it needed to enhance controls to ensure annual audits were conducted by the IB organizations due to the increased funding of these organizations. CRDF made efforts to work with the IBs to identify international audit firms working in the region to conduct the audits and this process took longer than had been anticipated, resulting in some audits being combined into two year audits. Each institution was, however, visited by CRDF program and award administration staff to monitor compliance regularly during the year. While not a substitute for a full external audit this does constitute a compensating control. **CRDF acknowledges that this system should be improved and has taken numerous steps including:**

- Requiring the IBs to undergo and complete annual external audits within 6 months of the close of the fiscal (calendar) year.
- Undergo CRDF-directed compliance audits conducted by external auditors engaged by CRDF directly on an annual basis. Two have been completed and two more are scheduled in the coming months.

In the executive summary (p. i, second bullet point) the IG states:

*"As evidence of our concerns over these controls, at the time of our audit an IB organization was involved in a fraud investigation which led to CRDF recouping approximately \$9,000."*

This point is again raised under section a (third paragraph), page 5. This statement is misleading and only partially correct. CRDF did indeed conduct a fraud investigation of one of the IBs as was disclosed by CRDF to the Inspector General. The audit was triggered when CRDF routine monitoring detected unusual procurement patterns by the IB. An external auditor was engaged to investigate the procurement practices of the IB and found significant weaknesses in the IB's internal controls related to procurement. While no direct evidence of fraud was uncovered by the audit, CRDF determined the risk level to be such that CRDF intervened with our government counterpart in the IB country and, as a result, the director of the IB was removed from the organization, and the IB placed under a strict remediation plan under CRDF direction. Enhanced cash controls were implemented with CRDF effectively taking direct control over the IB's financial operations using CRDF funds and a program of ongoing training and policy and procedure enhancement was conducted. We reiterate that NO funds were identified as fraudulently utilized by the IB by this audit.

The incident of fraud referenced in the IG report refers to a *separate* incident involving a CRDF Cooperative Grants Program (CGP) award, *unrelated to the IB*, involving a foreign institution. Again, CRDF internal controls and monitoring identified unusual patterns of requests from the grantee in the first quarter of the award resulting in the project being flagged for audit. Soon thereafter a whistleblower on the project team contacted CRDF with allegations of fraudulent activity. Payments were immediately suspended and a fraud investigator engaged (the audit was conducted concurrently with the investigation of the IB mentioned above). The investigation did indeed reveal multiple instances of fraud on the project. The project was immediately terminated

and all project participants barred from participation in future CRDF programs. The total amount paid to date under the project was \$8,480 representing unrecovered initial project advances. Due to CRDF monitoring and controls, losses were minimized. This amount was absorbed by CRDF and not charged to any federal grant. *This incident was the subject of a recent NSF Office of Investigations review which has now been closed (per notification of October 21, 2008 from the responsible NSF Special Agent) with no issues identified requiring Office of Investigations action.*

#### Supporting Documentation Not Reviewed Before Making IB Payments

Payments were made to the IBs on an advance basis with financial reports received and reviewed prior to payment of subsequent funds. While supporting documentation for each and every payment was not reviewed in toto, periodic reviews on a test basis did occur. The CRDF staff member responsible for the IBs during this period did not maintain adequate records and this deficiency has been corrected. CRDF takes strong exception to the assertion that CRDF's practice was to "simply put documents in a file without review." As noted above regarding the identification of potential fraudulent expenditures – it was the review of expenditure patterns and supporting documentation that identified the potential fraud, a fact that is not acknowledged by the IG in its report. CRDF acknowledges that written policies and procedures were not sufficiently clarified and consistently enforced. In response to the Inspector General's concerns review procedures have been significantly enhanced including:

- Requirements for more detailed monthly financial reports from the IBs have been implemented.
- Staff now perform regular, documented desk reviews of supporting documentation on a test basis on a monthly basis.
- CRDF has imposed additional cash control restrictions on the IBs limiting the amount of advanced funding provided subject to reporting requirements.
- CRDF has scheduled each of the IBs for an annual CRDF-directed external audit in addition to the annual financial audits the IBs themselves are required to conduct.
- CRDF has also scheduled intensive training of the IB staff in internal controls and allowability of costs and is in the process of a comprehensive review of IB policies and procedures in conjunction with the enhanced audit program specified above.

