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: White Paper on Management Fees 

I. Introduction

In certain instances the National Science Foundation provides management fees to its large facility awardees to “facilitate their basic operations and viability;”\(^1\) and permits awardees to use such fees for expenses that are otherwise nonreimbursable under governing cost principles. In an October 1, 2014 letter to Senators Charles Grassley and Rand Paul, the Foundation reported that seven of its awardees received management fees over the past five years: the National Ecological Observatory Network (NEON), SRI International, Associated Universities, Inc., Association of Universities for Research in Astronomy, Inc., Incorporated Research Institutions for Seismology, University Corporation for Atmospheric Research, and UNAVCO Inc. According to NSF, in FY 2013, the total amount of fees awarded across the Foundation’s award portfolio was $1,496,615. For further reference, the letter shows that between FYs 2010 and 2013 the total amount of management fees awarded for six of the seven recipients was $4,985,783.\(^2\)

The Office of Inspector General has begun a two-part review of management fees in NSF awards. As part of that job, we first conducted research on management fees to develop an understanding of the history behind and use of such fees that will guide a more in-depth review of how fees were managed and expended on particular awards.\(^3\) Our thoughts, based on this

---

\(^1\) Letter from NSF to Senators Charles Grassley and Rand Paul, dated October 1, 2014 [hereinafter NSF Letter].
\(^2\) Id. NSF did not include NEON in the table from which these figures were derived, which depicts management fee amounts for all other awardees listed above between FYs 2010 through 2014. Fees for several awardees were still being negotiated for FY2014, so we did not include fee awarded in that year in the total noted above, which therefore covers FYs 2010-2013. OIG has not independently verified this information, but will endeavor to do so in a follow-on review by looking at all available information.
\(^3\) NSF has informed us that it is updating its processes and policies pertaining to management fees. OIG will examine the efficacy of any changes in the second phase of this review.
initial research, are the subject of this white paper, which addresses: 1) the historical context giving rise to use of such fees; 2) the persistent policy debate surrounding them; 3) NSF policy and practice; 4) the results of a survey of other current rules, regulations, and guidance; and 5) our initial observations. In light of strong interest in this topic, we are providing you with a copy of this paper.

We note that NSF and other agencies may provide awards with other forms of fees, such as award fees and incentive fees. Our review is limited to management fees, which, as traditionally recognized, have a focused purpose in this context -- to cover necessary, but nonreimbursable, business expenses for the larger purpose of maintaining financial viability.

II. Origins of Management Fees for Research Centers

Following World War II, the government wanted to build upon the success it had achieved partnering with laboratories to develop technologies to assist with the war effort. By the 1960s, these efforts had coalesced around the creation of Federally Funded Research and Development Centers (FFRDCs). The mission of FFRDCs was to perform research and development and to provide services for the government that it was unable to undertake or provide for itself. The concept was for a federal agency to form a special relationship with a research entity via a long term contract or grant wherein the entity would perform key tasks for the agency. Frequently, at least in the early days, the contracts or grants were awarded on a non-competitive basis, with a focus on flexibility, responsiveness, and stability -- hallmarks of what made the World War II efforts so successful. Currently, there are 41 FFRDCs, funded by several agencies.

From the beginning, it was recognized that FFRDCs, typically non-profit entities almost wholly dependent upon government funding, might incur costs that could not be reimbursed as either a direct or indirect cost of a specific agency project. Covering such costs was viewed as essential to the FFRDC, as it enabled the entity to survive from year to year with the stability necessary to successfully complete the government’s tasks. Costs that needed to be paid included operating expenses unable to be covered by current revenue (termed “working capital” expenses), expenses such as advertising, the write-off of bad debt and interest on borrowings (termed

