NATIONAL SCIENCE FOUNDATION
4201 Wilson Boulevard
ARLINGTON, VIRGINIA 22230

OFFICE OF
INSPECTOR GENERAL

November 10, 2006

To: Dr. Steven C. Beering
Chairman, National Science Board

Dr. Arden L. Bement, Jr.
Director, National Science Foundation

From: Thomas C. Cost for Dr. Christine C. Boesz
Inspector General

Subject: Audit of the National Science Foundation's
Fiscal Years 2006 and 2005 Financial Statements

This memorandum transmits Clifton Gunderson LLP's financial statement audit report of the National Science Foundation (NSF) for Fiscal Year 2006, which includes Fiscal Year 2005 comparative information.

Results of Independent Audit

The Chief Financial Officer's (CFO) Act of 1990 (P.L. 101-576), as amended, requires NSF's Inspector General or an independent external auditor, as determined by the Inspector General, to audit NSF's financial statements. Under a contract monitored by the Office of Inspector General (OIG), Clifton Gunderson, an independent public accounting firm (IPA), performed an audit of NSF's Fiscal Year 2006 financial statements. The contract required that the audit be performed in accordance with the Government Auditing Standards issued by the Comptroller General of the United States, and Bulletin 06-03, *Audit Requirements for Federal Financial Statements*, issued by the United States Office of Management and Budget.

Clifton Gunderson issued an unqualified opinion on NSF's FY 2006 financial statements. In its Report on Internal Control over Financial Reporting, Clifton Gunderson identified two reportable conditions relating to NSF's post-award administration and contract monitoring. Clifton Gunderson also reported that there were no instances in which NSF's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA), and found no reportable noncompliance with laws and regulations it tested. Another IPA under contract with the OIG performed the audit of NSF's FY 2005 financial statements, and issued a report dated November 4, 2005.

Management's response dated November 7, 2006, follows Clifton Gunderson's report.

Evaluation of Clifton Gunderson's Audit Performance

To fulfill our responsibilities under the CFO Act of 1990, as amended, and other related financial management legislation, the OIG:

- Reviewed Clifton Gunderson's approach and planning of the audit;
- Evaluated the qualifications and independence of the auditors;
- Monitored the progress of the audit at key points;
- Coordinated periodic meetings with NSF management to discuss audit progress, findings, and recommendations;
- Reviewed Clifton Gunderson's audit report to ensure compliance with Government Auditing Standards and Office of Management and Budget Bulletin No. 06-03; and
- Coordinated issuance of the audit report.

Clifton Gunderson LLP is responsible for the attached auditor's report dated November 6, 2006, and the conclusions expressed in the report. We do not express any opinion on NSF's financial statements, internal control, conclusions on compliance with laws and regulations, or on whether NSF's financial management systems substantially complied with FFMIA.

The Office of Inspector General appreciates the courtesies and cooperation NSF extended to Clifton Gunderson LLP and OIG staff during the audit. If you or your staff has any questions, please contact me or Deborah H. Cureton, Associate Inspector General for Audit.

Attachment

cc: Dr. Dan E. Arvizu, Chair, Audit and Oversight Committee

Clifton Gunderson LLP
Certified Public Accountants & Consultants

INDEPENDENT AUDITOR'S REPORT

Dr. Steven Beering
Chairman, National Science Board

Dr. Arden L. Bement, Jr.
Director, National Science Foundation

In our audit of the financial statements of the National Science Foundation (NSF) for fiscal year (FY) 2006 we found:

- The NSF financial statements, which are the balance sheet as of September 30, 2006, and the related statements of net cost, changes in net position, budgetary resources, and financing are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America;
- No material weaknesses in internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations;
- Even though progress has been made in FY 2006 on the two reportable conditions noted in the FY 2005 auditor's report, certain matters in those conditions continue to exist and, accordingly, the two reportable conditions are noted in this year's report;
- No instances of noncompliance with the Federal Financial Management Improvement Act of 1996 (FFMIA);
- No instances of noncompliance with laws and regulations.

