




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

September 11, 2015

ALERT MEMORANDUM

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

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

Subject: NSF's Management Fee Policy

Introduction

On January 29, 2015, OIG provided NSF with observations on its draft management fee policy. The Foundation subsequently finalized the policy in June 2015. The Office of Inspector General has reviewed the final policy and this memorandum transmits our further observations.

As outlined in more detail below, NSF's final policy has strengthened the control environment pertaining to management fee in some respects. In other respects, however, it contains ambiguities and a lack of detail which create a risk that the fee could be misused and that such misuse may go undetected.

Background

In response to issues that surfaced about management fee awards in NSF's cooperative agreements, OIG carefully researched the subject and developed a white paper, which addresses the historical context surrounding such fee. We provided the white paper to NSF on November 24, 2014.¹ A few key points from that paper, which concern the recognized nature and purpose of management fee in the non-profit arena, are worth reiterating for context.

As the white paper notes, federal agencies have, for decades, provided management fees to Federally Funded Research and Development Centers (FFRDCs).² This practice arose from the recognition that these organizations might incur costs that could not be reimbursed as either a direct

¹ The white paper is posted on OIG's website at: http://www.nsf.gov/oig/_pdf/wp-mgmt-fees.pdf.

² Management fee use at NSF is not limited to FFRDC awards. Management fee has "also been used in other very limited situations when working with specialized nonprofit research organizations on large scale projects." Memorandum to Brett Baker, Assistant Inspector General for Audit, from Martha Rubenstein, Chief Financial Officer, NSF, dated November 24, 2015.

or indirect cost of a specific agency project. Since FFRDCs are typically non-profit entities, almost wholly dependent on government funding (often from a single agency), management fee served to ensure that needed, but otherwise nonreimbursable business expenses would be covered, thereby maintaining the entity's financial viability. Traditional categories for such expenses might include working capital expenses and general support capital expenses, as well as other "ordinary and necessary" business expenses.³

Through a series of reports, which date back to the 1980s, the Government Accountability Office (GAO) raised a number of issues relating to management fee. For instance, GAO noted confusion about the distinction between a "management fee" paid to a non-profit entity and a "profit," and underscored the need for concrete guidelines (with specific examples) to precisely define the boundaries of management fee use.⁴

NSF's Management Fee Policy

NSF's Draft Management Fee Policy (December 2014)

As noted, in December of 2014, NSF published a draft management fee policy in the Federal Register.⁵ OIG's memorandum in response explained that the proposed policy took steps to develop a control environment for management fees, but also pointed out areas where this progress could be enhanced.⁶

For reference, we observed that the draft policy strengthened the control environment in three areas:

- by acknowledging the historical rationale for such fees;
- by providing some guidance as to which unallowable costs NSF viewed as "potential[ly] appropriate needs," which may justify management fee use because they "directly or indirectly benefit NSF," as well as expenses that do not carry such a benefit; and
- by requiring an up-front determination of need (considering other sources of income), a description of planned use, and monitoring of actual use.⁷

In light of long-standing confusion over whether a non-profit entity could use management fee discretionarily (like a profit), we explained that "[a] specific statement that management fee is not tantamount to a profit would help ensure that the line between the two concepts is not blurred."⁸ Also, among other things, we observed that the policy could benefit from a statement emphasizing that management fee would only be appropriate for those unallowable costs minimally necessary to maintain an entity's financial viability.

³ See OIG White Paper at 3.

⁴ See *id.* at 3-4 (discussing GAO reports).

⁵ 79 Fed. Reg. 78497 (Dec. 30, 2014).

⁶ Memorandum from Dr. Brett Baker, Assistant Inspector General to Audit to Martha Rubenstein, Chief Financial Officer, NSF, dated January 29, 2015 [hereinafter Observations Memo].

⁷ *Id.* at 2.

⁸ *Id.* at 3.

NSF's Final Management Fee Policy (June 2015)

NSF's final management fee policy contains a number of positive steps toward ensuring greater accountability and transparency over management fee:

- It explicitly policy recognizes the historical uses for management fee, namely:
 - Working capital;
 - Facilities capital;
 - Other ordinary and necessary expenses not otherwise reimbursable under the governing cost principles.
- There is now a heading entitled “Prohibited Use of Management Fees” prefacing the non-exhaustive list of items for which management fee is not supposed to be used. The earlier draft simply provided a non-exhaustive list of eight expenditures that were not viewed to “benefit NSF.” Characterizing those expenditures as “prohibited” is much stronger and lends more transparency and accountability to the process.
- As did the draft, the final policy creates an audit trail for management fee by requiring prior approval of management fees as well as documentation of the use of management fees.
- The policy states that “[u]nexplained failure to reasonably adhere to planned uses of fee will result in reduction of future management fee amounts under the award.” Unlike the draft policy, which conditioned such action on “repeated” failures, the final provides NSF with flexibility to act -- as needed -- based on a single instance of an awardee's failure to adhere to planned use.

