**CERTIFIED MAIL – RETURN RECEIPT REQUESTED**

NOV 20 2012

John Healy
Director of Operations
Massachusetts Manufacturing Extension Partnership
100 Grove Street, Suite 108
Worcester, MA 01605

RE: Audit Resolution Determination Letter (ARDL)
Cooperative Agreement Number: 70NANB5H1144
Audit Report Number: DEN-18135

Dear Mr. Healy:

The National Institute of Standards and Technology (NIST) has reviewed the referenced audit report and determined that a **$1,051,452** refund is due NIST, within 30 days from the receipt date of this ARDL. Enclosed is a summary of the financial and non-financial findings reported in the audit report and our resolution of them.

The NIST records that support this ARDL are the audit report, your organization's post-audit response, the NIST official award file, and the enclosure to this letter. You have a right to appeal the NIST decision. If you decide to appeal this decision, two (2) copies of your written appeal and supporting documentation must be submitted to NIST and one (1) copy to the Office of Inspector General within 30 days after your receipt of this letter. Your appeal should be mailed to the attention of:

Patrick Gallagher
Director
National Institute of Standards and Technology
100 Bureau Drive
Building 101, Mail Stop 1000
Gaithersburg, Maryland 20899-1000

An additional copy of any appeal should be sent to:

Ann Eilers
Principal Assistant Inspector General for Audit and Evaluation
1401 Constitution Avenue, NW
Rm. 7886B
Washington, DC 20230

Your appeal must contain an explanation of your dispute with this Audit Resolution Determination and include any supporting documentary evidence or reference documents previously submitted to NIST. NIST will consider all information submitted in a timely manner. The appeal of this Audit Resolution Determination is your last opportunity to provide available information to support any dispute of the account receivable or any other aspect of this determination. There are no other administrative appeals available in NIST or the Department of Commerce concerning this matter. When a final decision has been rendered on any appeal, you will be notified of that decision by letter.

NIST will bill your organization for the amount owed 30 days post-receipt of this ARDL. The debt should be paid in one lump sum. Any interest earned on the amount owed must also be returned. You are also advised that funds used for payment of the debt must not come from other Federally funded projects or programs. Verification that other Federal funds have not been used may be made during future program visits or audits of your organization.

Failure to pay the debt by the due date will be considered grounds for any or all of the following: withholding payments under any current NIST awards to your organization; termination of any active NIST awards; referral to a debt collection agency or credit reporting bureau; collection through administrative offset; and may have a negative impact on future funding possibilities by NIST.

Appropriate corrective action will be taken retroactively regarding any debt that is established if the Audit Resolution Determination is modified on appeal. If a debt established by an Audit Resolution Determination is subject to administrative offset, receipt of an appeal may stay the offset of funds in accordance with 15 CFR 21.

An appeal does not prevent the establishment of an audit-related debt, nor does it prevent the accrual of interest on the debt. The Federal Claims Collection Standards provide that the rate of interest assessed on the debt shall be the current value of funds to the U.S. Treasury. At this time, that rate is *one (1) percent per annum*. Interest will continue to be charged until collection or final disposition of the debt.

If your debt becomes delinquent, it will be assessed both as an administrative charge to cover the cost of processing and handling the delinquent claim and a penalty charge not to exceed one (1) *percent per annum* on any portion of the debt that is delinquent for more than 90 days.

Please direct any questions regarding this matter to Leon Sampson at 301-975-3086.

Sincerely,

George Jenkins
Acting Chief, Grants and Agreements Management Division

Enclosure
cc: K. Stagner, A. Katsaros

## SUMMARY OF AUDIT RESOLUTION

Massachusetts Manufacturing Extension Partnership
Hollings Manufacturing Extension Partnership (MEP)
Cooperative Agreement Number: 70NANB5H1144
Audit Report Number: DEN-18135

The NIST records that support this audit resolution are the audit report, your organization's post audit response, the NIST official award file, and the information delineated below.

The Office of Inspector General (OIG), Denver Regional Office of Audits, conducted a financial and compliance audit of costs claimed by the Massachusetts Manufacturing Extension Partnership (MEP), the Recipient under the subject NIST Cooperative Agreement Number 70NANB5H1144. The audit covered the 12-month period of July 1, 2005, through June 30, 2006, and the OIG examined claimed project costs in the amount of $9,392,908. On April 30, 2009, Massachusetts MEP responded to the final audit report issued by the OIG. All comments were considered when developing this audit resolution.

## FINANCIAL FINDINGS

**1. Brief Statement of Findings and Recommendations:**

$4,167,430 in Questioned Subrecipient Costs

The OIG questioned $4,167,430 of costs incurred by two subrecipients, the Association for Manufacturing Excellence (AME) and Associated Industries of Massachusetts (AIM). According to the OIG, neither subrecipient could provide documentation demonstrating that its claims were based on actual costs incurred under Massachusetts MEP's subawards. Rather, both subrecipients reported large portions of their annual operating expenses as costs under the subawards. In addition, the OIG stated that neither subrecipient had written procedures in place to determine whether the amounts reported to Massachusetts MEP met allowability criteria established by applicable Federal cost principles.

A. Association for Manufacturing Excellence (AME)

The OIG cited the following concerns about the AME subaward, which resulted in the OIG questioning all of the $3,235,273 in costs claimed to NIST under the subaward.

(1) Allowability of costs based on the practice used to report costs to Massachusetts MEP in a manner that is not compliant with 15 CFR § 14.21.

(2) Significant understatement of program income reported to NIST since none of AME's revenue was included in the program income reported to NIST.

Total revenue reported in the unaudited financial statements from AME was approximately $3.8 million.

(3) Overstatement of indirect costs under the subaward, in that, under its practice of removing line items from total AME expenditures, Massachusetts MEP did not make corresponding reductions to the "General & Administration" costs.

B. Associated Industries of Massachusetts (AIM)

The OIG cited the following concerns about the AIM subaward, which resulted in the OIG questioning all of the $932,157 in costs claimed to NIST under the subaward.

(1) AIM reported expenditures that are not actual costs but estimates based on the organization's lobbying activities and membership mix.[1] This approach is non-compliant with 15 CFR § 14.21.

(2) The questionable validity of Massachusetts MEP's relationship with AIM as a valid subaward, based on a meeting with AIM's CFO during which he adamantly insisted that AIM was not a subrecipient to Massachusetts MEP.

(3) The form and structure of the subaward agreement in that it lacked the following:
   (A) A detailed budget, as required by NIST MEP's Operating Plan Guidelines.
   (B) No mention of NIST as the funding agency.
   (C) No reference to the applicable administrative and cost principles of 15 CFR, Part 14 (administrative), and OMB Circular A-122 (cost principles).
   (D) Grants Officer approval of the subaward in the amount of only $36,000 for the period July 1, 2005, through June 30, 2006. The OIG stated in the final audit report:

> *"There was nothing in either the agreement between Massachusetts MEP and AIM, or in NIST's cooperative agreement terms and conditions that indicated AIM would incur more than $900,000 in subaward expenses during the 1-year performance period."*

1 According to the OIG, AIM calculated its subaward cost claim by accumulating all costs incurred in three line items: salaries and benefits, taxes and insurance, and rent and utilities. AIM then reduced the figure by a factor to account for the percentage of its total costs related to lobbying activities. AIM claimed that 24.1% of its operations were dedicated to lobbying activities during the subaward performance period. Finally, AIM multiplied the calculated amount by a factor to reflect the percentage of AIM member companies that are manufacturers, which it claimed was 27.9%.

*"If NIST were to conclude that any of these costs are allowable, it should not accept more than the $36,000 approved in the terms of the Massachusetts MEP's cooperative agreement for the period July 1, 2005, through June 30, 2006."*

- **Recipient's Response:**

In its response dated April 30, 2009, Massachusetts MEP argued that all questioned subrecipient costs should be allowed. Its contention that the audit report erred is based on the following:

(1) Massachusetts MEP argues that the two organizations (AME and AIM), or "partners," are not subject to 15 CFR § 14.21 because they are not "subrecipients," and that their contributions to cost share claimed by the auditee should be evaluated instead against the requirements of 15 CFR § 14.23.

(2) Massachusetts MEP contends that § 3003(a)(3)(C) of the America COMPETES Act ("ACA" or "COMPETES Act"), Pub. L. No. 110-69, codified at 15 USC § 278k(c)(3)(C), a legislative amendment to the MEP Program's authorizing statute, requires the government to defer to an MEP Center's determination of the reasonableness and allocability of its own claimed cost share.

(3) Massachusetts MEP argues that a documentation requirement regarding contributions of personnel time set forth in General Term and Condition 14 of the cooperative agreement is procedurally defective under 15 CFR § 14.4.

(4) Massachusetts MEP argues that the applicable documentation standard for third-party in-kind contributions is set forth in 14 CFR § 14.23, especially subsections (a) and (h)(5)(i).

Additionally, the recipient asserts that the confusion about whether the partners are subrecipients or not arises from NIST Operating Guidelines of March 2005. Further, Massachusetts MEP provided the following responses specific to each of the two sources that comprised the questioned subawards.