The following sections discuss in more detail (1) these conclusions and our conclusions on Management's Discussion and Analysis and other supplementary information and (2) the scope of our audit.

OPINION ON FINANCIAL STATEMENTS

In our opinion, the accompanying FY 2006 financial statements including the accompanying notes present fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America, NSF's assets, liabilities, and net position as of September 30, 2006; and its related net costs; changes in net position; budgetary resources; and reconciliation of net costs to budgetary obligations for the year then ended.

NSF's financial statements as of and for the year ended September 30, 2005, were audited by other auditors; whose report dated November 4, 2005 expressed an unqualified opinion on those financial statements.

CONSIDERATION OF INTERNAL CONTROL

In planning and performing our audit, we considered NSF's internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with the Office of Management and Budget (OMB) audit guidance, not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance.

The objectives of an effective internal control system are the following:

- *Reliability of Financial Reporting*: Transactions are properly recorded, processed, and summarized to permit the preparation of financial statements and stewardship information in conformity with generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- *Compliance With Laws and Regulations*: Transactions are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements and any other laws, regulations, and government-wide policies identified by OMB audit guidance.
- *Reliability of Performance Reporting*: Transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect NSF's ability to record, process, summarize, and report financial data consistent with the assertions made by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected.

The prior year audit report noted two reportable conditions on Post-award Monitoring and Contract Monitoring. Even though management made strides in resolving some of the specific weaknesses reported last year in these areas, the overall concept of the matters continue to be reflected as reportable conditions in this year's report. **Exhibit I** details these two repeat reportable conditions, and describes the improvements made in FY 2006 as well as the continuing deficiencies that require management's attention in FY 2007. Neither of these reportable conditions is considered to be a material weakness.

As required by OMB Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*, we considered NSF's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the component's of NSF's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on these internal controls. Accordingly, we do not provide an opinion on such controls.

As further required by OMB Bulletin No. 06-03, with respect to internal control related to performance measures reported in the Management Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions and determined whether they had been placed in operation. Our procedures were not designed to provide assurance on internal control over reported performance measures and, accordingly, we do not provide an opinion on such controls.

We also noted other non-reportable matters involving internal control and its operation that we will communicate in a separate management letter.

SYSTEMS COMPLIANCE WITH FFMIA REQUIREMENTS

Under the Federal Financial Management Improvement Act of 1996 (FFMIA), we are required to report whether the financial management systems used by NSF substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Standard General Ledger (SGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

The objective of our audit was not to provide an opinion on compliance with FFMIA. Accordingly, we do not express such an opinion. However, our work disclosed no instances, in which NSF's financial management systems did not substantially comply with federal financial management systems requirements, Federal Accounting Standards and the SGL at the transaction level.

COMPLIANCE WITH LAWS AND REGULATIONS

Our tests for compliance with selected provisions of laws and regulations disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance. Providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

STATUS OF PRIOR YEAR'S REPORTABLE CONDITIONS

As required by *Government Auditing Standards* and OMB Bulletin No. 06-03, we have reviewed the status of NSF corrective actions with respect to the findings and recommendations included

in the prior year's Independent Auditor's Report dated November 4, 2005. The prior year audit report noted two reportable conditions: Post-award Monitoring and Contract Monitoring. Even though management made strides in resolving some of the specific weaknesses reported last year in these areas, the overall concept of the matters continue to be reflected as reportable conditions in this year's report, and such reportable conditions are attached as **Exhibit I** to this report.

CONSISTENCY OF OTHER INFORMATION

Management's Discussion and Analysis, required supplementary information (including stewardship information), and other accompanying information contain a wide range of data, some of which are not directly related to the financial statements. We do not express an opinion on this information. However, we compared this information for consistency with the financial statements and discussed the methods of measurement and presentation with NSF officials. Based on this limited work, we found no material inconsistencies with the financial statements or nonconformance with OMB guidance.