In view of the above (particularly the first three points), NSF appears to have moved away from the disconcerting notion that management fee is provided to an awardee for its discretionary use.⁹ Nonetheless, we continue to note that an explicit statement in the policy recognizing that the fee is *not* tantamount to a profit would avoid any lingering confusion on this point.

Despite the positive aspects of the final policy, we continue to have some concerns, which are detailed below:

- The policy's introductory paragraph explains that management fee may be needed because the awardee “organization is likely to incur certain legitimate business expenses that *may not be reimbursable under the governing cost principles.*” This language is misleading. As we previously emphasized, management fee has long been recognized as having a much more limited purpose. It is not available to give an awardee a blanket means to cover unallowable costs. Rather, the fee provides awardees with an ability to cover business expenses, which may not otherwise be allowable, but which are necessary for *operational stability*.¹⁰

⁹ See Letter from NSF to Senators Charles Grassley and Rand Paul, dated October 1, 2014, at 5.

¹⁰ See generally, OIG White Paper.

- The final policy omits any consideration of other sources of income in determining the amount of the fee award, thereby moving away from the principle that an awardee should only receive a fee based on its demonstrated need to maintain financial viability. In this regard, the omission departs from the draft policy, which had stated that “the proposal must also include a schedule of all federal, non-federal, and other sources of income to justify that alternate sources of income are not available to address potential needs covered in the proposal.”¹¹
- Charitable contributions may now be an appropriate use of management fee because they no longer appear on the list of examples for which NSF has deemed management fee to be inappropriate. In the draft policy, such contributions were listed among the items that did “not benefit” NSF, along with expenses for alcohol, tickets to concerts, lobbying, and others. It is unclear why NSF would want to create the impression that these contributions, which would not seem necessary to maintain financial viability, are an appropriate use of management fee.
- Two of the examples of potentially appropriate expenses that would qualify as “other ordinary and necessary” appear to overlap with allowable costs.¹² This creates a possible conflict with the final policy, which states that “costs incurred under the award that are otherwise allowable under the governing cost principles . . . *shall not* be included as proposed management fee elements.” (Emphasis added).
 - It is not clear how “educational and outreach activities” -- listed as “potential[ly] appropriate needs” under the policy -- differ from “advertising and public relations,” which are already allowed under the Uniform Guidance, 2 C.F.R. § 200.421. Insofar as there may be some substantive difference, explanatory language in the policy would minimize the risk of overlap.
 - Likewise, it is unclear from NSF’s policy how the contemplated use of management fee for “financial incentives to obtain (and retain) high caliber staff” relates to allowable “recruiting costs.” The Uniform Guidance, 2 C.F.R. § 200.463, allows travel costs of applicants, and relocation costs incurred as part of a standard recruitment program. This section also permits payment of “special emoluments, fringe benefits, and salary allowances incurred to attract professional personnel” so long as they “meet the test of reasonableness . . . [and] conform to the [entity’s] established practices.” Here again, insofar as there may be some substantive difference, explanatory language in the policy would minimize the risk of overlap.
- After the fact monitoring of how awardees use management fee represents a positive step forward, as listed above. However, some additional clarity appears warranted, namely:

¹¹ 79 Fed. Reg. 78498 (Dec. 30, 2014).

¹² In general, NSF should take care to ensure that expenses covered through management fee, including those related to facilities and working capital categories are not otherwise reimbursed through the award.

- While “unexplained failures to adhere to planned uses” will result in a future fee reduction, it is not clear whether an awardee’s explanation must be in writing. A written explanation would assist the review process.
- The frequency of NSF’s reviews is undefined. The draft policy contemplated “periodic” reviews, and we commented that the Department of Defense management fee policy called for annual reviews. The final policy now omits the word “periodic” and specifies no recurring review timeframe. We note that it does, however, require awardees to “provide information (typically annually) on the actual use(s) of the management fee.”
- Apart from the question of frequency, we again point out that describing who within NSF would perform the reviews would add clarity to, and promote efficiency in, the process.
- Finally, the policy should require that the information supporting award and use of management fee be sufficient to withstand any audit that may at some point be undertaken. Although the policy states that NSF will “conduct reviews” of such information, there is no assurance that these “reviews” will have the same level of scrutiny as an audit.

We hope that you will find these additional observations useful.

The primary point of contact for this memorandum within OIG is Dr. Brett M. Baker, Assistant Inspector General for Audit, at 703/292-7100 or email at bmbaker@nsf.gov.

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