



January 4, 2016

MEMORANDUM FOR: Ellen Herbst
Chief Financial Officer and Assistant Secretary for Administration

A handwritten signature in black ink, appearing to read "RB", with a long horizontal line extending to the right.

FROM: Richard Bachman
Assistant Inspector General for Audit

SUBJECT: *Complying with Uniform Guidance on Profit or Management Fees Under Federal Assistance Awards*
Final Memorandum No. OIG-16-013-M

The recently adopted “Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards” (“Uniform Guidance”) allows for, but does not require, award recipients (“recipients”) to receive a profit or management fee under grants and cooperative agreements. The guidance becomes especially relevant as cognizant federal agencies of the numerous recipients of Department of Commerce funding develop policies and procedures to control the awarding of profit or management fees. The Department, as a steward of public funds, must decide now how profit or management fees will be controlled.

In fiscal year (FY) 2014, the Department awarded \$1.2 billion in grants for a wide range of purposes, from economic development to atmospheric research. Given the size of the Department’s financial assistance portfolio, allowing recipients a profit or management fee will require an increase in funding or a decrease in the amount of work or research performed to support paying recipients a profit or management fee.

In this memorandum, we provide background discussion of how costs were previously considered—according to U.S. Office of Management and Budget (OMB) circulars—and the changes under the new Uniform Guidance. We then discuss implementation of the new Uniform Guidance—including potential issues that may arise—and respond to the Department’s current position on grantee profit and management fees. Finally, we offer recommendations for the Department moving forward.

Background

In December 2014, a total of 28 federal awarding agencies formally adopted the new Uniform Guidance, which streamlines previous OMB guidance into a single, comprehensive policy guide.¹

¹ 2 C.F.R. Part 200.

OMB focuses on this Uniform Guidance in a Controller Alert, “Management Fees or Profit under Federal Assistance Awards” (dated April 19, 2015), regarding whether to allow grant/cooperative agreement recipients to earn fees or profit under federal awards.² (The Controller Alert is included with this memorandum as appendix A.)

Implementation of the Uniform Guidance was the culmination of a 3-year collaborative effort across federal agencies, with public comment, to focus federal grant resources on improving performance and outcomes while promoting sound financial management of taxpayer dollars. This new reform reduces the administrative burden for non-federal entities receiving federal awards while reducing the risk of waste, fraud, and abuse. Before the Uniform Guidance, the treatment of costs under federal grants and cooperative agreements with educational institutions and nonprofit organizations was set by OMB Circulars A-21 (educational institutions) and A-122 (nonprofit institutions). While in effect, neither OMB Circular specifically addressed the allowability of the type of profit or management fees discussed in this memorandum. Likewise, the Uniform Guidance—which superseded the OMB Circulars beginning December 26, 2014—does not specifically address profit or management fees. It does address the concept of “profit” in broad terms: “The non-Federal entity may not earn or keep any profit resulting from Federal financial assistance, unless explicitly authorized by the terms and conditions of the Federal award.”³ The Council on Financial Assistance Reform (COFAR) has explained that this provision in the Uniform Guidance was intended only to make this long-standing requirement explicit for purposes of accountability and oversight.⁴

In accordance with the new Uniform Guidance, profit is typically unallowable. However, the Guidance does maintain the prior flexibilities for federal awarding agencies to allow award recipients to earn profit when expressly authorized by the terms and conditions of the federal award.⁵ Furthermore, in practice, federal awarding agencies treat management fees earned under grants and cooperative agreements as profit.

Implementation

Fees under appropriate circumstances

The Uniform Guidance allows for the use of either profit or management fees only in appropriate circumstances. Typically, federal awarding agencies permit management fees or profit in grants and cooperative agreements only in circumstances when the viability of the project may be at risk because the recipient organization has limited or no financial resources to cover certain ordinary and necessary business expenses that may not be reimbursable under the governing cost principles. For example, awards for construction or operations of large

² Office of Management and Budget, April 19, 2015. *Controller Alert: Management Fees or Profit under Federal Assistance Awards*. Washington, DC: OMB. Much of the information and discussion of the Uniform Guidance contained in this memorandum is taken from this Controller Alert.

³ 2 C.F.R. § 200.400(g).

⁴ OMB, *Frequently Asked Questions for OMB’s Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, at 2 CFR 200* [online]. <https://cfo.gov/wp-content/uploads/2014/08/2014-08-29-Frequently-Asked-Questions.pdf> (accessed September 28, 2015).