(A) Association for Manufacturing Excellence (AME)

Massachusetts MEP's response indicates that the operating plan, approved by NIST, describes the specific costs that AME was to, and did, incur. Further, the recipient stated there was no reporting income by AME because AME does not produce any program income in accordance with the definition of "program income" in 15 CFR § 14.2 (aa).

(B) Associated Industries of Massachusetts (AIM)

As outlined in the recipient's response, AIM does not track its costs related directly to its activities on behalf of manufacturers. Therefore, Massachusetts MEP and AIM agreed to an allocation method based upon the percentages of manufacturing members. Massachusetts MEP stated that *"the method of allocation was reviewed by and received approval from the NIST Program Officer, Grants Officer, and legal counsel. Massachusetts MEP established a reasonable basis for the valuation and meets the documentation standard for in-kind contributions under 15 CFR § 14.23(h)(5)."*

- **Resolution Actions:**

OVERVIEW

NIST agrees with Massachusetts MEP that neither AME nor AIM were subrecipients and thus were not required to comply with 15 CFR § 14.21. As discussed below, NIST has determined that the costs claimed for expenses incurred by AME properly should be considered third-party in-kind contributions. On the other hand, AIM was neither a subrecipient nor a third party contributor, but rather was a vendor of Massachusetts MEP. We evaluate the claims related to these two entities and conclude that the expenditures of AME benefitted itself as well as, and likely more than, they benefitted Massachusetts MEP and that there are insufficient grounds to allocate the relative benefits between them. We also conclude that none of the costs incurred by AIM are allowable, although $36,000 provided to AIM by Massachusetts MEP is allowable as a direct cost.

NIST finds that Massachusetts MEP's argument that the America COMPETES Act amendment, codified at 15 USC § 278k(c)(3)(C), gave Centers unreviewable final authority to determine the reasonableness or allocability of third-party contributions is flawed. NIST also rejects Massachusetts MEP's contentions that the documentation requirements of General Term and Condition 14 are invalid, and in so doing we reject the applicability of the documentation requirements of 15 CFR §14.23(h)(5)(i) to any but third-party in-kind contributions of "volunteer services." Finally, while Massachusetts MEP correctly notes that 15 CFR § 14.23(a) applies to third-party contributions, we note that such cost share contributions are, nevertheless, also subject to the documentation requirements of the award, the Program's regulations, and the applicable cost principles.

Following we discuss the issues raised by Massachusetts MEP's response to the final audit report, following which we consider the Center's cost share claims in light of this analysis.

a. Subrecipients:

A subrecipient is *"the legal entity to which a subaward is made and which is responsible to the recipient for the use of the funds provided."* 15 CFR § 14.2(jj) A subaward is an award of financial assistance in the form of money, or property in lieu of money, made under an award by a recipient to an eligible subrecipient or by a subrecipient to a lower

tier subrecipient. The term subaward includes financial assistance when provided by any legal instrument, even if the agreement is called a contract; conversely, simply denominating a relationship as between a recipient and a subrecipient does not create a subaward. The term subaward does not include the procurement of goods and services; nor does it include any form of assistance which is excluded from the definition of "award" in subparagraph (f) of 15 CFR § 14.2(ii).[2]

Massachusetts MEP argues that it is inappropriate to categorize its partners[3] as subrecipients because they did not receive Federal funds or property purchased with Federal funds, or other property from Massachusetts MEP. We evaluate the nature of Massachusetts MEP's relationship with AME and AIM, and the status of those entities as subrecipients, separately because they present significant distinctions.

Association for Manufacturing Excellence (AME)

We note that Massachusetts MEP itself appears to have considered AME to be its subrecipient during the audit period and for at least two years thereafter. Its agreement with AME that was operative for the audit period was denominated a "Recipient/Sub-Recipient Agreement" and stated that Massachusetts MEP would "make a sub-award of Federal financial assistance." Its operating plans during that time period (through June 30, 2008) referred to AME as a subrecipient. Moreover, Massachusetts MEP did not contest the characterization of AME as a subrecipient in its response to the draft audit report. It was not until its response to the final audit report that Massachusetts MEP first advanced the argument that AME was a third-party contributor.[4]

Nevertheless, a subrecipient relationship in name only is fictive, and NIST's review uncovered no financial assistance provided to AME by Massachusetts MEP in the form of either money or property in lieu of money. Indeed, it appears that there were no monetary payments of any kind from Massachusetts MEP to AME during the period subject to audit. Consequently, AME was not a subrecipient of Massachusetts MEP, and

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2 Subparagraph (f) of § 14.2 excludes from the definition of award *"technical assistance, which provides services instead of money,"* [as well as certain] other forms of assistance [such as] *" ... loans, loan guarantees, interest subsidies, or insurance; direct payments of any kind to individuals; and, contracts . . . "*

3 15 CFR § 14.2 provides no definition of the term "partners." While the term may accurately describe certain relationships a Center will have with other entities and otherwise be helpful, it is of no relevance when determining the obligations owed by the Center or the other entities under the terms and conditions of the award from NIST to the Center.

4 NIST also rejects Massachusetts MEP's contention that changes to the program's Operating Plan Guidelines adopted in 2005 required MEP Centers to cast all agreements with their partners as subrecipient agreements and to include the flow-down provisions applicable thereto. This contention is untrue.

any contributions made by AME to Massachusetts MEP would have been those of a third-party contributor not subject to the documentation requirements of 15 CFR § 14.21.[5]

Associated Industries of Massachusetts (AIM)

We note that, while the agreement between Massachusetts MEP and AIM is not itself called a subrecipient agreement, Massachusetts MEP's operating plans for the audit period and for at least two years thereafter referred to AIM as a subrecipient and referred to the agreement as a subrecipient agreement.

Unlike the situation with AME, however, Massachusetts MEP did provide financial assistance to AIM; Massachusetts MEP gave AIM $3,000 each month, or $36,000 annually. Massachusetts MEP states that these monies *"are not Federal funds that Massachusetts MEP receives under the cooperative agreement. Instead . . .* [they are] *State funds."* As near as NIST has been able to determine, the *"State funds"* provided to AIM by Massachusetts MEP are from monies that it received from the Commonwealth of Massachusetts as cost share under this cooperative agreement. In short, the funds are received by Massachusetts MEP under this award, and the use of those funds by Massachusetts MEP – the payment of them to AIM – is under this award. That they are State funds is a distinction without a difference. They are project funds, and as a recipient of project funds AIM cannot be a third-party contributor. It is difficult based upon the information available to determine whether the $3,000 monthly transaction is in the nature of a subaward to or a contract with AIM. Fortunately, it is not necessary to make that determination in order to be able to resolve this issue, because the claimed costs that were incurred by AIM are not allowable in either event. If AIM is a vendor, it cannot be a third-party contributor, and if AIM is a subrecipient, the financial management system and reporting deficiencies identified by the OIG final audit report apply.[6]

In sum, NIST considers AME to be a third-party contributor and AIM to be a vendor of Massachusetts MEP. A number of consequences flow from these determinations. First, AIM's claimed contributions are not allowable. Second, while AME is not required to satisfy the standards for financial management set forth in 15 CFR § 14.21, and the other

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5 Third-party in-kind contributions are *"the value of non-cash contributions provided by non-Federal third parties . . . [and] . . . may be in the form of real property, equipment, supplies and other expendable property, and the value of goods and services directly benefiting and specifically identifiable to the project or program."* 15 CFR 14.2(nn)

6 We note though that the AIM CFO "adamantly insisted" to the OIG that AIM was not a subrecipient of Massachusetts MEP, and stated that *"he had made it clear to Massachusetts MEP throughout the course of . . .* [AIM's] *working relationship with the partnership that AIM had no desire to be a subrecipient."* See final audit report at page 6. Additionally, the periodic nature of identical payments by itself suggests a recipient/vendor rather than recipient/subrecipient relationship. In this regard, we note that while "partners" is a generic term that can be applied to accurately characterize numerous types of collaborative and supporting relationships that a Center may have with other entities or organizations, the term has no specific meaning and is of no consequence in the context of determining the allowability of such another entity's incurred or contributed in-kind costs. In sum, it appears more likely that AIM was a contractor rather than a subrecipient of Massachusetts MEP.

provisions of 15 CFR Part 14 applicable to subawardees under § 14.5 do not flow down to it, all contributions to Massachusetts MEP from AME are subject to the standards of 14 CFR § 14.23, the Program regulations, the terms and conditions of the award, and the applicable cost principles.

b. Section 3003(a)(3)(C) of the America COMPETES Act (ACA):
Massachusetts MEP contends that the ACA, which clarified that a Center's authority to determine whether non-Federal costs contributed by third parties are programmatically reasonable and allocable under MEP Program procedures and thus includable as a portion of the Center's cost share, precludes an independent government determination of the reasonableness, allocability, and allowability of such included costs. In essence, Massachusetts MEP contends that the Federal government is required to allow, apparently as a ministerial function, all non-Federal costs claimed by a Center.

