

**U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON SCIENCE, SPACE, AND TECHNOLOGY**

HEARING CHARTER

*NSF's Oversight of the NEON Project and Other Major Research Facilities
Developed Under Cooperative Agreements*

**Tuesday, February 3, 2015
10:00 a.m. – 12:00 p.m.
2318 Rayburn House Office Building**

Purpose

On Tuesday, February 3, 2015, the Oversight and Research & Technology Subcommittees will hold a joint hearing to review the National Science Foundation's (NSF) oversight and management of the National Ecological Observatory Network Project (NEON Project) and other major research facilities developed under cooperative agreements. On December 3, 2014, the Committee held a hearing on the findings of two financial audits of the NEON Project conducted by the National Science Foundation's (NSF) Office of Inspector General (OIG) and the Defense Contract Audit Agency (DCAA).¹ These financial audits raised concerns about how NSF allowed NEON, Inc.² to use money for typically unallowable expenses such as liquor, lobbying contracts, and a \$25,000 holiday party. In addition, it was discovered that NSF was aware of questionable and unsupported contingency costs in NEON's proposal, but decided to move forward with the project regardless.

Considering that the NSF funds a variety of large research projects, it is necessary to further examine the oversight of American taxpayer dollars to ensure that they are not spent frivolously.

Witnesses

- **Dr. Richard Buckius**, Chief Operating Officer, National Science Foundation
- **Dr. James P. Collins**, Chairman, National Ecological Observatory Network
- **Ms. Kate Manuel**, Legislative Attorney, Congressional Research Service

Background

As the primary federal agency supporting basic scientific research, the NSF plays a key role in the construction and operation of major research equipment and facilities. NSF funds a variety of large research projects, including multi-user research facilities, tools for research and education, and distributed instrumentation networks. Funding support

¹ Information on the hearing is available at: <http://science.house.gov/hearing/full-committee-hearing-review-results-two-audits-national-ecological-observatory-network>

² National Ecological Observatory Network Inc. (NEON) is the independent 501(c) (3) corporation created to build, operate, and manage the network.

for these projects is coordinated with other agencies, organizations, and countries to ensure projects are integrated and complementary.

The National Ecological Observatory Network Project

The NEON Project is a continental-scale ecological observation facility with 62 planned sites across the United States sponsored by the NSF to gather and synthesize data on the impacts of climate change, land use change, and invasive species on natural resources and biodiversity over 30 years.³ NSF approved the overall project in late 2009 and the project manager's final construction proposal in 2011. NSF's review panel recommended that the budget for contingency costs be increased from approximately \$50 million to \$74 million, which brought the risk-adjusted total cost for the project to \$433.7 million from August 2011 through July 2016.

NEON Audits

Two audits have been completed on NEON. The NSF OIG initiated these audits due to concerns identified with the NSF's lack of monitoring of several high-risk projects prior to entering into cooperative agreements and its failure to routinely review the awardee's costs submitted.⁴

In June 2011, the OIG contracted DCAA to audit NEON's construction cost proposal. After several weeks of work, DCAA advised the OIG that it was cancelling the audit because information supplied by NEON was inadequate to complete the necessary financial analyses. NSF and the OIG then intervened, enabling DCAA to complete its audit. However, before the audit was completed, NSF surprisingly accepted NEON's cost proposal and authorized the award of \$433.7 million.

In September 2012, the audit was finalized. DCAA concluded that NEON's proposal was *not* acceptable as a basis for negotiation of a fair and reasonable cooperative agreement price. Of the proposed \$433.72 million project cost, DCAA described approximately \$102 million as "questionable" and described an additional \$52 million of proposed costs as "unsupportable." This audit was transmitted to NSF, accompanied by an OIG written alert about excessive costs and accounting deficiencies for major research facilities. This alert included a series of recommendations to NSF.

The OIG subsequently commissioned a second DCAA audit of NEON accounting systems. DCAA completed a draft of this audit in May 2013, but it was not forwarded to the OIG for review until October 2014, due to internal disagreements within DCAA about the scope of the audit.

³ <http://www.neonin.org/about>

⁴ See NSF OIG's testimony before the Science, Space, and Technology Committee on Dec 3, 2014: http://science.house.gov/sites/republicans.science.house.gov/files/documents/hearings/2014%2012%2003%20-%20Lerner%20Testimony%20-%20NEON_1.pdf

DCAA auditors found that NEON used management fees to pay for, among other typical federally unallowable expenses, \$112,000 lobbying contracts, \$25,000 for a holiday party, and \$11,000/year for coffee services.

However, after months of deliberation, senior management at DCAA concluded that the detailed information about management fee expenditures by NEON, contained in the draft audit exceeded the scope of the assigned audit. This information was omitted from the audit report forwarded to the OIG in October 2014. After resolving several technical issues, the OIG forwarded the final audit report to NSF in November 2014. As a result of their investigation, the OIG referred two cases of suspected fraud within NEON to the U.S. Department of Justice.