CRDF disagrees with the IG assertion that "CRDF cannot ensure the \$2 million of subaward costs for the IB organizations' activities benefited the NSF award, or were spent on valid and allowable costs." The support for the IBs comes from the Department of State under the Freedom Support Act and their activities are governed by the goals and objectives of the Department of State and carried out in accordance with plans developed with the Department of State. The IG's statement regarding "benefit to NSF" is unclear and contains no criteria as to what benefit is expected. CRDF and the IBs have carried out the programs for over ten years in accordance with objectives specified to the Department of State. While CRDF acknowledges

that improvements should be (and have been) made in the monitoring of IB costs, the IG did not identify any instance of an unallowable or inappropriate IB cost save for the "\$9,000" in expenses that were determined fraudulent (actual amount was \$8,480) cited above that is, in fact, not an IB-related cost and was identified and addressed by CRDF itself.

#### Costs for Administrative Contracts Allocated Without Adequate Support

The IG states (page i, second bullet point) that "the cost allocation methodology for administrative service contracts was arbitrary." This point is further address on page 6, point c. CRDF strongly disagrees with the assertion that the allocation methodology was "arbitrary." CRDF agrees that the allocation methodology was subjective, however, it was based on a reasonable and informed judgment of senior CRDF staff based on technical reports received and their direct knowledge of IB activities under the contract during the given month. While this methodology is not an appropriate mechanism for cost allocation it cannot be construed as "arbitrary."

Page 6, point c also contains evidence of a significant misunderstanding of the nature and substance of the administrative support contracts with the IBs and contains numerous factual inaccuracies.

Background: Recognizing the need for additional in-country support for CRDF activities (such as events, logistics, etc.) and projects (non-IB related) in Armenia, Azerbaijan, Georgia, and Moldova, CRDF contracted with each organization to provide general administrative support services in support of CRDF grant and project administration in these countries. Support services included:

- dedicated in-country staff to augment CRDF grant management staff in Arlington and Moscow (generally 1 to 1.5 FTE)
- receipt and dissemination of grantee payment requests, reports and other documents for CRDF awards (non-IB)
- In-country support for CRDF grantees (non-IB) with logistics such as travel
- In-country logistical support for CRDF events and other activities in country
- Payments in local currencies on behalf of CRDF grantees (non-IB)
- Dissemination of program information in the local scientific communities

These costs were funded from 2 primary elements:

- CRDF's Award Administration fee (Note: As explained to the IG during the fieldwork and indicated in CRDF's NICRA the costs of the management of CRDF grants and contracts are pooled and allocated among all programs that have grants and contracts. These programs include those funded by NSF but also other non-USG funders.).
- CRDF's GAP program, a fee-based service program offered by CRDF to third party organizations. Expenses for this program are paid from CRDF unrestricted funds, not funds originating from the U.S. Government.

For ad hoc "task orders" for special events or activities for a specific program, costs were charged directly to the specific program.

It is inaccurate to state the allocation of the general support contract monthly costs was directly allocated to the NSF award. The portion allocated for general grant and contract support was included in the "award administration base" and allocated to grants and contracts pursuant to CRDF's NICRA.

CRDF feels that the IG has overstated the risks associated with the subjective allocation methodology for the following reasons. The funding base for the IBs is narrow. The IB grant programs are all funded from a single source (Department of State via the NSF Cooperative Agreement). The contract costs were funded as stated above – either as general grant and contract support and allocated in accordance with the NICRA or to GAP unrestricted funds. Given that the overwhelming amount of effort under the administrative support contracts was devoted to support of grant and contract administration, the allocation methodology, while subjective, did not constitute a significant risk of misallocation to the USG and, in fact, most likely resulted in an effective subsidy from CRDF unrestricted funds paid under the contract since allocations were made conservatively.

Nevertheless, CRDF acknowledges that a more objective methodology would be more appropriate and effective and has instituted a timesheet system for the IBs and use labor as the basis for cost allocation for administrative contract expenses for those IBs who retain support contracts. Only 2 are projected to continue in 2009.

### Recommendations:

In the responses above, CRDF has identified the actions it has taken to address all 4 of the recommendations made in the IG report.