⁵ 2 C.F.R. § 200.400(g).

facilities may benefit from management fees or profit. For Small Business Innovative Research (SBIR) and Small Business Technology Transfer (STTR) awards, management fees or profit are required in accordance with the Small Business Administration (SBA) SBIR and STTR policy.⁶

As a point of comparison regarding appropriate payment of profit or management fees, NASA published a final rule in a November 13, 2014, *Federal Register* notice that would prohibit that agency from paying a profit or fee to recipients of grants or cooperative agreements.⁷ That rule, which became effective on December 15, 2014, defines “profit or fee”—explicitly including management fees—as the amount above allowable costs. NASA’s notice explains that payment of fees or profits is inconsistent with the intent of financial assistance awards (e.g., 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 stated that “[t]he intent of this rule is to clarify this point that NASA will not pay for profit or fee where profit or fee is defined as the amount above allowable costs. Management fees that are allowable costs within the guidelines established in [OMB Uniform Guidance] will continue to be paid.”⁸

Potential issues

Without explicit government wide or agency-specific guidelines, questions will continue to arise about how profit or management fees are awarded and used. And questions about the risk of misuse, at public expense, will remain. For example, the National Science Foundation (NSF) was recently queried by United States Senators Charles Grassley and Rand Paul about the widespread use of management fees to awardees where NSF is the cognizant federal agency.

A Defense Contract Audit Agency audit report of an NSF cooperative agreement holder identified the management fee as payment for lobbying, parties, and coffee services. NSF’s widespread use of management fees to awardees affects the Department of Commerce and its bureaus as well. For example, in FY 2014 the Department had \$25,115,552 awarded to the University Corporation for Atmospheric Research (UCAR), for which NSF has cognizance—and on which UCAR, according to UCAR’s policy on management fees, can collect a management fee of 3 percent (or \$753,466).

UCAR states that the fee represents contributions to UCAR’s general fund to cover expenses necessary for UCAR corporate operations not included in the direct awards budget. However, UCAR has a lobbying office in Washington, DC that cannot be paid for using the management fee. Management fees, unlike the fees paid to government contractors, cannot be used to pay for inappropriate activities, including lobbying or alcoholic beverage purchases.

Any Department award may be subject to profit or management fees, unless the Department takes a proactive approach to preserve public funds for the purpose of the grant or cooperative agreement, while allowing recipients to charge a management fee or earn profit in instances where this is appropriate and in the best interest of the public.

⁶ OMB Controller Alert: *Management Fees or Profit under Federal Assistance Awards*.

⁷ 79 Fed. Reg. 67347 (Nov. 13, 2014).

⁸ 79 Fed. Reg. 67347, 67348 (Nov. 13, 2014).

The Department's Position on Grantee Profit and Management Fees

The Department currently reviews requests for profit or management fees; however, in accordance with a Department Office of General Counsel (OGC) conclusion, profit or management fees are generally not allowed unless specifically authorized by law. The Department, in reply to a March 6, 2015, OMB data call request about profit and management fees, stated that

[t]he Department of Commerce (DOC) does not award management fees/profits to assistance recipients unless there is a statute that allows them to be awarded. Prior to 2008, DOC did permit fees/profits, but a request by a recipient for such a fee prompted an extensive legal review of that policy. The DOC Office of General Counsel concluded that, as a matter of law, it is not permissible to pay such fees/profits on assistance unless there is an authorizing statute. The DOC position is spelled out in detail in the attached document (It's the Law, "Paying Fee or Profit on Grants and Cooperative Agreements", Vol. 17, January 4, 2008). This conclusion was also incorporated into the DOC *Grants Manual*.

The Department further stated in an email dated October 29, 2015, that

[i]t currently is the view of DOC that payments of fee or profit on financial assistance awards may be in conflict with the so-called 'purpose' statute, 31 U.S.C. 1301(a): "Appropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by law." This conclusion was heavily informed by Comptroller General decisions (see *In re Matter of: Department of Labor-Grant to N.Y. Worker's Comp. Bd.*, (B-303927 (June 7, 2005); 62 Comp. Gen. 701, 702 (1983); 42 Comp. Gen. 289 (1962)). There is an analogous purpose requirement in the Federal Grant and Cooperative Agreement Act (31 USC 6304(I).

However, since the release of the final 2015 Uniform Guidance, other government agencies are now allowing the payment of profit or fee, while, as discussed above, an earlier draft Guidance prompted NASA to issue its current policy to clarify that it specifically prohibits the payment of profit or fees that are not allowable costs. Further clarification and reconciliation of these differing approaches to the payment of profit or fees among government agencies may prompt the Department to change its position in the future. Therefore, we encourage Department management to consider our recommendations (see "Conclusion," below).

Conclusion

The Department should carefully consider establishing an appropriate justification process for allowing management fees or profit in the terms and conditions of any federal award.

Recommendations

We recommend that the Chief Financial Officer and Assistant Secretary for Administration ensure that

- I. agency controls be established and designated officials consulted on issues of policy or guidance on federal awards when determining whether management fees or profit are appropriate;

2. the Department receives and reviews a reasonable justification and explanation from each grant or cooperative agreement recipient that provides the intended use of any management fees or profit awarded;
3. Department policy or guidance identifies examples of inappropriate uses of management fees or profit (e.g., purchase of alcoholic beverages, entertainment, meals for non-business purposes, membership dues for social or sporting clubs, and lobbying); and
4. management fees or profit are not used to circumvent statutory or other limitations included in the terms and conditions of the award on otherwise allowable costs.