OBJECTIVES, SCOPE AND METHODOLOGY

Management is responsible for (1) preparing the financial statements in conformity with accounting principles generally accepted in the United States, (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA), as codified in 31 U.S.C. 3512 are met, (3) ensuring that NSF's financial management systems substantially comply with FFMIA requirements, and (4) complying with other applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles.

We are also responsible for (1) obtaining a sufficient understanding of internal control over financial reporting and compliance to plan the audit, (2) testing whether the financial management systems used by NSF substantially comply with the three FFMIA requirements, (3) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements and laws for which OMB audit guidance requires testing, and (4) performing limited procedures with respect to certain other information appearing in the Performance and Accountability Report.

In order to fulfill these responsibilities, we (1) examined on a test basis, evidence supporting the amounts and disclosures in the financial statements, (2) assessed the accounting principles used and significant estimates made by management, (3) evaluated the overall presentation of the financial statements, (4) obtained an understanding of internal control related to financial reporting (including safeguarding of assets), compliance with laws and regulations (including execution of transactions in accordance with budget authority), and performance measures reported in Management's Discussion and Analysis of the Performance and Accountability Report, (5) tested relevant internal controls over financial reporting, and compliance, and

evaluated the design and operating effectiveness of internal control, (6) considered the process for evaluating and reporting on internal control and financial management systems under FMFIA, (7) tested whether the financial management systems used by NSF substantially complied with the three FFMIA requirements, and (8) tested compliance with selected provisions of certain laws and regulations.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by the FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, we caution that our internal control testing may not be sufficient for other purposes.

We did not test compliance with all laws and regulations applicable to NSF. We limited our tests of compliance to those laws and regulations required by OMB audit guidance we deemed applicable to the financial statements for the fiscal year ended September 30, 2006. Our work on FFMIA would not necessarily disclose all instances of lack of substantial non-compliance with FFMIA requirements. We caution that noncompliance with laws and regulations may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to the financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and OMB Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements.*

We have considered management's response (Exhibit II) and have concluded that no change is needed to our original findings, conclusions, or recommendations. We will evaluate the status of these findings during the FY 2007 audit.

This report is intended solely for the information and use of NSF's management, NSF's Office of Inspector General, OMB, the Government Accountability Office, and the U.S. Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

Clifton Gunderson LLP

Calverton, Maryland
November 6, 2006

NATIONAL SCIENCE FOUNDATION
CONSIDERATION OF INTERNAL CONTROL
REPORTABLE CONDITIONS
September 30, 2006

1. Post-Award Oversight For High Risk Grants and Cooperative Agreements

Condition Background

NSF awards grants and co-operative agreements (co-ops) to various organizations, including colleges and universities, non-profit organizations, state and local governments, and Federally Funded Research & Development Centers (FFRDC). In FY 2006, NSF expended approximately $4.9 billion in grant and co-op awards (collectively referred to as awards) to 2,367 institutions, representing over 41,000 awards. As such, it is important that NSF oversee the financial performance of these awards to ensure Federal funds are properly spent on allowable costs benefiting NSF's research activities. As noted in prior audit reports, Post-Award Monitoring was a Reportable Condition.

In response to the Reportable Condition in the FY 2005 audit report, NSF management initiated procedures which improved its post-award oversight process. Some of the more significant procedural changes began to be implemented after the second quarter of the year, including the hiring of a contractor in May 2006 to perform desk reviews of high risk awards that did not receive an Award Monitoring & Business Assistance Program (AMBAP) site visit in fiscal year 2005 and 2006. Other improvements in the processes made in FY 2006 were as follows:

- Modified the medium and low risk award Federal Cash Transactions Report (FCTR) transaction testing process for FY 2006 to include the first quarter of FY 2006 along with the last three quarters of FY 2005.
- Revised the risk assessment process to be used for FY 2007 by incorporating additional risk factors, such as "Total Intended Award Amount."