### **II. CRDF Lacks a Full Understanding of Cost Principles Related to Identification and Segregation of Unallowable and Unallowable Costs**

CRDF disagrees with the basic premise of this section. Rather than CRDF lacking an understanding of OMB Circulars A-110 and A-122, CRDF has a fundamental disagreement with the IG's interpretation of these regulations.

CRDF disagrees with the assumptions stated on page 8 that CRDF's briefing to members of Congress and their staff are unallowable public relations costs.

Public information-sharing is a fundamental part of CRDF's operations, without which attainment of our statutory and NSF-approved objectives would be severely impaired. Sec. III.B of the NSF Funding Arrangement (INT-9531011, Amendment 003) explicitly calls for CRDF to conduct its activities "*in accordance with the Business Plan..., as amended.*" At the request of NSF, CRDF updated its original Business Plan with one dated May 2, 2005 which provides as follows:

-- p. 4: CRDF will "[c]ommunicate [its] successes and the impact of its activities to external stakeholders and the general public; provide information to interested Congressional members and staff on CRDF activities." [emphasis added]

-- p. 5: A CRDF goal is to "[a]dvance public and legislative understanding of CRDF's mission and impact in the United States and abroad."

-- p. 5: Another CRDF mission is to "[p]romote strong feedback with funders....".

-- p. 5: A current CRDF objective for action is to "[p]romote public education, outreach and leadership."

-- p. 8: "The CRDF's development efforts also will involve the active participation of the Board and Advisory Committee as well as managers responsible for communications, evaluation, Congressional relations and events to ensure a coordinated, integrated approach to this very high-priority goal. It recognizes that CRDF's success in the future will depend not only on continued program excellence but also the organization's ability to understand and communicate its vision, accomplishments, impact and future goals."

In carrying out its business plan under the NSF Cooperative Agreement, CRDF follows OMB Circular A-122, Attachment A, Item 1, which states:

*The only allowable public relations costs are:*

*(1) Costs specifically required by the Federal award;*

*(2) Costs of communicating with the public and press pertaining to specific activities or accomplishments which result from performance of Federal awards (these costs are considered necessary as part of the outreach effort for the Federal award); or*

*(3) Costs of conducting general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary keep the public informed on matters of public concern, such as notices of Federal contract/grant awards, financial matters, etc.*

*a. Costs identified in subparagraphs c and d if incurred for more than one Federal award or for both sponsored work and other work of the non-profit organization, are allowable to the extent that the principles in Attachment A, paragraphs B. ("Direct Costs") and C. ("Indirect Costs") are observed.*

Although the IG claims that the costs of briefings on the Hill are unallowable public relations costs, the draft report cites language in OMB Circular A-122, Attachment A, Item 25, Lobbying, instead of the section on public relations. On those occasions when CRDF is attempting to influence legislation it follows the requirement of Item 25 and charges those costs to Lobbying which CRDF treats as unallowable.

On page 10, 1st paragraph the IG states that these costs have inappropriately been charged to the NSF grant. These charges have not only been charged to the NSF grant but rather have been charged to overhead, which is allocated to all CRDF programs, both Federally and non-Federally funded, as required by OMB Circular A-122, which states:

### *C. Indirect Costs*

*1. Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective. Direct cost of minor amounts may be treated as indirect costs under the conditions described in subparagraph B.2. After direct costs have been determined and assigned directly to awards or other work as appropriate, indirect costs are those remaining to be allocated to benefiting cost objectives. A cost may not be allocated to an award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to an award as a direct cost. 2. Because of the diverse characteristics and accounting practices of non-profit organizations, it is not possible to specify the types of cost which may be classified as indirect cost in all situations. However, typical examples of indirect cost for many non-profit organizations may include depreciation or use allowances on buildings and equipment, the costs of operating and maintaining facilities, and general administration and general expenses, such as the salaries and expenses of executive officers, personnel administration, and accounting.*

### Labor

The majority of the questioned costs in the report relate to the allocation of administrative labor, page 12, for [REDACTED]. Once again, CRDF and the IG have a basic difference on what criteria to use when determining the appropriateness of labor allocations.