The OIG correctly rejected Massachusetts MEP's argument that § 3003(a)(3)(C) of the COMPETES Act gave centers unreviewable final authority to determine the reasonableness or allocability of third-party contributions. Massachusetts MEP's proposed construction of the amendment is simply not supported by the provision's text. The critical provision provides that:

> *"All non-federal costs contributed by such entities and determined by a Center as programmatically reasonable and allocable under MEP program procedures are includable as a portion of the Center's contribution."* 15 USC § 278k(c)(3)(C).

Massachusetts MEP's proposed interpretation is overreaching; it ignores entirely the qualifying phrase "under MEP Program procedures" and it stretches the meaning of the term "includable" beyond that which makes sense in the context in which the term is employed. Massachusetts MEP in essence argues that the term "includable" really means "to be allowed by NIST." Instead, it makes most sense and is most reasonable that the unidentified actor doing the including in the latter part of the sentence is the same actor that is identified in the beginning of the sentence as making the determinations, that is, the Center. Also, as the OIG noted, the term "includable" is permissive and not mandatory. NIST agrees upon the understanding that "those costs" refers to contributed costs incurred by third parties. If a center determines that contributed third-party costs are reasonable and allocable, they may include them as non-Federal costs that the Center claims. They are, of course, not obligated to include all such contributed costs; they may have non-Federal contributions that exceed their cost share obligations.

Moreover, Massachusetts MEP's proposed construction would represent a drastic departure from well-established government-wide policies under which the ultimate determination that a recipient of Federal financial assistance made proper use of those monies is made by the agency that dispensed them and not by the recipient that received them. Massachusetts MEP's proposed interpretation of the provision is simply too strained to support such a departure from well-established law. The COMPETES Act did not disturb the bedrock principle that the final authority to determine the reasonableness,

allocability, and allowability of all costs claimed by recipients of MEP awards rests with the government.

Finally, Massachusetts MEP misapprehends the audit report when it contends that the OIG's refusal to apply Massachusetts MEP's proposed construction of § 3003(a)(3)(C) in this audit also was premised upon a determination that the provision, which was enacted subsequent to the period of time subject to this audit, does not apply retroactively. The OIG in fact determined that the statute does apply retroactively. OIG did not apply Massachusetts MEP's proposed construction of the provision because it rejected that construction.[7]

c. Cost Sharing and Matching General Term and Condition 14:

The award General Term and Condition (GTC) relating to cost sharing and matching for the time period subject to this audit[8] required Centers to provide the following documentation in support of contributions of personnel time:

- Projects/tasks worked;
- Dates worked;
- Number of hours;
- Hourly salary rate and allowable fringe benefits paid; and
- Certified time and attendance records.

GTC 14 also provides that *"Third Party In-Kind Contributions must be evidenced by written documentation that is signed by the contributor and Center that describes the contribution, its value, and when and for what purpose it was donated."*

Massachusetts MEP claims that under 15 CFR § 14.4 these documentation requirements for contributions of personnel required the approval of the Office of Management and Budget (OMB) because they are *"in excess of the matching cost standards set forth in 15 CFR § 14.23."* Massachusetts MEP is incorrect. GTC 14 addresses documentation requirements not addressed in 15 CFR § 14.23. As Massachusetts MEP notes, 15 CFR § 14.23(a) sets forth criteria applicable to all cost share contributions, as follows:

(1) Are verifiable from the recipient's records.
(2) Are not included as contributions for any other federally assisted project or program.

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7 Moreover, as the OIG explained, had it agreed with Massachusetts MEP's interpretation of the statute, the amendment would not have retroactive applicability because that interpretation would substantively have changed prior law, and substantive changes of prior law are not to be given retroactive application by implication.

8 The General Terms and Conditions (GTCs) issued by the Program in June 2005, numbered the GTC relating to cost share and matching as GTC 13. The identical term was numbered 14 in the subsequent (April 2006) set of GTCs. Massachusetts MEP's response to the final audit report references GTC 14 when discussing this issue. For convenience, we do so as well in this document.

(3) Are necessary and reasonable for proper and efficient accomplishment of project or program objectives.
(4) Are allowable under the applicable cost principles.
(5) Are not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching.
(6) Are provided for in the approved budget.
(7) Conform to other provisions of this part [14], as applicable.

While section 14.23(a) establishes criteria applicable to all cost share contributions, it establishes no documentation requirements for any particular type of contribution. The Center recognizes as much when it asserts that the applicable documentation requirements are set forth in 15 CFR § 14.23(h)(5)(i).[9] Indeed, nowhere does 15 CFR § 14.23 establish documentation requirements that apply to contributions of personnel. It only says that they shall be documented. 15 CFR §14.23 (h)(5)(ii) And, inasmuch as there can be no dispute but that under § 14.23(a)(1) such costs must be supported by records, the documentation requirements of GTC 14 satisfy an interstitial need not addressed by Part 14. They do not provide an exception from and are not inconsistent with that Part. Similarly, they combine and are in accord with the applicable cost principles. See 2 CFR Part 230 (A-122) App. B.8.m.

d. Allocability:

Even though AME, which the OIG considered to be a subrecipient is actually a third-party in-kind contributor, its contributions are nevertheless required to satisfy the documentation requirements of 15 CFR § 14.23; the reporting requirements listed in the entities' agreements with Massachusetts MEP; applicable MEP General Terms and Conditions; and applicable cost principles. We here address certain applicable requirements of allocability when costs inure to the benefit of both an award and to other activities as set forth in the cost principles and as clarified in the ACA.

A basic consideration of the cost principles is that *"[t]o be allowable under an award, costs must . . . [b]e reasonable for the performance of the award and allocable thereto . . ."* 2 CFR Part 230 (A-122), App. A.2.a.
The cost principles further explain the concept of allocability:

> A cost is allocable to a particular cost objective such as a grant . . . **in accordance with the relative benefits received**. A cost is allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

9 While section 14.23(h)(5)(i) does address documentation requirements, it only applies to contributed "volunteer services." Volunteer services are unpaid services contributed by the volunteer. They are not paid personnel services contributed by a third-party employer. The claimed personnel services that are here at issue were not volunteer services; thus, section 14.23(h)(5)(i) is not applicable to those expenses.

(1) Is incurred specifically for the award;
(2) **Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received**; or
(3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown. Id. at § A.4.a.

In its discussion of third-party contributor costs, the OIG discussed third-party services that "directly benefit" and are "specifically identifiable to the Massachusetts MEP project." That statement derives from GTC 14, applicable to Massachusetts MEP during the audited period, and from 15 CFR. § 14.2(nn).

We note, however, that the COMPETES Act was enacted in the interim, and by specifically addressing the nature of the nexus between third-party activity and an MEP award sufficient for such activity to be eligible as a non-Federal cost share contribution it clarified the "directly benefit" and "specifically identifiable" allocability components of third-party contributions.

Section 3003(a) of the ACA provides that:

> *"In meeting . . . its [cost share] requirements, it is anticipated that a Center will enter into agreements with other entities . . . to accomplish programmatic objectives and access* ***new and existing resources that will further the impact of the Federal investment*** *made on behalf of small- and medium-sized manufacturing companies. All non-Federal costs, contributed by such entities and determined by a Center as programmatically reasonable and* ***allocable under MEP program procedures*** *are includable as a portion of the Center's contribution."*

*Codified at* 15 USC § 278k(c)(3)(C).

The legislative clarification further provides:

> *[C]osts incurred means the costs incurred in connection with the activities undertaken to improve the management, productivity and technological performance of small- and medium-sized manufacturing companies.* Id. at § 278k(c)(3)(B)

In short, the ACA clarified that both "new and existing" contributed costs can "benefit" an MEP Center so long as they "further the impact of the Federal investment made [to that Center] on behalf of small- and medium-sized manufacturing companies," are "incurred in connection with the activities undertaken to improve the management, productivity and technological performance of small- and medium-sized manufacturing companies," and are otherwise "programmatically reasonable and allocable under MEP

program procedures." These legislative pronouncements thus require that the contribution must enhance the operation or output of the Center to which it is made and be in compliance with all other award terms and conditions, including, for example, the cost principles' provision that contributions benefitting "both the award and other work" must be distributed "in reasonable proportion to the benefits received."

DISCUSSION

Having determined that AIM is either a subrecipient or, more likely, a vendor of Massachusetts MEP and that AME properly should be considered a third-party in-kind contributor, NIST has reviewed Massachusetts MEP's $4,167,430 claimed expenses for their costs.

As noted above, it is a conflict and impermissible for a grantee's vendor to make contributions to that recipient, and there is no dispute but that the substantiation and documentation of AIM's claimed costs do not satisfy the standards applicable to the contributions of a subrecipient. Therefore, whether it's a vendor or a subrecipient, all claims for costs contributed by AIM, that is, $932,157, are not allowable. As to claims for costs incurred by AME totaling $3,235,273, NIST has determined that the documentation Massachusetts MEP provided is insufficient and does not satisfy the requirements of GTC 14, or the cost principles, 2 CFR Part 230 (A-122), App. A. section A.4. and App. B. section 8.m.