While we commend NSF for initiating these changes, continuous refinements and completion of these initiatives are needed. Accordingly, the following section explains why this matter continues to be a Reportable Condition.

Condition Status at September 30, 2006

NSF's process to monitor its grantees\co-op partners to ensure that expenditures were allowable, allocable, and reasonable under the terms of the award\agreement did not ensure that appropriate oversight reviews were performed at a material number of institutions with high risk awards where a site visit was not performed.

NSF's procedures require that awards are assessed as high, medium, or low risk based on objective factors. The procedures also require that institutions with high risk awards receive a more detailed level of review, such as an AMBAP or Total Business System Review (TBSR) site visits on a cyclical basis every four or five years.

For FY 2006, NSF's risk assessment process initially identified 340 high risk awards at 206 institutions valued at $3.2 billion. NSF applied various factors to reduce the number and dollar amount of awards for which a site visit or desk review would be performed, resulting in 286 awards to 153 institutions valued at $2.7 billion being excluded from the population for which site visits and desk reviews would be performed. Some factors NSF used to exclude grants from the population are not appropriate, such as grant awards due to expire and grant awards at institutions that had received an AMBAP review in the past 4 years. The grants about to expire totaled approximately $700 million and many of these awards were continuing and/or the award period had been extended. The grant awards with previous AMBAP reviews totaled approximately $880 million. The AMBAP site visits provide an in-depth oversight of the internal controls instituted by the awardees; however, they are performed on a four year cycle for an awardee.

As a result of using the exclusion factors, approximately $2.7 billion (84%) of the originally identified FY 2006 high risk awards did not receive any type of review in FY 2006. While eliminating certain awards from site visits and desk reviews is reasonable given available resources, there should still be some form of annually implemented oversight procedures for the remainder of the high risk awards at a level no less stringent than the oversight given to medium and low risk awards.

Ultimately NSF performed site visits for grantees (AMBAP reviews) and for co-ops (TBSR) on only 33 FY 2006 awards valued at $324 million at 32 institutions. While NSF initiated desk reviews for 24 awards valued at $287 million in FY 2006, it completed reviews of only 13 awards, valued at $103 million by September 30, 2006.

With respect to Federally Funded Research and Development Centers (FFRDCs), we found that the Standard Operating Guidance BFA 2005-1, *Post Award Monitoring & Oversight of FFRDCs and Complex Cooperative Agreements*, dated June 29, 2005, does not provide guidance on how to perform TBSRs for FFRDCs and large facilities that are in planning, under construction, or in operation. These are some of the largest awards that NSF makes valued at approximately $780 million annually. If there are no specific policies and procedures for conducting and documenting TBSR oversight activities for these FFRDCs and large facilities, there is an increased risk that NSF will not identify issues which need to be resolved and/or award funds that are not being used for their intended purposes.

Condition Summary

In conclusion, we believe that management has improved its award oversight control structure in FY 2006. However, the oversight review coverage for high risk awards, either by site visit or desk reviews, does not appear sufficient to conclude whether organizations managing high risk awards, as a whole, are spending funds awarded consistent with the terms

and conditions of the grant award or co-op agreements. In addition, the actual desk review process did not begin until May 2006, and only 13 high risk grant desk reviews and 2 co-op TBSR reviews were completed by September 30, 2006. Therefore, the effectiveness of these changes, the adequacy of the procedures performed, and the results of the desk reviews when they are ultimately completed are uncertain.

We commend NSF for expanding its award oversight process in FY 2006 to include implementing the desk review process recommended in the FY 2005 audit report, pursuing enhancements to the risk assessment process, and incorporating the first quarter of FY 2006 in the FCTR transaction testing. However, continued refinement to the oversight model and review process is needed to ensure that costs on the financial statements were spent in accordance with the terms of the grant agreements.