---

5 See www.nsf.gov/statistics/ffrdclist for a list of FFRDCs and information related to them. For a general historical overview, see GAO’s October 2008 report entitled Opportunities Exist to Improve the Management and Oversight of Federally Funded Research and Development Centers.
6 In April 1962, the Bureau of Budget, the precursor to the Office of Management and Budget, submitted the Report to the President on Government Contracting for Research and Development, also known as the Bell Report. The Bell Report endorsed the use of “allowances” beyond the “precise limitations of cost financing or specific tasks” in order to provide “operational stability” to an organization.
7 Id. The FFRDCs of today are more complex in structure, in that some are administered by industrial firms, some by nonprofits and some by academic institutions. See www.nsf.gov/statistics/ffrdclist.
8 See General Accounting Office’s [now Government Accountability Office] (GAO) 1982 report entitled Fee Guidelines Still Needed for Government-Sponsored Nonprofit Organizations, GAO/PLRD-82-54 (July 1982) [hereinafter 1982 GAO Report]. It states that the rationale for paying fees to Government-sponsored nonprofit organizations is to provide operating stability and to cover certain nonreimbursable expenses. The findings of this report are discussed in greater detail, infra.
“nonreimbursable” expenses), and expenses for such items as capital expansion (termed “general support capital” expenses). The concept of a “management fee” was created in order to bridge the gap between what could be reimbursed under the award as a direct or indirect cost and what could not, but was still needed. It was designed as a mechanism or tool to ensure that an FFRDC’s “ordinary and necessary” but otherwise nonreimbursable business expenses would be covered.

A 2003 Congressional Research Report, Department of Homeland Security: Issues Concerning the Establishment of Federally Funded Research and Development Centers (FFRDCs) summed up this practice as follows:

While Centers are not-for-profit entities, they are allowed to charge the government fees above and beyond the cost of carrying out their responsibilities. Some Centers charge fees to cover ordinary and necessary costs of doing business that are not otherwise reimbursable, but that the government recognizes must be incurred. These fees can also be used by an FFRDC to conduct independent research. The [Federal Acquisition Regulation (FAR)] acknowledges the legitimacy of such fees.

III. **Long-Standing Concerns about Management Fees**

Concerns have arisen through the years about the use of management fees to cover FFRDCs’ non-reimbursable costs. The 1982 GAO Report, which generally laid out the history detailed above, also described the concerns surrounding management fees since their inception.

Notably, the 1982 report shows that the wisdom of awarding a management fee to an organization viewed as “quasi-governmental” was a problematic issue. It describes concerns about the term “fee,” which it notes is normally associated with the for-profit rather than the non-profit world. The report explains that the reason for paying fee to non-profit organizations differs from the reason for paying fee to for-profit organizations. “Fees paid to for-profit organizations are viewed as contributions to profits, whereas fees paid to nonprofit organizations are considered necessary to provide required operating capital and to cover certain nonreimbursable expenses.” The report notes that, as early as 1969, GAO recommended that the Office of Management and Budget (OMB) develop guidance that specified the costs contracting officers should provide fees to cover.

Ten years after the 1982 GAO Report, in July 1992, the Senate Committee on Governmental Affairs, Subcommittee on Oversight and Government Management, examined management fees
in a report entitled *Inadequate Federal Oversight of Federally Funded Research and Development Centers*. This report was based upon a year-long examination and survey of FFRDCs and was highly critical of many aspects of FFRDC operation. In the cover letter accompanying the report, Senator Carl Levin stated: “FFRDCs today operate under an inadequate, inconsistent patchwork of federal cost, accounting and auditing controls whose deficiencies have contributed to the wasteful or inappropriate use of millions of federal dollars by FFRDCs.” Senator Levin specifically decried the use of “multi-million dollar management fees which are being dispensed without federal guidelines or detailed cost justifications.” The report recommended that governmentwide standards be immediately adopted.