Most importantly, NIST is unable to determine how Massachusetts MEP identified and extrapolated specific costs incurred by AME as allocable, award-related costs.[10] It certainly appears, as the OIG stated, that Massachusetts MEP simply selected and claimed certain costs after reviewing the financial reports of AME's normal operating expenses and backing out those that are unquestionably unallowable.

At bottom, Massachusetts MEP has claimed 100% of AME's operating costs, including but not limited to, salaries (including fringe), office expenses, rent, telephone, stationary, printing, office supplies, and travel and meeting expenses for activities – principally national and regional conferences, at which Massachusetts MEP participated, and the publication of the association's trade magazine, to which Massachusetts MEP contributed – that Massachusetts MEP considers consistent with the goals of the MEP program, generally

10 In its response to the audit report Massachusetts MEP contends that AME's costs were reviewed and specifically approved when authorized NIST officials approved the Center's operating plans for the audited time period. However, NIST's approval of an operating plan that identifies anticipated sources and amounts of matching in-kind costs, and the nature of activities supported by such expenses, like its approval of a budget, is not itself an allowability determination, nor is it a guarantee that upon audit and review the anticipated costs will be determined reasonable or allocable. Rather, it is an approval based upon the information provided that as a general matter the planned relationships and activities are understood to be consistent with program objectives. Moreover, contrary to Massachusetts MEP's assertion, NIST's approval of the operating plans did not include any specific approval of the claimed AME costs. Finally, if it were true that NIST approval of an operating plan is the final word on these questions, the OIG questioning of AME's costs on the ground that they were not documented in compliance with the requirements of a subrecipient would stand because the Center's NIST-approved operating plan identified AME as a subrecipient.

reduced by a percentage amount that was unrelated to small- and medium-sized manufacturers. However, as discussed above, under the cost principles, costs that mutually benefit the recipient and the contributor are allocable only if they can be distributed in reasonable proportion to the benefits received. Assuming for the sake of argument that Massachusetts MEP correctly deducted all AME costs that are not otherwise allowable and that the services supported by the remaining claimed costs provided some benefit to the Massachusetts MEP award, it is apparent that most, if not almost all, of those costs also benefitted AME, particularly inasmuch as the claimed expenses were for AME activities that in large part pre-existed, and presumably would have been incurred even without, its relationship with Massachusetts MEP.

Massachusetts MEP states that activities performed by third-party contributors such as AME *"are mutually beneficial to the [contributing entity], its members, the MEP Center's clients and the MEP Center,"* and explains that the activities of such contributing entities *"reduc[e] . . . duplication of activities"* and *"increase MEP mission effectiveness, penetration, and output."* That may be, but Massachusetts MEP failed to apportion the benefits that it received from the mutually benefitting efforts of AME, and has not provided grounds upon which NIST could make such a determination. Massachusetts MEP has neither identified increased costs incurred by AME as a result of providing services that benefit Massachusetts MEP's program, nor adequately explained how and the extent to which AME either changed its activities or integrated MEP services into their own activities for the purpose of reducing duplication of activities or increasing Massachusetts MEP's mission effectiveness. We reject as simply unreasonable the notion that, but for its relationship with AME, Massachusetts MEP would have undertaken to host conferences and publish a magazine to provide the MEP-related services that AME's conferences and its magazine provided, either in addition to, or instead of, the projects that the Center did undertake. There is no particular formula that would be applicable across-the-board for reasonably proportioning mutually beneficial costs between a Center and its third-party contributors. Instead, the distribution of costs will vary depending upon the unique circumstances of each relationship. There are, however, some factors that should be considered in all circumstances. For example, the extent to which any revenue that is generated by the activity of a third-party for which costs are claimed is shared with the recipient would be a reasonable reflection of the relative apportionment of the benefits. The benefits of existing resources being used by a contributing third-party as they had been prior to its partnering with an MEP Center without additional resources or supplemental effort or other modification necessarily accrue primarily to the contributing entity. The extent to which the recipient of contributed services can control the manner and timing of the delivery of those activities is an indication of benefits accruing to it. Predetermined quantitative and mutually agreed upon modifications to either the input or the results of contributed services would be useful indicators of the distribution or redistribution of benefits. Finally, as a general rule, the relative proportion of benefits received is likely to vary for different activities undertaken by a contributing third-party.

For all the above stated reasons, Massachusetts MEP's third-party costs could be disallowed in their entirety. However, NIST's review, and the MEP Program Office's familiarity with the operation and performance of the Massachusetts MEP Center under its award, including the nature and extent of cooperation and collaboration between the Center and AME,

convinces us that at least some of the AME activities for which claimed contributed costs were incurred indeed to some extent benefitted the award as well as AME even though no basis has been presented for proportioning those benefits. NIST therefore exercises its discretion and recognizes 25%, or $808,818, of the claimed total of $3,235,273 as in-kind contributions from AME as having been so incurred and thus allocable to the award. Recognizing, as did the OIG, that AME provided supporting documentation for its reported costs and that Massachusetts MEP reviewed those submissions, and not penalizing Massachusetts MEP's failure to comply with GT&C 14[11] because the Program has since abandoned those requirements, NIST further disallows 10% of those costs, or $80,881 ($808,818 x 10% = $80,881) because of inadequate documentation as to the apportionment of benefits. In sum, we disallow $3,439,493 of Massachusetts MEP's claimed subrecipient costs and third-party contributions and allow $727,937.

- **Financial Summary:**

| | | |
|---|---|---|
| A. | Costs Questioned: | $ 4,167,430 |
| B. | Costs to be Allowed: | $ 727,937 |
| C. | Costs to be Disallowed: | $ 3,439,493 |

- **Rationale and/or Legal Basis for Action:**

15 CFR, Section 2(g), *"Definitions,"* states:

> *"(g) Cash contributions means the recipient's cash outlay, including the outlay of money contributed to the recipient by third parties."*

2 CFR Part 230 (A-122), App. B.8.m. states:

> *"m. Support of salaries and wages.*
>
> *(1) Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports, as prescribed in subparagraph (2), except when a substitute system has been approved in writing by the cognizant agency. (See subparagraph E.2 of Attachment A.)*
>
> *(2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals)*

11 Two sets of GT&Cs applied during the audit period: one, issued June 2005, applied for the first nine months of the audit period; it was replaced by GT&Cs issued April 2006. The GT&C concerning the documentation of cost share was numbered 13 in the first set of GT&Cs and 14 in the later set. We here refer to GT&C 14 to be consistent with the audit report.

*whose compensation is charged, in whole or in part, directly to awards. In addition, in order to support the allocation of indirect costs, such reports must also be maintained for other employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s) (e.g., an employee engaged part-time in indirect cost activities and part-time in a direct function). Reports maintained by non-profit organizations to satisfy these requirements must meet the following standards:*

*(a) The reports must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.*
*(b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.*
*(c) The reports must be signed by the individual employee, or by a responsible supervisory official having firsthand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.*
*(d) The reports must be prepared at least monthly and must coincide with one or more pay periods."*

15 CFR 14.23 states, in part, the following:

*"(a) All contributions, including cash and third party in-kind, shall be accepted as part of the recipient's cost sharing or matching when such contributions meet all of the following criteria:*
*(1) Are verifiable from the recipient's records.*
*(2) Are not included as contributions for any other federally assisted project or program.*
*(3) Are necessary and reasonable for proper and efficient accomplishment of project or program objectives.*
*(4) Are allowable under the applicable cost principles.*
*(5) Are not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching.*
*(6) Are provided for in the approved budget.*
*(7) Conform to other provisions of this part, as applicable."*

15 CFR § 290.4 states, in part, the following:

> *"(c) Host contribution. The host organization may count as part of its share:*
> *(4) In-kind contributions of full-time personnel,*
> *(5) In-kind contribution of part-time personnel, equipment, software, rental value of centrally located space (office and laboratory) and other related contributions up to a maximum of one-half of the host's annual share. Allowable capital expenditures may be applied in the award year expended or in subsequent award years."*

2 CFR Part 230 (A-122), App. A. section A.2. states, in part:

> *"To be allowable under an award, costs must . . . [b]e reasonable for the performance of the award and allocable thereto under these cost principles . . ."*

2 CFR Part 230 (A-122), App. A, section A.4,a states, in part:

> *"A cost is allocable to a . . . grant . . . in accordance with the relative benefits received. A cost is allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:*
>
> ******
>
> *(2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received."*

Section 3003(a)(3)(C) of the COMPETES Act states, in part:

> *"All non-federal costs contributed by such entities and determined by a Center as programmatically reasonable and allocable under MEP program procedures are includable as a portion of the Center's contribution."* (15 USC § 278k(c)(3)(C).)*"*

§ 14.23(a)(1) states:

> *"(a) All contributions, including cash and third party in-kind, shall be accepted as part of the recipient's cost sharing or matching when such contributions meet all of the following criteria:*
> *(1) Are verifiable from the recipient's records."*

15 CFR § 14.2(ii) instructs, money has to be provided by the recipient as *"an award of financial assistance"* and not for the *"procurement of goods and services."*

15 CFR § 14.2(ii), Subparagraph (f) of § 14.2, in turn, excludes *"technical assistance, which provides services instead of money,"* as well as certain other forms of assistance from the definition of award.