Recommendations: We recommend that NSF management:

1. Complete the desk review program implemented for high risk awards and evaluate the benefit and effectiveness of such reviews to the overall award oversight process.
2. Refine factors used in the Risk Assessment model to determine which organizations managing high risk awards are considered for desk reviews or AMBAP site visits. Circumstances leading to exclusion should be clearly demonstrated.
3. Expand the coverage of review of high risk awards. Such coverage increase should include implementing FCTR transaction testing for high risk awards excluded from the AMBAP or TBSR site visits and desk reviews for that fiscal year.
4. Revise Standard Operating Guidance to reflect the process for planning and scheduling TBSRs for FFRDCs and other large facilities, the documentation requirements for the TBSR, and the disposition of its results.

2. Contract Monitoring

Conditions: In FY 2006, NSF expended approximately $550 million on active contracts and interagency agreements for the delivery of products and services. Of this amount, $225 million was disbursed through advance payment programs with three contractors, including $177 million for logistical support of the U.S. Antarctic Program (USAP). In accordance with Federal requirements, Federal agencies must have controls in place to assess the risks faced from both external and internal sources to ensure that contractors use federal funds consistent with the objectives of the contract, and that funds are protected from waste, fraud, or mismanagement. However, during our FY 2006 audit, we found that NSF does not have a comprehensive, risk-based system, including detailed policies and procedures, in place to oversee and monitor its contract awards.

In March 2006, the Division of Acquisition and Cooperative Support (DACS) completed a Contracts Manual that details policies and procedures for contract administration and oversight. However, the manual is not comprehensive in that it does not include any specific policies and procedures for risk assessment or risk mitigation plans for contracts that may require expanded oversight. The manual also does not define the specific roles and

responsibilities for contract personnel (i.e. contracting specialist, contract officer) regarding their regular activities, including contract file documentation and maintenance. In addition, the manual describes the general requirements of the Federal Acquisition Regulation (FAR), but it does not provide NSF specific guidance necessary to implement FAR policies and procedures.

In addition, in response to the Reportable Condition disclosed in the FY 2005 audit report, NSF management initiated a quarterly expenditure report (QER) review program in FY 2006. While the QER program involves the review of vouchers submitted by its three largest contractors, these reviews, while important, are only one piece of a rigorous contract oversight program. As reported in the FY 2005 audit report, NSF did not adequately review quarterly expenditure reports submitted by its three largest contractors receiving payments in advance for services that they provide to NSF. To address this problem, during FY 2006, NSF contracted with the Defense Contract Audit Agency (DCAA) to perform quarterly expenditure report reviews for three advance payment contractors for the four quarters ended September 30, 2005, through June 30, 2006. These reviews have been completed, and while no significant findings were noted, these reviews have a limited scope that may not identify unallowable costs. Therefore, these reviews are not an adequate substitute for a comprehensive, risk-based system needed to provide management with material assurance that costs paid by NSF are valid.

This lack of appropriate contract oversight was also evident during our review of NSF's property account balance of approximately $551 million at September 30, 2006, including $142 million relating to Construction in Progress. NSF's largest contractor is responsible for acquiring, maintaining, and performing a physical inventory of the NSF's USAP property (PP&E). NSF relies on the contractor to maintain all related source documentation, and records amounts for PPE activities based on the summary reports provided by the contractor. However, NSF does not perform any independent verification of the PP&E amounts reported by the contractor, nor does it maintain copies of source documentation supporting PP&E amounts included in its financial statements.

In addition, cost-incurred audits continue to reveal internal control weaknesses, non-compliance with federal regulations, and significant questioned costs. For example, recent DCAA cost-incurred audits of NSF's largest contractor have identified approximately $55.5 million in questioned costs for FY 2000 through 2004. DCAA also reported that the contractor was not in compliance with Federal Cost Accounting Standard 418, *Allocation of Direct and Indirect Costs*, for FYs 2000 to 2002. NSF is responsible for establishing controls to ensure that contractors use federal funds consistent with the terms and conditions of their contractual agreements. Therefore, a combination of its QER program and implementation of comprehensive oversight policy and procedures is needed to ensure effective contract administration.