In 1995, in two reports, *Use of Contract Fee by the Aerospace Corporation*¹⁵ (hereinafter, *Aerospace*) and *Use of Fee by the MITRE Corporation*,¹⁶ (hereinafter MITRE) GAO again turned to the issue of FFRDC costs that were being covered by management fees. In *Aerospace*, GAO found that the awardee had used part of its fee to fund such items as travel in excess of per diem, spouse and guest meals, and personal use of company furnished cars. In *MITRE*, the awardee had used part of its fee to pay for holiday parties, personal expenses for company officers and receptions and dinners. In both cases, although the Department of Defense (DoD) (the sponsoring agency) did have general guidance regarding how a fee is to be determined, GAO recommended that DoD adopt additional guidelines to identify appropriate restrictions on use of the fee and to precisely define -- with specific examples -- what constitutes an ordinary and necessary expense. In each case, DoD concurred with the report findings and indicated that it would take steps to improve its procedures governing management fees.

In 1996, in its report entitled *Issues Related to the Management of DoD Sponsored Centers*, GAO explained that federal agencies were attempting to address concerns about FFRDC fees in a variety of ways, and it reiterated its long-standing recommendation to develop governmentwide guidelines. More recently, and more generally, in its 2008 report entitled *Opportunities Exist to Improve the Management and Oversight of Federally Funded Research and Development Centers*,¹⁷ GAO observed that agencies vary in FFRDC oversight, including oversight of fees, and recommended that agencies share best practices (such as DoD’s FFRDC management plan, discussed infra.).

**IV. NSF Policy and Practice**

NSF has authority under 42 U.S.C. §1870 (c) to “enter into contracts or other arrangements or modifications thereof, for the carrying on, by organizations or individuals . . . of such scientific or engineering activities as the Foundation deems necessary to carry out the purposes of this chapter.” Further, NSF is permitted under 18 U.S.C. §1870 (d) “to make advance, progress, and other payments which relate to scientific or engineering activities without regard to the provisions of section 3324(a) and (b) of title 31 [which limit the payment of advances] . . . .”

---

¹⁵ GAO/NSIAD-95-174 (Sept.1995).
¹⁶ GAO/NSIAD-96-26 (Nov.1995).
The specific NSF rules relating to fees, which NSF appears to have adopted under this general authority, are found in two places: NSF’s Manual 10, Proposal and Award Manual (PAM), and NSF’s Proposal and Award Policies and Procedures Guide (PAPPG).

The PAM Chapter VI.E.3 states:

Payment of Fees

NSF policy permits the payment of fees for performance of Government-supported work to organizations that have made legitimate requests in response to formal program solicitations where the payment of fees is permitted.

The amount of any fee provided by NSF is negotiated with the organization by DGA or DACS in consultation with the responsible program. The fee may not exceed 15 percent of the total project costs provided by NSF (excluding the fee). In most cases, the fee is lower. In determining the fee to be paid, consideration should be given to the following: the degree of difficulty or complexity of the work to be performed, the potential public benefits as a result of the work, the level of investment in the work being performed, and the performer’s past performance record, and the extent of any subcontracting.

For awards resulting from proposals that were not submitted in response to formal solicitations that permitted appropriate fees, the payment of fees may be authorized on a case-by-case basis by the Director of DGA or DACS, as appropriate. In order for such authorization to be given, the Foundation must have an especially strong interest in having the work performed because of substantial potential public benefits. Such exceptions, however, rarely will be made.

The PAPPG Part II Chapter V.E. states:

Fee Payments under NSF Grants

Payment of fees (profit) are allowable only if specifically permitted by a program solicitation and only to the extent that it does not exceed the amount negotiated by the Grants and Agreements Officer and specified in the award letter.

NSF provided additional information about its use of management fees in response to questions posed by Senators Grassley and Paul. According to NSF,

Most of [the organizations receiving management fees] have limited or no other sources of funding. The purpose of the management fee in many of these cases, therefore, is to facilitate the basic operations and viability of these nonprofits, so that our overall investment remains sound.\textsuperscript{18}

\textsuperscript{18} NSF Letter, p. 4.
NSF also stated that it considers several factors when determining whether a management fee is warranted, including:

- financial or other liability or risk assumed;
- retained earnings used to fund work;
- facilities and capital acquisition plans;
- working capital funding;
- addressing unreimbursed costs deemed ordinary and necessary for operations;
- the utility of fee as a performance incentive; and
- fee to attract qualified organizations.  