The final memorandum will be posted on the OIG's website pursuant to section 8M of the Inspector General Act of 1978, as amended. In accordance with Department Administrative Order 213-5, within 60 days of the date of this memorandum please provide us with an action plan that responds to all of the recommendations. If you have any further questions or comments, please contact me at (202) 482-2877 or Kenneth Stagner, Regional Inspector General for Audits, at (303) 312-7650.

Appendix A

Text of

Controller Alert: Management Fees or Profit under Federal Assistance Awards issued April 19, 2015.

Controller Alerts are designed to highlight emerging financial management issues that may require agency attention or action. These Alerts are intended to inform the Chief Financial Officer (CFO) community of key issues where the Office of Management and Budget (OMB) believes further action may be warranted, but do not constitute official guidance or prescribe specific tasks for agencies beyond consideration of appropriate steps to address the issue. Additional Controller Alerts can be viewed at <https://max.omb.gov/community/x/ihXjJg>.

This Controller Alert reminds Federal awarding agencies to exercise due diligence when considering whether to allow grant and cooperative agreement recipients to earn management fees or profit under Federal awards. This Alert also requests data from Federal awarding agencies regarding the prevalence of this practice.

Background

In December 2014, twenty-eight Federal awarding agencies formally adopted the *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (“Uniform Guidance”), which streamlined previous OMB guidance into a single, comprehensive policy guide (available at 2 CFR 200). Implementation of the Uniform Guidance is a culmination of a three-year collaborative effort across Federal agencies, with public comment, to focus Federal grant resources on improving performance and outcomes while promoting sound financial management of taxpayer dollars. This reform reduces administrative burden for non-Federal entities receiving Federal awards while reducing the risk of waste, fraud, and abuse.

In accordance with the Uniform Guidance, profit is typically unallowable; however, the guidance does maintain the prior flexibilities for Federal awarding agencies to allow award recipients to earn profit when expressly authorized by the terms and conditions of the Federal award, see 2 CFR §200.400. Furthermore, in practice, Federal awarding agencies treat management fees earned under grants and cooperative agreements as profit. Agencies should remember that the Uniform Guidance allows for the use of either management fees or profit only in appropriate circumstances, such as those highlighted below.

Allowance of Management Fees or Profit

Typically, Federal awarding agencies permit management fees or profit in grants and cooperative agreements only in circumstances when the viability of the project may be at risk because the recipient organization has limited or no financial resources to cover certain ordinary and necessary business expenses that may not be reimbursable under the governing cost principles. For example, awards for construction or operations of large

facilities may benefit from management fees or profit. For Small Business Innovative Research (SBIR) and Small Business Technology Transfer (STTR) awards, management fees or profit are required in accordance with the Small Business Administration (SBA) SBIR and STTR policy directives.[1]

This Alert reminds Federal awarding agencies to carefully consider whether there is an appropriate justification for allowing management fees or profit in the terms and conditions of the Federal award. This includes having agency controls, policy or guidance for Federal award officials to consult when determining whether management fees or profit are appropriate. For instance, Federal awarding agencies should review and receive a reasonable justification and explanation from the potential recipient that provides the intended use of the management fees or profits. Agency policy or guidance also should include examples of inappropriate uses of management fees or profit such as purchase of alcoholic beverages, entertainment, meals for non-business purposes, membership dues for social or sporting clubs, and lobbying. Management fees should not be used to circumvent statutory or other limitations included in the terms and conditions of the award on otherwise allowable costs. OMB has posted examples of agency best practices regarding management fees or profit to the Council on Financial Assistance Reform (COFAR) OMB MAX site at: <https://community.max.gov/x/0AcJg>.

Data Collection Request

OMB is collecting data to better determine: (1) the extent to which Federal awarding agencies allow grant and cooperative agreement recipients to earn management fees or profit; (2) the extent to which awards currently permit such fees or profit under the terms and conditions of the award; and (3) whether Federal awarding agencies have agency-specific policy or guidance regarding this practice. This data collection and associated instructions will be made available through the COFAR OMB MAX site at: <https://community.max.gov/x/0AcJg>. Responses to this data collection are requested by close of business May 29, 2015.

Please contact Gil Tran (Hai_M._Tran@omb.eop.gov) or Rhea Hubbard (RHubbard@omb.eop.gov) if you have questions on this data collection request.

[1] The SBA SBIR and STTR policy directives are available at: https://www.sbir.gov/sites/default/files/sbir_pd_with_1-8-14_amendments_2-24-14.pdf and http://www.sbir.gov/sites/default/files/sttr_pd_with_1-8-14_amendments_2-24-14.pdf, respectively.