Furthermore, during our FY 2006 audit, we found that NSF did not fully document its oversight and contract monitoring activities. Specifically, we found:

- A contractor submitted its final FY 2006 Annual Program Plan (APP) to NSF for approximately $164 million in October 2005. In January 2006, the plan was approved by DACS at only $144 million; however, the funds were provided to the contractor during FY 2006 at the originally proposed amount of $164 million. In September 2006, the contract was modified to reflect the amount in the contractor's original APP. Consequently, the contractor was technically operating without an official approved APP during the first three months of FY 2006, and the advance payment allotments made during the year were not consistent with the DACS January 2006 approved amount of $144 million.

- For one major contractor, we noted that an interim TBSR report was issued in November 2001; however, the TBSR has not been finalized. Also, NSF was unable to provide documentation evidencing that accounting and estimating systems reviews had been conducted.

- A desk review of a contractor's FY 2006 employee compensation plan was initiated in October 2005; however, NSF was unable to provide documentation regarding the status or results of the review. As a result, it is unclear whether the contractor's compensation plan was found to be reasonable.

- In our review of a sample of procurement transactions during FY 2006, we noted 3 instances out of 45 contracts folders selected for examination that were incomplete. The deficiencies noted in our limited sampling contract folders are an indication that the total population as a whole may have similar deficiencies, if testing was expanded.

    - NSF was unable to provide documentation indicating whether the procurement was a sole source or competitive bid.
    - The purchase requisition amount was not properly authorized, resulting in the purchase order amount exceeding the authorized purchase requisition in one case.

In conclusion, it appears that contractors' use of NSF funds may not be consistent with the objectives of the contract; contract funds may not be adequately protected from waste, fraud, and mismanagement; laws and regulations may not be completely followed; and reliable and timely financial information may not be obtained for financial reporting in a timely manner.

Recommendations: NSF needs to develop a more comprehensive, risk-based, internal management monitoring program to ensure that contractors use NSF funds consistent with the objectives of the contract, and that funds are protected from waste, fraud, or mismanagement. To accomplish these objectives, we recommend that NSF management:

1) Expand the Contracts Manual initiated in FY 2006 to include specific policies and procedures required for contract risk assessment, and risk mitigation plans for

contracts that may require expanded oversight. The manual should also provide specific guidance to implement FAR policies and procedures as they relate to NSF, and provide descriptions of specific roles and responsibilities for contract personnel regarding their day to day oversight activities. In addition, the manual should include procedures to ensure that contract folder documentation is complete, that there are no material discrepancies between documents, and that reviews of the adequacy of contract folder contents is performed more thoroughly. A checklist should be developed and consistently utilized to accomplish that objective.

2) Continue to perform Quarterly Expenditure Report reviews. In addition, management should perform appropriate and timely follow up on the findings and recommendations in the OIG cost-incurred reports issued for FYs 2000 to 2004, and subsequent years.

3) Maintain an electronic copy of key source documentation (i.e. invoices, purchase orders, etc.) used to support the PP&E activity and balances in NSF's financial statements. The documentation threshold amount requirement should be sufficient to achieve coverage of 75% of the total acquisition balance. In addition, NSF should implement a validation process to compare amounts reported in the PP&E accounts to supporting documentation prepared by the contractor on a test basis throughout the year (sampling both large and smaller purchases).

NATIONAL SCIENCE FOUNDATION
MANAGEMENT'S RESPONSE TO FY 2006
INDEPENDENT AUDITOR'S REPORT
November 6, 2006

NATIONAL SCIENCE FOUNDATION
4201 WILSON BOULEVARD
ARLINGTON, VIRGINIA 22230

November 7, 2006

To: Christine C. Boesz
Inspector General

From: Thomas N. Cooley
Chief Financial Officer

Subject: Management's Response to Independent Auditor's Report
Fiscal Year 2006

I am extremely pleased that the National Science Foundation (NSF) is receiving its ninth clean opinion on the audit of its Financial Statements for fiscal year 2006. Throughout the audit, NSF worked closely with the auditors and provided full cooperation and assistance in ensuring the successful completion of this important process. The Foundation is continually striving to enhance accountability and controls in a Federal environment of increasing financial complexity. This achievement continues to gain significance as the level of investments and commitments needed to obtain a clean opinion increase.