NSF explained that the management fee represents the parties’ agreement as to a fixed amount constituting a fee or profit earned by the awardee. Further, because it views “fees awarded [as] discretionary funds, NSF does not require . . . awardees [to] report how those monies are expended; thus, it does not require that the awardees submit an accounting of how they may cover otherwise unallowable costs with management fee.” In its letter to Senators Grassley and Paul, NSF described NEON’s use of management fees for certain expenditures as “disconcerting.” The Foundation stated that it is “continuing to reassess [its] policies and practices regarding management fee administration.”

V. A Survey of other Rules, Regulations, and Guidance

A. OMB Circulars and Uniform Guidance

Until December 26, 2014, guidance as to the treatment of costs under federal grants and cooperative agreements with educational institutions and non-profit organizations is set forth in OMB Circulars A-21 (educational institutions) and A-122 (non-profit institutions). Neither OMB Circular specifically addresses the allowability of the type of management fees discussed in this memorandum.

Likewise, the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance), which replaces the circulars, and which becomes effective January 1, 2015, does not specifically address “management fees.” It does address the concept of “profit” in broad terms as follows:

Section 200.400(g)

The non-Federal entity may not earn or keep any profit resulting from Federal financial assistance, unless expressly authorized by the terms and conditions of the Federal award.

---

19 Id., pg. 3
20 Id.
21 Id., at pg. 5 (emphasis added).
22 In FY 2013, NEON used such fees for, among other things, an office Christmas party ($25,000), coffee services ($11,000), $3,000 for Board of Directors dinners (including alcohol), and lobbying contracts ($112,000).
23 2 CFR § 200.
In Frequently Asked Questions released on August 29, 2014, the Council on Financial Assistance (COFAR) addressed the following question: “How does the usage of the term “profit” in §200.400(g) apply, if at all, to Federal awards with or performed by nonprofit organizations?” It responded:

- The guidance in section 200.400(g) states that the non-Federal entity may not earn or keep any profit resulting from Federal financial assistance, unless expressly authorized by the terms and conditions of the Federal award (with a reference to §200.307 Program income).

- The guidance in 200.400(g) is intended only to make this long-standing requirement explicit for purposes of accountability and oversight. It has always been true that costs under Federal awards must be reasonable, allocable and allowable. By definition, this has always excluded any additional increment for profit beyond cost for non-Federal entities executing Federal awards or subawards.

B. The Federal Acquisition Regulation (FAR)

NSF uses cooperative agreements for its large facility awards. The FAR, which pertains to procurement contracts, is therefore not directly applicable to NSF’s management fees. However, for reference, we note that it provides the following general guidance concerning payment of fees to FFRDCs:

§35.017-1(d)

The sponsoring agreement or sponsoring agencies’ policies and procedures may also contain, as appropriate, other provisions, such as identification of-
(1) Any cost elements which will require advance agreement if cost-type contracts are used; and
(2) Considerations which will affect negotiation of fees where payment of fees is determined by the sponsor(s) to be appropriate.