15 CFR § 14.2(jj) states that a subrecipient is *"the legal entity to which a subaward is made and which is responsible to the recipient for the use of the funds provided."*

Hollings MEP General Term and Condition (GTC) 14 (June 2005) required Centers to provide the following documentation in support of contributions of personnel time:

- *"Projects/tasks worked;*
- *Dates worked;*
- *Number of hours;*
- *Hourly salary rate and allowable fringe benefits paid; and*
- *Certified time and attendance records."*

**2. Brief Statement of Findings and Recommendations:**

$908,823 in Unallocable Contract Costs

The OIG final audit report questioned $908,823 in direct and indirect costs incurred under two contracts awarded to Massachusetts MEP. The OIG emphasized that these contracts, related to the New England Manufacturing Supply Chain Initiative and Machine Operators Skills Training (MOST) Grants, *". . . were received by Massachusetts MEP to provide services to the respective procuring entities, rather than awarded by Massachusetts MEP as part of its NIST cooperative agreement activities."*

(A) New England Manufacturing Supply Chain Initiative

Massachusetts MEP signed a vendor agreement with officers of its managing agent vendor, MEP Management Services, Inc. (MEP MSI). Under this agreement, Massachusetts MEP served as a second-tier subcontractor under a U.S. Department of Defense (DoD) contract, which had been awarded to Concurrent Technologies Corporation to expand access among small- and medium-sized manufacturers to Defense Department supply chains. Concurrent Technologies subsequently awarded a subcontract to MEP MSI, which in turn, awarded a subcontract to Massachusetts MEP.

The subcontract provided for MEP MSI to compensate Massachusetts MEP for services at stated billing rates, plus reimbursement for reasonable expenses in accordance with the Federal Acquisition Regulation (FAR).

> *"The subcontract, as amended, requires Massachusetts MEP to (1) identify and establish working relationships with organizations and initiatives that could add value to the program, (2) support Defense Logistics Agency plans to integrate manufacturing capability data from multiple sources and make these data available to Defense Department procurement decision makers, (3) collect capability data from small manufacturers in six New England states and store the data using existing databases, (4) assist capable small manufacturers selected for participation in prototypes to increase their capabilities to become*

*Defense Department suppliers, and (5) collect and report performance metrics to measure the effectiveness of the program."*

During the period July 1, 2005, through June 30, 2006, Massachusetts MEP claimed $765,078 in costs to NIST for services under the DoD subcontract. Massachusetts MEP's financial records indicate that it received $638,427 in revenue under the subcontract, which the OIG verified was included in program income reported to NIST.

The OIG examined Massachusetts MEP's operating plan submitted to NIST for the period July 1, 2005, through June 30, 2006, and found that, while the manufacturing supply chain initiative was mentioned, the plan did not *". . . disclose that costs associated with the services were funded under a Defense Department subcontract."*

(B) Machine Operators Skills Training (MOST) Grant[12]

In August 2005, Massachusetts MEP received a subcontract from Maine MEP, which also retained Time Wise Management Systems, Inc. (TWMS) (formerly MEP MSI) as its managing agent. According to the vendor agreement signed by officers of the Maine MEP and Massachusetts MEP, the U.S. Department of Labor (DOL) awarded a contract to the State of Maine, Department of Economic and Community Development. The state then awarded a subcontract under its DOL contract to Maine MEP, which awarded a subcontract to Massachusetts MEP on August 1, 2005, making Massachusetts MEP a second-tier subcontractor.

> *"The subcontract requires Massachusetts MEP to designate a staff member as liaison with the project manager, and to (1) identify small and medium-size manufacturers to participate in the program, (2) work with local career centers to recruit potential machine operator trainees, and (3) identify institutions that can provide training facilities. It also requires the MEP to assist the project manager with other activities deemed necessary for the success of the program. The subcontract pays MEP a fixed amount of $125,000 per year made in monthly installments plus reimbursement for reasonable expenses. The performance period for the subcontract was July 1, 2005, through June 30, 2007."*

The OIG found that during the period of July 1, 2005, through June 30, 2006, Massachusetts MEP claimed $143,745 to NIST for services under the DOL subcontract, and received $220,970 in revenue under the subcontract. The OIG verified that the revenue was included in program income reported to NIST. In reviewing Massachusetts MEP's operating plan submitted to NIST for the period July 1, 2005, through June 30, 2006, the OIG *". . . found no mention of the Machine Operators Skills Training Grant program or any reference to the Department of Labor-funded training program in the operating plan."*

[12] The vendor agreement between Massachusetts MEP and Maine MEP identifies the Department of Labor agreement as a contract, although the program's name implies it was a grant.

Lastly, Massachusetts MEP did not accumulate costs for the supply chain and MOST subcontracts under the cost center established for the cooperative agreement but instead established separate cost accounting centers for each of the subcontracts.

Based on the above, the OIG concluded that services provided under these agreements were for the direct use and benefit of the procuring entities rather than for the MEP project. Accordingly, the OIG determined that costs incurred under the two subcontracts ($765,708 under the New England Manufacturing Supply Chain Initiative and $143,745 under the MOST Grant), must be allocated to the respective subcontracts, not the MEP cooperative agreement.

- **Recipient's Response:**

In its response to the final audit report, Massachusetts MEP stated that the OIG's determination that the two subcontracts awarded to it were for the direct benefit of the awarding entities represented a fundamental misunderstanding of the purpose and operation of MEP Centers. Rather, it asserted the contracts were awarded to Massachusetts MEP because they would increase the ability of Massachusetts MEP to reach small- and medium-sized manufacturers, and provided funds for Massachusetts MEP to transfer technology to local manufacturers. It took the position that the proposed disallowance of $908,823 should be denied because the costs incurred for the projects were determined by the Center, pursuant to its statutory authority, to be reasonable and allocable to the MEP Program as activities that improve the competitiveness of SMEs in the global market through the adaptation and transfer of technology to SMEs.

Massachusetts MEP stated that the Department of Labor, Employment and Training Administration partnered with NIST MEP on other initiatives and recognized the critical need for skills training for American manufacturers so that American manufacturing could remain competitive in the global market. Additionally, it noted, NIST MEP remained the main point of contact for the Interagency Network of Enterprise Assistance Providers ("INEAP"), in which the Department of Defense and the Defense Logistics Agency were directly involved. It pointed to the NIST MEP website to emphasize that discussions of the INEAP have focused on joint service delivery programs, similar to the Supply Chain and MOST initiatives. It also stated that other MEP Centers worked closely with Department of Defense contractors on Supply Chain initiatives and NIST's support and encouragement of the partnerships and programs was evidence that such activities and initiatives are well within the MEP mission, so its determination that the costs were allocable to the MEP Center was reasonable.

Massachusetts MEP noted the contracts were awarded to the Massachusetts MEP Center because of its unique qualifications to provide the services required under the award. It referenced the Center's authority to determine which costs were reasonable and allocable to the MEP award in accordance with the America COMPETES Act, P.L 110-69, Sec 3003, 121 Stat. 587 (2007). It stated that NIST supported these types of activities and

encouraged Centers and their clients to compete for Federal contracts. It referenced the following provision in the MEP statute to support its eligibility for such dollars:

> *"In addition to such sums as may be authorized and appropriated to the Secretary and Director to operate the Centers program, the Secretary and Director also may accept funds from other Federal departments and agencies for the purpose of providing Federal funds to support Centers."*

Massachusetts MEP outlined the criteria for a cost to be allocable to an award as follows: (1) is incurred specifically for the award; (2) benefits the award and other work and can be distributed in reasonable proportion to the benefits received; or (3) is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown (2 CFR Part 230, App. A (4)). It then asserted under that basis, the costs of the contracts were allocable to the Massachusetts MEP award because the contracts and the work performed thereunder were in furtherance of the Massachusetts MEP's mission. It further stated it incurred the costs associated with the contracts not because of the contracts themselves, but because the contractors were like many other clients who contract with Massachusetts MEP for services. The fees for services performed allowed the Center to fulfill its mission by assisting small- and medium-sized manufacturers to improve their competitiveness.

Massachusetts MEP believed the benefit of the contracts flowed to Massachusetts MEP and to the small- and medium-sized manufacturers whose businesses were improved through the programs it offered. It stated the contracts allowed Massachusetts MEP to expand its service offerings.

