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Office of the Inspector General

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MEMORANDUM

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

From: Dr. Brett M. Baker
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Subject: Observations on NSF's Proposed Management Fee Policy

I. Background and Purpose

In response to issues that surfaced about management fees under NSF's cooperative agreements, the Office of Inspector General (OIG) included a review of management fee in NSF awards in the Fiscal Year 2015 audit plan. As an initial step to inform our understanding of this issue, OIG staff carefully researched the subject and developed a white paper, which addresses the historical context surrounding such fees. Among other things, the paper also provides some initial observations about NSF management fee awards. The white paper was provided to NSF management on November 24, 2014, and subsequently posted on OIG's website.[1] Since that time, on December 30, 2014, NSF published a proposed management fee policy in the Federal Register. Once finalized, the new policy is to be incorporated into the Foundation's Large Facilities Manual.

An interdisciplinary team within OIG has reviewed the proposed policy with a central focus on matters raised in the white paper. The team's consolidated observations are discussed in this memorandum.

II. Contextual Summary of OIG's White Paper on Management Fees

For reference, the white paper noted that management fees have long been provided to Federally Funded Research and Development Centers (FFRDCs) based on a recognition that these centers -- which are typically non-profit entities almost wholly dependent on government funding -- might need to incur costs that could not be reimbursed by the government. The fee was designed

[1] The paper is accessible at: http://www.nsf.gov/oig/reports/wp-mgmt-fees.pdf.

as a mechanism to ensure that an FFRDC's "ordinary and necessary," but otherwise nonreimbursable, business expenses would be covered and thus maintain the entity's financial viability.

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, which are discussed in the white paper. 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.

The OIG white paper describes the different approaches that NASA and the Department of Defense have taken with respect to management fees. It notes that NASA is moving away from use of these fees in the non-profit arena, whereas DoD has a process that involves an annual review to evaluate whether actual management fee use was consistent with what was initially proposed. Finally, the white paper made several observations regarding NSF's management fee use, namely that: 1) some awardees receiving such fees appeared to have other sources of revenue and/or assets, 2) some of the factors NSF considers in determining whether to award a management fee (such as a performance incentive and to attract qualified organizations) seemed inconsistent with the historical purpose of such fees, and 3) in its response to a letter concerning management fee usage to Senators Grassley and Paul, NSF indicated that it viewed management fee use as entirely discretionary and, in that sense, appeared to equate it with the concept of "profit." The paper observed that management fee use should be consistent with the historical rationale for such fees – *i.e.*, to cover business expenses that are necessary to maintain operational stability.

III. Observations on the Proposed Management Fee Policy

NSF's proposed policy takes steps to develop a control environment for management fees. In particular, it: 1) acknowledges the historical rationale for such fees, 2) provides some guidance on unallowable costs that viewed as "potential[ly] appropriate needs," which may justify management fee use because they "directly or indirectly benefit NSF,"[2] as well as expenses that do not carry such a benefit, and 3) requires an up-front determination of need (considering other sources of income), a description of planned use, and monitoring of actual use.

We offer the following observations concerning the draft policy.

1. Parameters of Management Fee Use

The draft states that management fees cannot be used for allowable costs and provides three examples of costs that are "potential[ly] appropriate" for management fee use (because they

[2] According to the draft policy, "[a]mounts for . . . expenses that are ordinary and necessary but not otherwise reimbursable can provide a reasonable allowance for management initiative and investments that will directly or indirectly benefit NSF."

confer a direct or indirect benefit on NSF): "contract terminations and losses, certain appropriate educational and public outreach activities, and providing financial incentives to obtain and retain high caliber staff." The draft further provides a non-inclusive list of eight expenditures that "do not benefit NSF." It would seem that such expenses are not appropriate for management fees use, but the policy does not expressly state that the fee cannot be used in this manner. These expenses include the purchase of "[a]lcoholic beverages" and "[l]obbying as set forth in the Uniform Guidance." If the Foundation's intent is to exclude these items from management fee coverage, it should make that intention clear.

Observations:

- The examples of unallowable costs that are "potential[l]y appropriate" for management fee and the nonexhaustive list of costs that "do not benefit NSF" provide some guidance to NSF staff and awardees. However, the outer limits of management fee use are not concretely established. There is some question about whether some/all unallowable costs (apart from the eight explicitly listed as ineligible) could be deemed appropriate for management fee expenditures in a particular case. A tightly-defined boundary, combined with careful scrutiny of management fee proposals and review of actual use would lower the risk of misuse or abuse. That risk could also be mitigated by prefacing the examples in the policy with a statement emphasizing that only those unallowable costs minimally necessary to maintain an entity's financial viability are appropriate for management fee coverage.

- Explicit recognition that management fee use is not discretionary could avoid any lingering confusion between such a fee (which has a limited purpose) and "profit" (which can be used for any purpose). We note that the draft policy states that "[g]enerally, NSF does not pay a profit or fee to organizations under financial assistance . . . [h]owever a management fee may be authorized for awards to non-profit organizations in the limited circumstances . . . ." 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.

- It is unclear from NSF's draft policy how the contemplated use of management fee for "incentives to attract staff" interrelates with 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." To the extent there is overlap with allowable costs, such expenses are not eligible to be covered by management fee.

- Similarly, it is not clear how "educational and outreach activities" – listed as "potential[ly] appropriate needs areas for management fee -- differ from "advertising and public relations," which are already allowed under the Uniform Guidance, 2 C.F.R. § 200.421.

2. Fee Award, Drawdown, and Monitoring

As mentioned, the draft policy contemplates an assessment of need and a review of proposed management fee use prior to award. A management fee will be set as a sum certain and drawn down "in proportion to costs incurred." The draft states that NSF will "periodic[ally] review" actual use, and that further fee awards may be reduced if an awardee's use differs from what was originally planned.

Observations:

- To facilitate a decision on whether a management fee is warranted, the draft policy requires that fee proposals "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." Defining "income" to explicitly include gifts might help avoid problems of interpretation. Also, because income can vary from year-to-year, a look at income across a period of years would provide a wider picture for agency decision-makers. NSF might, for example, ask for such information over a period of 3-5 years. Information concerning cash on hand and net assets might also be useful for NSF to consider in making a determination as to the management fee.

- The draft's discussion concerning an awardee's management fee drawdown "in proportion to costs incurred during the performance period" raises a question of scope. Does this statement refer only to those costs that would be appropriate and needed for management fee use (a construct that would make sense), or does it broadly include other direct or indirect costs?

- The frequency of NSF's "periodic reviews of management fee usage" is undefined. In the white paper, OIG noted that DoD's policy calls for annual reviews. According to that agency's FFRDC management plan: the "sponsor/contracting activity should perform an annual fee review assessing the extent to which the prior representations and justifications regarding fee have proven reliable (both as to the fee amount and the planned uses of the fee)." Apart from the question of frequency, describing who within NSF would perform the reviews would add clarity to, and promote efficiency in, the process.

- The draft policy does not address what happens if an awardee's need for a management fee or its planned use of that fee changes during the course of an award. Would an awardee have to report new sources of nonfederal funds? Would NSF approval be needed before an awardee could use the fee for a different purpose?

- Under the draft policy, "[r]epeated, unexplained failure to reasonably adhere to planned uses of fee will result in reduction of further management fee amounts under the award." It is unclear whether an awardee's explanation must be in writing and how many unexplained failures would trigger a fee reduction. Also, a fee reduction would likely occur during a future renegotiation, which could be years after a finding of misuse. Repayment and/or forfeiture of management fee would present a more immediate way to address the matter.

We hope you will find these 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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