Management Fees

“Management Fees” were created in the early 1960s to cover unallowable costs that might otherwise jeopardize the financial stability of a nonprofit entity. The intent was that the fees were only to be used for “ordinary and necessary” business expenses.⁵ Concerns have arisen about the use of management fees to cover non-reimbursable costs for Federally Funded Research and Development Centers (FFRDCs) like the NEON Project. In its 1982 report, GAO found that awarding a management fee to a quasi-governmental organization was generally problematic. The report also noted that as early as 1969, GAO recommended that OMB adopt government-wide guidelines for use of management fees.⁶

Nevertheless, OMB has not adopted such guidelines, instead leaving it to individual federal agencies to devise their own policies for management fees. Until December 24, 2014, the relevant OMB Circulars (A-21 and A-122) concerning treatment of costs under federal grants and cooperative agreements with non-profit organizations did not address the allowability of management fees. OMB’s new Uniform Guidance (which replaces those circulars as of January 1, 2015) addresses management fees only in the context of forbidding a non-profit entity from deriving a “profit.”⁷

In response to questions that have arisen regarding specific federal agencies’ management fee policies, GAO noted that federal agencies differ in oversight of management fees for FFRDCs and recommended that agencies share best practices.⁸

These cooperative agreements were to build, operate, and maintain NSF’s Major Research Equipment and Facilities Construction (MREFC) facilities. According to NSF, it provides management fees to some of its large facility awardees to “facilitate their basic operations and viability.” NSF permits awardees to use such fees for expenses that are otherwise non-reimbursable under the Office of Management and Budget’s cost

⁵ The NSF OIG, in a November 14, 2014 report entitled, “White Paper on Management Fees,” describes the history of management fees for non-profit organizations receiving federal grants, the lack of OMB guidance, and relevant federal agencies’ policies, including NSF.

⁶ GAO Report, B-146810, *Need for Improved Guidelines in Contracting with Government-Sponsored Nonprofit Contractors*.

⁷ Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, Section 200.400(g).

⁸ GAO-09-15 (October 2008)

principles. NSF indicated that it currently pays management fees on seven of its cooperative agreements with non-profits corporations. These fees range from .5% to 2% of a project's total cost.⁹

On December 30, 2014, four weeks after this Committee's first hearing on the issue, NSF proposed a new management fee policy.¹⁰ NSF described the need for management fees for non-profits to pay for otherwise unallowable costs that are considered ordinary and necessary business expenses. It also included a non-exhaustive list of potentially, though not expressly stated, prohibited expenses such as alcohol, travel for non-business purposes, luxury items, and lobbying as set forth in the Uniform Guidance at 2 CFR 200.450. Furthermore, the proposal, while calling for an undefined periodic review, only *reduces* the amount of the management fee if the policy is not followed.

By comparison, a recent NASA final regulation prohibits paying a management fee that is otherwise unallowable under federal guidelines, effective December 15, 2014.¹¹ The rationale stated by NASA is that according to OMB Uniform Guidance: Cost Principles, Audit, and Administrative Requirements for Federal Awards, "Federal agencies are only authorized to pay for allowable, allocable, reasonable, and necessary costs." Under this standard, alcohol, excessive parties, and lobbying would be unallowable and thus prohibited.

In 2011, the Department of Defense (DOD) adopted a slightly different management plan for FFRDCs that posits management fees may be justified to cover certain non-reimbursable FFRDC expenses. The main features of DOD's policy: (1) require grant recipients to identify and justify each management fee expense in its fee proposal; (2) prohibit use of such fees for direct or indirect costs; and (3) require the submission of a comprehensive, annual fee review.

Contingency Costs

In order to keep MREFC project costs from escalating during construction, NSF instituted a no-cost overrun policy for MREFC-funded projects. "This policy requires that the total project cost estimate developed at the Preliminary Design stage have adequate contingency to cover all foreseeable risks, and that any cost increases not covered by contingency be accommodated by reductions in scope."¹² Program managers are required to maintain a contingency control log in order to notify NSF of all proposed uses of contingency funds.

According to the now former OMB Circular A-110, "The Budget Plan is the financial expression of the project or program as approved during the award process ... Recipients are required to report deviations from budget and program plans, and request prior approvals for budget and program plan revisions, in accordance with this section."

⁹ October 14, 2014 letter from NSF Director Cordova to Senators Charles Grassley and Rand Paul.

¹⁰ 79 Fed. Reg. 78497 (Dec. 30, 2014)

¹¹ 79 Fed. Reg. 67347 (Nov. 13, 2014)

¹² *National Science Foundation Large Facilities Manual*, March 31, 2011, p. 18.

Allowable contingency funds in a project budget are defined in the now former OMB Circular A-122 as costs that can be “foretold with certainty as to time, intensity, or an assurance of their happening.” A project contingency acknowledges that specific items within an approved project budget plan may be subject to change in cost (e.g., construction materials) that cannot be predicted with precision. However, Circular A-122, asserts that, “Contributions to a contingency reserve or any similar provision made for events the occurrence of which *cannot* be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable.”¹³ In this case, NEON included over \$150 million of questionable or unsupported contingency costs in their proposal. Given that this is ultimately the American taxpayer’s money, we expect NSF to explain why they awarded this cooperative agreement knowing that information.

¹³ OMB Circular A-122, pp. 26-7.”