(A) New England Manufacturing Supply Chain Initiative

Massachusetts MEP provided the following overview of the New England Manufacturing Supply Chain sub-contract questioned in the final audit report:

> *"Concurrent Technologies Corporation ("CTC") received a contract under a limited competitive bid process from the Defense Logistics Agency, an agency within the United States Department of Defense, to ultimately improve defense acquisition of resources and materials with the goal of obtaining parts and materials domestically in the New England area, utilizing an existing Supply Chain of small and medium sized manufacturers. The multi-phase program was known as the Rapid Mobilization of Manufacturing Sources. CTC then awarded a subcontract to MEP MSI to assist in on-the-ground operations and investigations of the capability of small and medium sized manufacturers. In order to reach more small and medium sized manufacturers in the six-state area, MEP MSI in turn contracted with individual MEP Centers, including Massachusetts MEP, to provide outreach, education, and other services under the contract.*

> *Under the Vendor Agreement between MEP MSI and Massachusetts MEP, Massachusetts MEP was responsible for conducting outreach and education on the Supply Chain and Supply Point initiatives with their small and medium-sized manufacturing clients and to assess the capabilities of their clients to participate in Defense contracting and subcontracting processes. The ultimate goal was to inform small and medium sized manufacturers throughout Massachusetts about opportunities in defense manufacturing and to get them involved in defense procurements. To do so, Massachusetts MEP staff conducted face-to-face meetings and on-site assessments with their clients to ascertain capacities and capabilities of those manufacturers."*

Massachusetts MEP stated that assisting small- and medium-size manufacturers in Massachusetts to be more competitive for DoD and DLA contracts was clearly within the Massachusetts MEP's statutory mission. It further stated that the program involved the direct transfer of technology and process improvements described in the Programmatic Objectives at 15 CFR § 290.3(b).

It referenced the approval of the Massachusetts MEP 2005 operating plan by NIST, which described the goals and activities of the Supply Chain Initiative, prior to the release of funds for the 2005-2006 operating year.

Massachusetts MEP indicated that its interest and involvement with supply chain initiatives was not unique as other Centers engaged in such activity, which was supported by NIST, as evident from its "Supply Chain" Community of Practice on the website maintained by NIST for the MEP network. The forum allowed MEP Centers to share their experiences and opportunities for involvement and improvement of the supply chain on behalf of their small- and medium-sized manufacturer clients. Massachusetts MEP asserted such activities were clearly allocable to its program.

(B) Machine Operators Skills Training (MOST) Grant

Massachusetts MEP provided the following overview of the Machine Operators Skill Training (MOST) sub-contract questioned in the final audit report.

> *"In July of 2005, the Maine Department of Economic and Community Development ("DECD") received a financial assistance award from the Department of Labor, Employment and Training Administration to provide job opportunities for small and medium-sized manufacturers by increasing their competitiveness (thereby increasing their ability to win contracts and bring in revenue) and to provide training for machinists to allow them to become Computer-Numerically Controlled ("CNC") Operators, Programmers, and Machinists, of which there is a significant shortage of qualified and trained workers in the United States.*

*The activities required of Massachusetts MEP in order to perform the services under the Scope of Work are well within the scope of and complementary to the objectives of the MEP program, stated in 15 CFR § 290.3(b), Program Objective, and the enabling statute, 15 USC § 278k. As stated in the regulation, the objective of the MEP program is 'to enhance productivity and technological performance in United States manufacturing.' This is the same objective as the MOST program. The MOST program aims to enhance productivity through training machine operators to be CNC operators, critical to enable SMEs to utilize recent improvements in technology, as more and more machines are run by computers, knowledge in computer technology becomes more important. NIST MEP demonstrated approval of the MEP partnership with the MOST program by awarding Mr. Jack Healy, Director of Operations for Massachusetts MEP, the Innovator of the Year Award at the 2008 National MEP Conference held in Orlando, Florida, specifically for Massachusetts MEP's participation in the MOST Program."*

Massachusetts MEP contended that the work performed under the vendor agreement was not outside the normal operations of Massachusetts MEP, but consisted of information sharing with Maine MEP. It stated that the OIG provided an inaccurate characterization of the funds received by Massachusetts MEP under the vendor agreement while referencing OMB Circular A-133, which states that vendor payments should not be considered Federal awards.

- **Resolution Actions:**

NIST agrees with the Massachusetts MEP Center that its Manufacturing Supply Chain Initiative (SCI) subcontract and its MOST contract represent the type of MEP Center activity that the program not only considers squarely within the scope of the MEP program, but encourages its grantees to pursue. These contractually required activities are within the scope of the MEP award in three ways. First, the performance required of the Center under both contracts – (1) assessing the capability of small- and medium-sized manufacturing clients and educating those clients regarding the contracting needs and requirements of the Defense Logistics Agency (DLA) so as increase their participation in DLA procurement under the SCI contract; and (2) identifying and coordinating the participation of small- and medium-sized manufacturers in need of skilled machine operators, machine operators needing advanced training, and local educational and other institutions able to provide sites at which advanced machine operator training could be provided under the MOST contract – is fully aligned with MEP award purposes of enhancing the productivity, competitiveness, and technological performance of such manufacturers. Second, developing the relationships with educational institutions and private industry that are required by both contracts accords fully with the statutorily explicit expectation that MEP Centers will enter into such agreements to accomplish programmatic objectives. Finally, obtaining contracts with third parties that provide payment to a Center for services provided under its MEP cooperative agreements

serves to satisfy that Center's cost share obligation. For these reasons, the Program has encouraged Centers to obtain contracts pursuant to which program income is generated by the performance of award-related services.

Further, NIST disagrees with the OIG to the extent that it considers costs not allowable solely because they are incurred providing services under a contract "received" by a Center rather than expended by the Center pursuant to a contract that it "awarded." We note in this regard that there is no dispute but that Massachusetts MEP accounted for the payments it received – from Time Wise Management Systems, Inc. (TWMS)[13] under the SCI contract and from Maine MEP under the MOST contract – as program income; in contrast, contracts that a grantee awards consist entirely of expenses and do not generate any income. We also reject the OIG's determination that the services provided by the MEP Center under these agreements were not for the benefit of the cooperative agreement. Services performed under a contract need not benefit only the procuring entity; nothing precludes the performer of services under a contract from accruing not just the benefits of payment but also directly benefitting from the services it provides. Indeed, this is precisely the situation when, as here, services provided under contractual obligation are provided by the recipient of a grant that contemplates, permits, and encourages the recipient to provide those same services.

The defect with Massachusetts MEP's claims for costs incurred under its SCI and MOST contracts, which results in their disallowance, is not that the Center received rather than awarded them, or that the Center's performance of them benefitted the procuring entities and not the MEP program. Instead, the problem is that they were sub-contracts under Federal awards.[14] Massachusetts MEP's SCI contract was a second-tier subcontract under a contract awarded by the Department of Defense, and its MOST contract was a subcontract under an award made by the U.S. Department of Labor.[15] In short, the Federal government has already paid – to Concurrent Technologies Corporation and to the State of Maine Department of Economic and Community Development – for the services provided by Massachusetts MEP under its contracts with TWMS and Maine MEP, respectively. Allowance of these costs under Massachusetts MEP's NIST cooperative agreement would have the Federal government paying twice for the same services to the extent of the Federal share of that award.[16] Such double-dipping cannot be allowed.[17] In this regard, we note that while

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13 MEP MSI changed its name to Time Wise Management Services, Inc. (TWMS) during the audit period. Because it retains the name and is currently known as TWMS, we so refer to it hereafter.

14 In so stating, no implication is intended as to whether costs claimed in performance of these contracts duplicate any otherwise claimed direct or indirect costs.

15 It is not certain whether the MOST program in the first instance was a Federal grant or a Federal contract. See audit report at 11, n.1. The distinction is of no significance for this analysis. The critical point is that they were Federally funded.

16 Massachusetts MEP's reliance on OMB Circular A-133, Subpart B, § ___.210(c) for the proposition that the payment it received under these contracts were not Federal funds ignores the requirement that such a vendor not be *"subject to the compliance requirements of the Federal program."* § ___.210(c)(5). Both its SCI and its MOST contracts required Massachusetts MEP's compliance with the FAR.

17 One consequence of this determination is that the payments received by Massachusetts MEP under these

Massachusetts MEP discussed the SCI in its operating plan for the applicable time period, it did not disclose that the initiative was funded by a Defense Department contract, and the operating plan did not discuss the MOST contract at all. In short, Massachusetts MEP did not disclose that Federal funds from other Federal agencies were already paying for the SCI and MOST contracts.

In addition, the role of TWMS in these contracts presents another troubling concern. TWMS is under contract as managing agent for both Massachusetts MEP and Maine MEP and was instrumental in securing both the SCI and the MOST contracts for Massachusetts MEP. Indeed, Massachusetts MEP was TWMS's subcontractor on the SCI award. There is an inherent conflict of interest if a Center enters into a separate contract for goods or services with its managing agent or enters into a contract with an entity that has the same managing agent. Here, until they are signed at least, TWMS regularly acts on behalf of Massachusetts MEP identifying, screening, recommending, and negotiating contracts. Thereafter, Massachusetts MEP relies heavily upon its managing agent to monitor and ensure compliance with the contracts that it has entered into. The Center expects and needs to be able to rely upon TWMS for advice, guidance, and service upon the assumption that its agent is acting on its behalf and in its best interests. TWMS' ability to act on behalf of, and in the Center's best interests, is obviously and materially compromised when it is either the other contracting party or simultaneously serves as managing agent to both the Center and the other contracting party. Clearly, these situations present at least the appearance of self-dealing on the part of TWMS. The SCI contract with TWMS provides a telling illustration. The contract provided that TWMS would compensate Massachusetts MEP for services at stated billing rates plus reimbursement for reasonable expenses in accord with the Federal Acquisition Regulation. The contract was amended several times to, among other things, adjust the contract billing rates. Nevertheless, Massachusetts MEP lost money on the deal, reporting costs totaling $765,078 and revenue of only $638,427.18. We don't know whether TWMS, unlike the Center, a for-profit entity, earned a profit on the deal, but there obviously was a conflict for TWMS between ensuring any such profit or minimizing losses for itself on the one hand and maximizing program income or providing the best quality MEP program services, on the other.