The basis cited in the proposed audit findings for questioning certain labor and related costs is the position description questionnaires, which were filled out by each CRDF staff in October 2006, as a part of our internal evaluation of job titles and compensation conducted by the Hay Group. This was the first such effort undertaken by CRDF to make these documents consistent throughout the organization and used a methodology unfamiliar to CRDF at the time. These questionnaires were prepared as part of a larger project to ensure that employees were properly compensated based on a comprehensive consideration of their entire range of duties. The allocations of time filled in by each employee were estimates only. The figures, while reviewed by management, were not based on precise, fully verified data; they were designed and intended (and subsequently used) solely for the stated purpose, and not to serve as the basis for allocation of costs to federal awards.

As employees performed their duties during the course of the year they filled in actual time spent, both in the aggregate and on individual awards or projects, on timesheets. It would have been inappropriate to use the results of the Hay Group questionnaires to allocate costs to federal awards, and CRDF did not do so.

Allocation of costs to NSF and other federal awards is governed by the applicable cost principles in OMB Circular A-122 [2 CFR Part 230]. Section 8 of Attachment B of the Circular states:

*Support of salaries and wages.*

*(1) Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports, as prescribed in subparagraph (2), except when a substitute system has been approved in writing by the cognizant agency. (See subparagraph E.2 of Attachment A.)*

*(2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. In addition, in order to support the allocation of indirect costs, such reports must also be maintained for other employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s) (e.g., an employee engaged part-time in indirect cost activities and part-time in a direct function). Reports maintained by non-profit organizations to satisfy these requirements must meet the following standards:*

- (a) The reports must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards. [Emphasis added]*

The documents the IG reviewed -- i.e., the results of the Hay Group compensation questionnaire -- were pre-incurrence estimates rather than after-the-fact determinations. They, therefore, cannot properly be applied as the basis for artificially constructed labor allocations. Doing so is inconsistent with the express provisions of OMB Circular A-122. CRDF's post hoc determinations, on the other hand, comply fully with the Circular's requirements

We have asked each employee on the list of questioned labor costs to review their activity for 2006. In the case of three employees who are no longer at CRDF we asked the Director of Development and External Relations to perform an evaluation of the time they spent in 2006. (He was their supervisor and is personally knowledgeable of their responsibilities and performance during this period.) For all employees we either have a revised questionnaire or in the case of the [REDACTED] we have e-mails attesting to the time they spent on potentially unallowable activities in 2006. We are happy to share the revised questionnaires with you.

For nine months of 2006 CRDF's former President and CEO was Senior Advisor to the current President and CEO, who assumed the position in April 2006. There are significant differences between the IG analysis and the statements of these two individuals who estimate they spent between one and six hours per month lobbying. The IG's analysis appears to be based on an overly expansive interpretation of what constitutes "lobbying" costs subject to disallowance under OMB Circular A-122, Att. B, sec. 25. In order to check this point, we consulted federal assistance law counsel. Attached is a memo from our attorney, Attachment A, on analyzing what constitutes unallowable lobbying. This interpretation does not support the figures used in the IG's analysis.

Further, we have performed an analysis of labor costs for those individuals for the first nine months of 2008. As noted by the IG, CRDF has had training on Federal cost principles (conducted twice by the audit partner of CRDF's audit firm). This analysis supports the results below.

We have taken this information and updated the chart you provided to CRDF. That updated chart is attached, Attachment B, and it shows an adjustment of labor charged to unallowable (lobbying, fundraising, etc) activities totaling \$13,857. This is significantly different than your questioned labor costs of \$181,047.

**Non labor costs:**

Of the costs questioned in items 2 through 7 on pages 13 through 17 we agree with the IG report except for the following:

***Business Meetings and Events:***

The following are clearly allowable under OMB Circular A-122, Att. B, sec. 29.

*Meetings and conferences. Costs of meetings and conferences, the primary purpose of which is the dissemination of technical information, are allowable. [emphasis added]*

\$1,750 Exhibit space at an international technical conference in Dallas

\$4,661 Catering and table decorations at the XVI International AIDS Conference in Toronto and \$5,869 meals at an Industry event at the Cleveland Clinic Foundation

***Dues and Subscriptions:***

United Airlines Red Carpet membership is an allowable cost per CRDF's written policies for employees who travel extensively for business. It is considered a "health and welfare" cost which permits employees time to rest and work during long international trips and is neither a country club nor a social or dining club.