NSF generally agrees with the two reportable conditions and is committed to resolving the issues noted in your report. The attachment provides some specific comments in a few areas. NSF has made significant progress in addressing the underlying causes for these conditions and will continue its efforts in these areas. In addition, the Foundation plans to provide a detailed corrective action plan that will highlight its activities to resolve these matters.

I appreciated receiving the draft audit report earlier than anticipated. I particularly found the presentation to be balanced and the executive summary helpful in facilitating Management's communications.

I would like to commend both of our organizations for the professionalism exhibited during the audit. It is important to recognize the time and efforts spent by all parties during Clifton Gunderson's initial audit year.

cc: Dr. Arden L. Bement, Jr.
cc: Dr. Kathleen Olsen

Attachment (Management's Response to Auditor's Report)

Attachment
Management's Response to Auditor's Report

Post –Award Oversight for High Risk Grants and Cooperative Agreements

We generally agree with the condition as stated by the auditors. We would like to re-emphasize that the National Science Foundation (NSF) has proactively taken action to refine its post award monitoring program. In doing so, the Foundation has addressed many of the issues noted in the condition statement.

Concerning the specific recommendations, we offer the following comments:

1. Desk Reviews - We concur and note that it was always NSF's intention to complete the desk reviews initiated in fiscal year (FY) 2006. This was the inaugural year for the desk review process. As such, significant time was spent designing and implementing the policies, procedures, and practices governing this program. However, NSF was still able to complete 54% of the FY 2006 desk reviews before the FY ended.

The desk review component of our monitoring program is being implemented consistent with the Corrective Action Plan entered into between NSF Management and the Office of Inspector General on February 14, 2006. All desk reviews identified in the FY 2006 risk assessment will be completed. We have identified, scheduled, and commenced FY 2007 desk reviews.

2. Risk Assessment Modifications - We concur with this recommendation and have proactively taken steps to address this issue. We have implemented changes to the 2007 Risk Assessment Model that incorporated a new data field called Total Intended Award Amount (TIAA) in an effort to identify awards that stood a chance of being incrementally funded and extended. The TIAA field indicates NSF's intention to award additional funds above the amount cumulatively awarded as of the date of the Risk Assessment data run. This allows the Risk Assessment Model to identify continuing award increments that appear to be about to expire soon from the data run information, but where there is an intention (assuming satisfactory scientific progress and availability of funds) to issue additional award increments.

NSF's award system is a dynamic, living portfolio. The Risk Assessment data run is a "snap shot in time." There may always be a possibility that an award appearing to expire in the near future on the Risk Assessment data run, might be extended.

3. Federal Cash Transactions Report (FCTR) Transactional Testing - We concur that our FCTR transactional testing is focused on low and medium risk awards. FCTRs are an aggregated expenditure report of all awards, regardless of risk ranking, at an institution. Through previous analyses we determined that a very small subset of NSF awardees managed a portfolio solely comprised of high risk awards. The total dollar value of those awards was less than 1 percent of the high risk population.

We plan to consult with our contractors, who execute our FCTR transactional testing, to obtain assistance in constructing a sampling and stratification plan for appropriate coverage of low, medium, and those high risk awards not subject to desk reviews, Award Monitoring and Business Assistance Program or Total Business Systems Review site visits.

Contract Monitoring

We generally agree with the condition stated in the report concerning the need for independent verification of property plant and equipment information. In addition, NSF will consider your recommendation on maintaining source documentation in relation to the cost/benefit involved and other potential alternatives that may address the overall condition.