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contracts are not program income. Massachusetts MEP's reliance upon the provision of the program's authorizing statute, 15 USC § 278(k), that allows for the *"accept[ance] of funds from other Federal departments and agencies"* is misplaced because that authorization is expressly specific to the Secretary of the Department of Commerce and the Director of NIST, and does not allow Centers to accept funds from other Federal agencies and department and use them under their MEP awards.

18 We note that had this contract been with a non-Federal entity the $126,651 of costs that exceed program income would not be allowed in any event because they would constitute business losses. See 2 CFR Part 230 (OMB Circular A-122), App. B. ¶ 26, Losses on other sponsored agreements or contracts.

- **Financial Summary:**

| | | |
|---|---|---|
| A. | Costs Questioned: | $ 908,823 |
| B. | Costs to be Allowed: | $ 0 |
| C. | Costs to be Disallowed: | $ 908,823 |

- **Rationale and/or Legal Basis for Action:**

OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, Appendix A, Section A.(2)(f) states the following:

> *"To be allowable under an award costs must . . . [n]ot be included as a cost . . . of any other federally financed program in either the current or a prior period."*

Appendix A, Section A.(4)(a) states the following;

> *"A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received."*

15 CFR §14.42 – Codes of conduct states the following:

> *"No employee, officer, or agent shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the employee, officer, or agent, any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award."*

15 CFR §14.43 – Competition states the following:

> *"The recipient shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals shall be excluded from competing for such procurements."*

3. **Brief Statement of Findings and Recommendations:**

$10,745 in Questioned Contractual and Other Direct Costs

The OIG questioned $10,745 of costs incurred before the funding period's start date of July 1, 2005, which included: $7,259 in contractual costs for consultant charges and $3,486 in indirect costs associated with the questioned direct costs. As outlined by the OIG in the final audit report, pre-award costs are unallowable unless approved in writing by NIST; the OIG found no evidence of NIST approval for pre-award costs.

- **Recipient's Response:**

Massachusetts MEP did not challenge the pre-award costs questioned by the OIG.

- **Resolution Actions:**

In that Massachusetts MEP did not receive authorization from the Grants Officer to incur pre-award costs, NIST agrees with the OIG and will, therefore, disallow $10,745 in pre-award costs.

- **Financial Summary:**

| | | |
|---|---|---|
| A. | Costs Questioned: | $ 10,745 |
| B. | Costs to be Allowed: | $ 0 |
| C. | Costs to be Disallowed: | $ 10,745 |

- **Rationale and/or Legal Basis for Action:**

15 CFR § 14.28 states the following:

> ***"Period of availability of funds.*** *Where a funding period is specified, a recipient may charge to the grant only allowable costs resulting from obligations incurred during the funding period and any pre-award costs authorized by the Grants Officer."*

4. **Brief Statement of Findings and Recommendations:**

$1,093,495 Questioned in Excess Program Income

The final audit report observed that for the 12 months that ended June 30, 2006, Massachusetts MEP reported earning $2,689,506 in program income, of which $1,596,011 was used to fund non-Federal expenditures. The OIG questioned the remaining $1,093,495 in excess program income, which was not accounted for by Massachusetts MEP, and recommended that it be deducted from total project costs. The OIG further noted that

Massachusetts MEP's operating plan for the year ending June 30, 2006, did not anticipate generating program income in excess of its budgeted non-Federal matching share requirements. The operating plan budget projected that Massachusetts MEP would generate $1,900,000 in program income, all of which would be applied to non-Federal expenditures with no undisbursed program income remaining.

The audit report stated the following:

> *"In May 2006, NIST issued a universal amendment to all MEP cooperative agreements that were in effect as of July 1, 2005, stating that excess program income could be carried over to a subsequent funding period with the grants officer's prior approval."*[19]

The OIG examined the terms and conditions of Massachusetts MEP's cooperative agreement and subsequent amendments and found no NIST approval for retaining undisbursed program income to be applied in future award periods. Further, the OIG consulted with NIST's Grants & Agreements Management Division (GAMD) as to whether it intended to allow Massachusetts MEP to retain a large balance of undisbursed program income for use in future award periods. The NIST Grants Specialist confirmed that Massachusetts MEP had not requested approval to carryover that undisbursed program income for use in future award periods.

In the absence of the Grants Officer's approval to carry over any of its undisbursed program income to the subsequent award period, *"according to the cooperative agreement's terms and conditions and federal regulation, the undisbursed program income must be used to reduce the federal share of Massachusetts MEP's expenditures; 15 CFR Sec. 14.24(c) requires amounts 'in excess of any limits stipulated' to be deducted from total allowable project costs in computing the amount of federal funds for which the recipient qualifies."* Accordingly, the final audit report reduces total accepted project costs by $1,093,495 in excess income in computing Massachusetts MEP's Federal funds earned for the year ended June 30, 2006.

- **Recipient's Response:**

In its response to the final audit report, Massachusetts MEP reiterated its response to the draft audit report, as summarized below.

(1) Massachusetts MEP stated that, *"... for the period in question was subsequently re-calculated to reflect final adjustments to the Center's financial reports, resulting in a reduction to $951,000."*

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19 *"The purpose of the amendment was to incorporate NIST's revised MEP General Terms and Conditions, dated April 2006, into all active awards. Section 15 F of the revision, "Excess Program Income," states program income in excess of what is required in an operating year to meet the non-Federal share of the award may be carried over to the subsequent funding period with the prior written approval of the grants officer."* (From the final audit report.)

(2) Massachusetts MEP disagreed with the final audit report's conclusion that *"...there is still no evidence that NIST approved carry-forward of the excess cited in this report."* (The OIG's conclusion is based on the fact that the award amendment giving approval to carry-forward undisbursed program income of $541,092 from the award period ended June 30, 2008, into the period beginning July 1, 2008, does not specifically reference the undisbursed program income as of June 30, 2006.)

Massachusetts MEP contends that, while it did not obtain carry forward approval of undisbursed program income from the operating period ended June 30, 2006, to the subsequent operating period beginning July 1, 2006, *"The Massachusetts MEP operating plan for the period beginning July 1, 2008 reported this undisbursed program income for the years ending in 2006, 2007, and 2008 and identifies that 1/3 of that net income is 'restricted.' The restricted amount adds to $541,092 and ties to the number identified on page 32 in the budget and page 33 in the budget narrative. NIST MEP identified and approved $541,092 of carry-forward program income in amendment 11, special award condition 9 for the 2008-2009 program year."*

(3) Massachusetts MEP argued that only one-third of any excess program income amount is reportable to NIST and potentially used to reduce allowable program costs. Massachusetts MEP states that the remaining two-thirds of any excess program income *"is unencumbered by the grant requirements."* The Center cites a 1984 decision by the Department of Health and Human Services Departmental Appeals Board, stating that *"one must look to other federal agency regulations for guidance"* on handling program income because neither NIST nor the Department of Commerce have issued regulations relative to program income under the MEP program.

In its response to the final audit report, Massachusetts MEP contended that *"The OIG attempts to impose an additional requirement on the expenditure of program income in the Final Audit recommendations by mandating that program income first be spent before applying any other cost share. Under this interpretation, if program income is greater than or equal to the costs of a given period of the award, all of the program income must be spent on those costs first before any other match can ever be counted."* Massachusetts MEP referenced a 1981 decision by the Department of Health and Human Services Departmental Appeals Board to bolster its rejection of the Center's perceived *"additional requirement on the expenditure of program income"* imposed by the OIG in the final audit report.

- **Resolution Actions:**

NIST agrees with the OIG that Massachusetts MEP generated program income in excess of the amount it applied to satisfy its cost share obligation, did not account for that excess program income or otherwise add it to the award funds to further the project's purposes,[20] and did not request permission to carry forward the excess program income to the subsequent operating period beginning July 1, 2006. NIST also agrees with the OIG that, in such a circumstance, in accordance with the MEP Program General Terms and Conditions and Federal regulation, such undisbursed excess program income must be deducted from total allowable project costs that are used to compute the amount of Federal funds for which a recipient qualifies.

NIST evaluated each of Massachusetts MEP's responses to the audit report's program income finding, as follows.