***Marketing Costs:***

We dispute the proposed disallowance of \$1,950 for the exhibit space at the AAAS conference. This is the major conference on the advancement of science in America and worldwide and CRDF annually makes a presentation on the results of the work under one or more projects. For example, in 2008 we made a presentation on "Changing Models of Research in Higher Educations: International Perspectives". The exhibit space CRDF occupies allows us to share with conference participant's information on the results of many activities undertaken by CRDF on behalf of its clients. This is an allowable costs per OMB Circular A-122, Att. B, sec. 29.

\$5,125 Design and construction of a booth for use in displaying CRDF programmatic information and accomplishments at public events is also allowable under sec. 29.

\$4,575 was spent on a farewell event for CRDF's departing President and CEO. Such events are specifically designed to increase employee morale, a fully allowable cost under OMB Circular A-122, Att. B, and sec. 13. CRDF has a policy of holding farewell events for departing staff, particularly those who have been with CRDF for some time. The former President and CEO was one of the founding employees of CRDF and was employed at CRDF for more than ten years. We followed our long standing practice on the reception which was held at CRDF's offices.

***Miscellaneous:***

The report incorrectly states that the cost of this item was \$10,121. In reality the cost was \$8,638.31 for a holiday dinner cruise on the Potomac for all CRDF staff. While the event is normally held at a restaurant, it was held on the Odyssey in 2006, at approximately the same costs as holiday events in prior and subsequent years. In 2007 the cost of this event at a restaurant was \$8,881.65. This is an employee morale expense allowable under OMB Circular A-122, Att. B, and sec. 13. Neither the event nor the cost are exceptions from long standing CRDF practices. Of the costs of the Odyssey event, \$2,040 was listed on the invoice for beer, wine, soda and juice. While we agree that alcohol costs are unallowable, the appropriate amount for this item is \$2,040, not \$10,121.

Summary:

We would appreciate an explanation of the figure of \$1,187,424 on page 9, second paragraph from the end, which appears to be an extrapolation of some sort, but we cannot determine its basis. Please explain the methodology by which this number was calculated.

While CRDF fundamentally disagrees with a number of the assertions and regulatory interpretations set forth in the report, CRDF has responded to many of the recommendations of the IG prior to the issuance of this report including enhanced staff training programs, improved monitoring systems, clarified and expanded policies and procedures, and other actions we feel have strengthened CRDF's overall management of federal funds. Given, however, the significant differences between the IG interpretation of Federal regulations and CRDF's we request that CRDF's full response be included in your audit report

We look forward to further discussions with your staff on the draft audit.

Sincerely,

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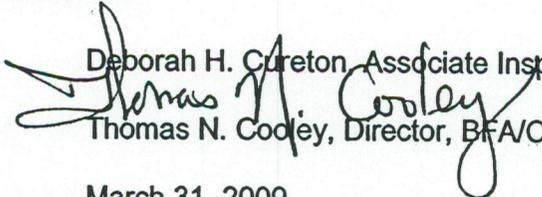
## National Science Foundation

4201 Wilson Boulevard, Arlington, Virginia 22230

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### Memorandum

**TO:** Deborah H. Cureton, Associate Inspector General for Audit, OIG

**FROM:**  Thomas N. Cooley, Director, BFA/Chief Financial Officer

**DATE:** March 31, 2009

**SUBJECT:** Management Comments – Draft Audit Report for the U.S. Civilian Research and Development Foundation (*Re: Memorandum to Tom Cooley, March 4, 2009*)

This memorandum responds to the OIG request for factual inaccuracies found in the Draft Audit Report for the U.S. Civilian Research and Development Foundation (CRDF). These comments, including areas that could benefit from clarification, are provided in the attachment.

It is our professional judgment that there is insufficient information available for rendering NSF Management's position at this time. Once the audit report is finalized, NSF will begin the resolution process to assess the findings, recommendations, and conclusions with the benefit of first-hand interactions with the awardee institution and cognizant program staff.