C. National Aeronautics and Space Administration

In a Federal Register notice on November 13, 2014, NASA published a final rule that would prohibit that agency from paying a profit or fee to recipients of grants or cooperative agreements. The rule, which will become effective on December 15, 2014, defines “profit or fee” (explicitly including management fees) as amounts above allowable costs. NASA’s notice explains that payment of fees or profits is inconsistent with the intent of financial assistance awards (grants and cooperative agreements), which are funding vehicles used to advance a public interest, and that payments to assistance awardees must be in line with OMB cost principles. In explaining the rule, NASA has also stated:

“[I]t is necessary to clarify the regulation with regard to the payment of profit or fee on grants or cooperative agreements in order to prevent payment for unallowable costs.”25

“NASA pays for business expenses/costs that are reimbursable in accordance with guidelines in OMB Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards . . . . Paying business expenses/costs that are not reimbursable through a management fee would be circumventing these OMB guidelines and inappropriate for financial assistance instruments.”26

D. Department of Defense

In 2011, DoD adopted a management plan for FFRDCs. In Appendix E, DoD explains that management fees may be justified to cover working capital, facilities capital, and otherwise nonreimbursable expenses. With regard to the latter category, DoD states:

Since DoD strictly limits its FFRDC contractors in the types of work they may perform, frequently requiring them to work exclusively or predominantly for the DoD, FFRDC contractors forego other sources of revenue. They thus have less flexibility than many contractors to cover “ordinary and necessary business expenses” that are normally not allowable on federal cost-type contracts. Fee may provide operating flexibility needed to maintain a healthy company. Fee may reflect costs that will be used by the FFRDC contractors for a variety of other [unreimbursable] “ordinary and necessary” expenses not included in the above two categories [of permissible management fees -- working capital and facilities capital]. This includes reasonable allowance for management initiatives and investments that will directly or indirectly benefit DoD. In order for these expenses to become appropriate for consideration as a fee need, they must be separately identified and justified in the fee proposal.

DoD’s management plan expressly provides that such fees cannot include amounts for allowable direct or indirect costs:

Costs incurred under the FFRDC contract that are allowable under the cost principles (i.e., commercial using FAR 31.2, not-for-profit using OMB Circular A-122, or university affiliated using OMB Circular A-21), regulations, or statues applicable to that FFRDC contract must be classified as direct or indirect (overhead/G&A) charges to the contract and not included as proposed fee elements. Exceptions to this guideline may be made with sponsor approval. (emphasis added)

Finally, the management fee plan requires review and assessment:

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). Repeated, unexplained failure to reasonably adhere to planned uses for fee should serve as a basis for challenging either the appropriateness and/or magnitude of proposed fee. (emphasis added).

E. Initial Observations

In light of the foregoing, we offer the following initial observations:

- Based on historical precedent, management fees were warranted in order to help ensure the financial viability of an organization with limited sources of revenue. Information from publicly available sources revealed the following about the seven awardees NSF listed as fee recipients in its letter to Senators Grassley and Paul:
  
  o An internet search indicates that SRI International (an NSF awardee and management fee recipient) is not solely dependent on NSF for its financial viability. Apart from NSF, which provides only 6% of SRI’s overall funding, it receives revenue from DoD (63%); the National Institutes of Health (11%); Industry (8%), other federal, state, and local agencies (6%); the Department of Education (4%); and foundations (2%).

  o Single Audit report (A-133) data for FY 2013 shows that each awardee had multiple income sources, including, in many instances, income from other government agencies and/or non-governmental sources. In addition, each reported some amount of cash on hand (ranging from (IRIS) to (AURA)), and six reported net assets (ranging from (IRIS) to (SRI)). See Table, Attachment 1.

- Some of the factors NSF considers in determining whether to award a management fee (using a management fee as a performance incentive or to attract qualified organizations) appear to be inconsistent with the historical purpose of such fees. We will explore this in more detail in the second phase of our review. It is worth mentioning that GAO’s October 2008 report entitled Opportunities Exist to Improve the Management and Oversight of Federally Funded Research and Development Centers addresses this: “Fixed fees are often used when, according to the agencies we reviewed, the FFRDC will need working capital or other miscellaneous expense requirements that cannot be covered through reimbursing direct and indirect costs.” In contrast, the report states, “[a]ward or incentive fees . . . [not management fees] are intended to motivate contractors toward such areas as excellent technical performance and cost-effective management.”