First, NIST rejects Massachusetts MEP's claim that a portion of excess program income proportionate to the two-thirds non-Federal share of an award is somehow "unrestricted" and that the Center needs apply, either as carry forward or as a deduction from total award costs, only the amount of undistributed program income that is proportionate to the Federal share of the award. Whether program income has "a Federal character" is not the issue. Without regard to the extent that non-Federal funds support a project, program income in its entirety is no more "unrestricted" than are contributed non-Federal award funds, which do not have a Federal character. Both are committed to the award. In the absence of a regulation or term and condition to the contrary, excess program income only becomes unrestricted to the extent that it remains after being deducted from total award costs. As the OIG correctly stated, *"there are specific directions for handling excess program income in 15 CFR Sec. 14.24, which codifies OMB Circular A-110 for the Department of Commerce. NIST augmented these directions with MEP-specific policy in general terms and conditions for MEP awards. There is no provision in either the OMB or NIST policy that directs recipients to report only a percentage of the excess program income to the government."* 15 CFR Sec. 14.24(c) requires accounting for the Federal and non-Federal portions of the excess by reducing total allowable project costs before computing Federal funds earned. Once this calculation is completed, the excess has been resolved and the recipient is under no obligation to track and report any portion of the excess to NIST.[21]

Second, regarding Massachusetts MEP's claim that, if re-calculated to reflect final adjustments to the Center's financial reports, undisbursed program income for the period in question was actually $951,000, NIST agrees with the OIG that the Center did not provide

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20 MEP Program General Term and Condition 14 required that program income first be applied to meet a Center's cost share obligation. It does not preclude program income in excess of that obligation from being added to the award funds and used for project purposes during the operating plan year.

21 We reject Massachusetts MEP's assertion that the final audit report or NIST's resolution would *"mandate that program income first be spent before applying any other cost share"* as misplaced and incorrect. There is no such mandate. Cash is to be expended as expenses are incurred. There simply is no requirement that program income be expended before cash contributions.

documentation to support any such adjustment. Nevertheless, NIST reviewed the two Financial Status Reports (SF-269s) submitted by Massachusetts MEP for the quarter ended June 30, 2006, one signed on July 31, 2006, and the other signed on August 23, 2006. The later SF-269, which represents the revised, final SF-269 for the operating period ended June 30, 2006, reports $1,093,495 in undisbursed program income. The earlier SF-269 reported that undisbursed program income totaled $1,077,295. Therefore, NIST will disregard the suggested "recalculated" amount of $951,000 in its resolution of this issue and will employ the Center's own final report of $1,093,495 as the amount of undisbursed program income Massachusetts MEP had on hand as of June 30, 2006.

Third, NIST evaluated Massachusetts MEP's assertion that the $541,092 of undisbursed program income that it eventually requested and received approval to carry forward to the July 1, 2008, through June 30, 2009, operating year could be tied to the amount ($1,093,495) questioned in the final audit report, as Massachusetts MEP claimed. As noted, the operating plan for the July 1, 2006, through June 30, 2007, period projected program income of $1,900,000; made no mention of undisbursed program income from the prior year, notwithstanding the $1,093,495 in undisbursed program income reported on the SF-269 for the period ended June 30, 2006; and included no request to carry undisbursed program income forward to the current operating year. In its next year's – July 1, 2007, through June 30, 2008 – operating plan, Massachusetts MEP included $100,676 in undisbursed program income, although carry forward approval was not requested.[22]

Massachusetts MEP's operating plan for July 1, 2008, through June 30, 2009, budgeted "restricted program income," described as "program income from previous operating years," of $541,092, asserting that $317,011 was from the year ended June 30, 2006, and $224,081 from the year ended June 30, 2007. However, the amounts of "restricted program income" from prior years employed in the July 1, 2008, through June 30, 2009, operating plan, differ significantly from the amounts reported for the same periods in those prior years' operating plans, and there are discrepancies among those prior year budgets as to the amount of undisbursed program income on hand at the various years' ends. It may be that the $541,092 of "restricted program income" budgeted for the July 1, 2008, through June 20, 2009, operating year includes excess program income from the July 1, 2005, through June 30, 2006, audit period. However, NIST is not willing to rely on Massachusetts MEP's assertion that the entire $541,092 represents undisbursed income from that period. Moreover, inasmuch as Massachusetts MEP's explanation of the '08-'09 carry forward does not mention the $100,676 that was carried forward into the previous year without expectation of being expended, identifies no excess program income for that immediately preceding year, and given the discrepancy between the amounts of prior year "restricted program income" used in the '08-'09 operating plan and the amounts reported in those prior years' operating

22 The '08–'09 operating plan states (p. 31): ***Undisbursed Program Income: $100,676*** *has been calculated to be $100,676. This amount is intended to be used as working capital but will not be expended during the operating year. The undisbursed program income is part of the fund balance, which the Center is trying to build to mitigate risk of delayed or lost funding. The Center is not anticipating any additional undisbursed program income during the operating year.*

plans, NIST s unable to determine with any confidence whether, and if so how much of, the carry forward approved for the '08-'09 plan year includes excess program income from the audit period.[23]

In summary, NIST agrees with the OIG that excess undistributed program income in the amount of $1,093,495 is to be deducted from the total allowed project costs when determining the net allowable project costs on which the earned Federal share is based. In addition, because it proceeded here and presumably following the audit period upon the incorrect assumption that unexpended program income proportionate to the non-Federal two-thirds share of the award was somehow "unrestricted," Massachusetts MEP is required to review and correct its year-end financial statements for operating years subsequent to the audit period to account for all program income, and either request approval to carry excess program income forward or repay NIST amounts owed from past years by calculating the earned Federal share after deducting the unrestricted or otherwise unaccounted for program income from total project costs for each of those years and remitted any amount of Federal funds disbursed exceeding that amount.

Finally, because of the size of the debt owing, and inasmuch as the inaccuracies in its financial reports are based upon fundamental errors in applying applicable award terms and conditions, regulations, and cost principles, and are likely to result in significant additional monies owed to NIST, Massachusetts MEP will be designated high risk until all financial miscalculations and deficiencies are corrected and rectified.

- **Financial Summary:**

| | | |
|---|---|---|
| A. | Costs Questioned: | $ 1,093,495 |
| B. | Costs to be Allowed: | 0 |
| C. | Costs to be Disallowed[24]: | $ 1,093,495 |

- **Rationale and/or Legal Basis for Action:**

The *Hollings Manufacturing Extension Partnership General Terms and Conditions,* April 2006, Term 14, states in part, the following:

> "*F. Excess program income*
>
> *Program income in excess of what is required in an operating year to meet the non-Federal share portion of the award may be carried over to the subsequent funding period WITH THE PRIOR WRITTEN APPROVAL*

23 NIST recognizes that the claim made in Massachusetts MEP's '08-'09 operating plan that the carry forward there requested included $317,011 attributable to the audit period is consistent with its claim here that "recalculated" program income for the audit period totals $951,000. NIST, nevertheless, remains unable to confirm or verify either contention.

24 Deducted from total allowed project costs.

*OF THE GRANTS OFFICER, for the same purpose of the non-Federal Share of the annual operating budget. When award close-out commences, NIST share of all cumulative undisbursed Program Income, i.e., carryover plus any excess earned but not expended in the final operating year, shall be returned to NIST within 90 days after the expiration date of the award."*

*15 CFR § 14.24 "Program income*" states in part, the following:

*"(b) Except as provided in paragraph (h) of this section, program income earned during the project period shall be retained by the recipient and, in accordance with DoC regulations or the terms and conditions of the award, shall be used in one or more of the ways listed in the following:*
*(1) Added to funds committed to the project by the DoC and recipient and used to further eligible project objectives.*
*(2) Used to finance the non-Federal share of the project.*
*(3) Deducted from the total project allowable cost in determining the net allowable costs on which the Federal share of costs is based.*

*(c) When an agency authorizes the disposition of program income as described in paragraph (b)(1) or (b)(2) of this section, program income in excess of any limits stipulated shall be used in accordance with paragraph (b)(3) of this section.*

*(d) In the event that the DoC does not specify in its regulations or the terms and conditions of the award how program income is to be used, paragraph (b)(1) of this section shall apply automatically to all projects or programs."*

## COMBINED SUMMARY OF FINANCIAL RESOLUTION

| | | |
|---|---|---|
| Total Federal Funds Disbursed: | | $2,364,771 |
| Costs Incurred: | $9,392,908 | |
| Less: Costs Questioned OIG: | ($5,086,998) | |
| Costs Accepted Per Audit Report: | $4,305,910 | |
| Less: Excess Program Income: | ($1,093,495) | |
| Audited Costs Reinstated by NIST: | $ 727,937 | |
| Costs Accepted by NIST: | $3,940,352 | |
| Federal Cost Share Ratio: | 33.33% | |
| Less: Federal Funds Earned: | | $1,313,319 |
| **Refund Due NIST:** | | **$1,051,452** |

When making payment of the Refund Due NIST, please make check payable to National Institute of Standards and Technology, indicate the award number and "Audit Refund" on the check and mail the payment to:

ATTN: Julie Weiblinger
Finance Division
National Institute of Standards & Technology
100 Bureau Drive
Building 101, Room A809, Mail Stop 1624
Gaithersburg, MD 20899-1624

Please note that the recipient's Appeal does not preclude NIST from its collection efforts of "Refund Due NIST" amount, 30-day post receipt date of the ARDL by the recipient.