Changes to the established audit report issuance process, as suggested by your memorandum and several OIG communications, represent a significant change in the audit resolution process that would not be consistent with our established protocols. Any proposal for changes to the process merit further discussions by both parties as they alter the distinct roles of our organizations. I would appreciate it if your staff would contact Alex Wynnyk, CAAR Branch Chief, to set up a meeting that includes all major stakeholders.

I am pleased that you have found our mutual collaboration helpful during the audit and look forward to the outcome of dialogue about the resolution process.

#### Attachment

**cc:** Mary Santonastasso, Director, BFA/DIAS  
 Karen Tiplady, Director, BFA/DGA  
 Larry Weber, Acting Director, OD/OISE  
 Vanessa Richardson, Director, OD/OISE  
 Michael Kuklok, Sr. Audit Manager, OIG  
 Alex Wynnyk, CAAR Branch Chief, BFA/DIAS

## ATTACHMENT

### Audit of CRDF's Costs and Administrative Controls for the Fiscal Year Ended December 31, 2006 (Draft, March 2009)

As requested, Management reviewed the draft CRDF audit report for factual inaccuracies to be corrected in the final version of the report. Below are our suggestions for corrections, as well as several areas that we believe would benefit from clarification:

#### Management Comments on Factual Inaccuracies

Page i, last paragraph and page ii, paragraph 1 – The audit report describes costs as being “questionable costs.” Management suggests use of the term “questioned costs” to conform with standard language used in Government Auditing Standards.

Page 1, “Background”, last paragraph, last sentence – “NSF requested the OIG conduct an audit of CRDF operations due to the large government grants amounts awarded to CRDF since 1995 and because NSF has never audited CRDF since its inception.”

This statement is factually inaccurate. Management is not authorized to audit its awardee; the OIG has responsibility for this function. Additionally, Management first requested an OIG audit of CRDF in FY 2004 as required under the Memorandum of Agreement between the U.S. Agency for International Development (Department of State) and the NSF.

Page 1, paragraph 3, line 9, missing word – “The purpose of the Institutional Building program is to help build an organizational peer review and grant making organization ...”

Page 4, paragraph 4, last line – Management suggests removing the term “improper payment” and simply ending the sentence with “at risk.”

Page 9, paragraph 2, line 2, grammatical error – “CRDF charged unallowable costs direct[ly]...”

Page 9, paragraph 2, line 10, grammatical error – “CRDF also provid[ed]...”

Page 10, footnote 3, “NSF had not finalized CRDF’s indirect cost rate for FY2005” –

Management suggests that this be modified. As previously agreed upon by the State Department and NSF, the FY 2005 indirect cost rate was to be negotiated by the Department. NSF believes that State Department is currently negotiating the FY2005 rate, but suggests that OIG verify this information before including it in the final report.

Page 10, paragraph 5, line 7, missing word – “In addition to the questioned costs above...”

#### Management Suggestions for Clarifications:

Page 3, “Scope and Methodology”, last bullet, last sentence –

It would be helpful to know whether *all* pool costs were reviewed including, for example, the multiple fringe benefit pools and occupancy costs. Based on the review conducted in

the audit, can Management accept the proposed FY 2006 rates for these cost items as presented in this document?

Page 6, paragraph c, "Costs for Administrative Contracts Allocated without Adequate Support" –

Management suggests that an explanation of the costs for administrative contracts be included in the final report. The report is published on the OIG Web Page for public access. A lay person would not know what these costs represent.

Page 7, recommendation 1.3 –

Management suggests that "regular financial site visits" be defined so that the average lay person understands what is meant by this phrase.

Page 11, Recommendation 2.4 –

The current audit is for FY2006. If Management determines that the questioned costs should be disallowed, how does the OIG propose that prior year rates be "corrected to remove and/or classify unallowable and unallocable costs?"

Page 11, Recommendation 2.6 – "Given the seriousness of the deficiencies, contract for independent incurred costs audits to be conducted for all years prior to FY2006 ..."

Under the terms and conditions of the award, CRDF is required to have annual A-133 audits. Is the OIG recommending that CRDF now also pay for incurred cost audits with program funds?

Page 14, Schedule of Indirect Costs –

Management suggests that column headings are needed so that the data will be more easily understood by internal staff and external lay readers.