---

• Given the historical rationale for the use of management fees, an awardee’s actual use of management fees should be consistent with that rationale -- i.e., to cover business expenses that are necessary to maintain operational stability. In this regard, we note that DoD’s management plan for FFRDCs requires “[t]he Sponsor/contracting activity [to] perform an annual fee review” that examines whether “prior representations and justifications regarding fee have proven reliable (both as to the fee amount and the planned uses of the fee).” DoD’s plan further provides that failure to adhere to planned uses for fees can serve as a basis for challenging the appropriateness or magnitude of a proposed fee.

• There is precedent for payment of management “fee” as an item outside of “cost.” At the same time, such a “fee” is not directly analogous to “profit” because its use is encumbered by a traditionally-recognized purpose. In light of this precedent, silence on the topic of management fees in the OMB Circulars and superseding Uniform Guidance creates ambiguity about the appropriateness of such fees under federal grants and cooperative agreements.

VII. Conclusion

Based on the foregoing, management fee appears to be a hybrid payment that is neither a “profit,” as traditionally conceived, nor a reimbursable “cost.” Federal agencies have awarded these fees to FFRDCs for many years to cover ordinary and necessary, but otherwise unreimbursable, business expenses. Yet persistent and unresolved questions have been raised about this use, notably how to define an entity’s ordinary and necessary business expenses and whether certain expenses should fall within that designation. Absent explicit governmentwide or agency-specific guidelines, such questions will continue to be raised about how fees are awarded and used, and the risk of misuse -- at taxpayer expense -- will remain.

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.

Copy: Dr. Fae Korsmo, Office of the Director’s Liaison to OIG
Dr. Michael Van Woert, Executive Officer, National Science Board

---

28 DoD, Federally Funded Research and Development Center Management Plan, pg. E-2 (April 25, 2011), found at: http://www.acq.osd.mil/docs/FFRDC%20Mgmt%20Plan%20May%202011.pdf. For reference, NSF has informed us that its use of management fee is not limited to FFRDC awards. According to the Foundation, these fees are also used in limited situation when working with specialized nonprofit research organizations on large scale projects.

29 Id.
# Attachment 1
## Financial Data

<table>
<thead>
<tr>
<th>Organization</th>
<th>Federal Government Income Sources</th>
<th>Nongovt. Income Sources</th>
<th>Uncertain Income Source</th>
<th>National Science Foundation Expenditures</th>
<th>Expenditures from Other Federal Agencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>IRIS</td>
<td>$33,502,347</td>
<td>$1,073,500</td>
<td>$130,688</td>
<td>$32,911,215</td>
<td>$0</td>
</tr>
<tr>
<td>AUI</td>
<td>$91,934,302</td>
<td>$3,177,246</td>
<td>$6,330,008</td>
<td>$93,742,721</td>
<td>$299,099</td>
</tr>
<tr>
<td>UNAVCO</td>
<td>$19,720,253</td>
<td>$20,520,530</td>
<td>$0</td>
<td>$19,523,189</td>
<td>$232,331</td>
</tr>
<tr>
<td>NEON</td>
<td>$83,729,045</td>
<td>$59,972</td>
<td>$0</td>
<td>$63,244,264</td>
<td>$0</td>
</tr>
<tr>
<td>UCAR</td>
<td>$200,534,000</td>
<td>$12,319,000</td>
<td>$8,785,000</td>
<td>$121,388,000</td>
<td>$79,146,000</td>
</tr>
<tr>
<td>SRI</td>
<td>$526,859,000</td>
<td>$20,584,000</td>
<td>$7,737,000</td>
<td>$30,631,822</td>
<td>$354,515,631</td>
</tr>
<tr>
<td>AURA</td>
<td>$221,276,466</td>
<td>$5,979,534</td>
<td>$8,939,000</td>
<td>$122,759,650</td>
<td>$108,220,866</td>
</tr>
</tbody>
</table>