What We Found

The South Carolina Manufacturing Extension Partnership (SCMEP) received a NIST cooperative agreement in 2005 that, as amended, funded operations of its MEP center for 2 years (July 2005-June 2007). Total estimated costs of the project were $13.6 million. The federal share was capped at $4.5 million.

We audited SCMEP to determine whether its claimed costs were allowable under the terms of the agreement and whether the recipient had complied with all other MEP operating guidelines, award terms, and conditions. We also examined the costs submitted by four entities (“subrecipients”) that received cooperative agreement funding from SCMEP to operate centers.

Background

Congress established the Manufacturing Extension Program in 1988 to provide manufacturers with technical and business management assistance aimed at improving their profitability, productivity, and global competitiveness.

The South Carolina Manufacturing Extension Partnership was one of the original three extension centers established under the program in 1989. Today there is at least one center in every state and a total of 59 MEP centers located across the country.

What We Recommended

National Institute of Standards and Technology

South Carolina MEP Award No. 70NANB5H1187 (ATL-18567)

The South Carolina Manufacturing Extension Partnership claimed costs totaling $11.4 million for the period July 2005 through March 2007, and received federal reimbursements of $3.8 million. Our audit found that the recipient could not properly support approximately $3.4 million in costs claimed by four of its subrecipients, largely for contract, matching share, and in-kind expenses incurred while operating MEP centers. Three subrecipients—Greenville Technical College, South Carolina Export Consortium, and University of South Carolina—did not provide complete, verifiable documentation to support their claims or program income (generated by fees, etc., charged to firms that use a center’s services). The fourth—Clemson University—claimed costs that were largely outside the scope of the MEP project. We questioned the $3.4 million in claimed costs.

In addition, the subrecipients’ MEP agreements did not contain the required budget information, and none had written procedures in place to determine whether amounts reported to SCMEP were allowable under federal cost principles.

Finally, two of three subrecipients that qualified for single audits* did not separately identify the NIST MEP program. Therefore these grants were not subjected to the proper audit techniques required under the Single Audit Act.

*The Single Audit Act requires nonfederal entities that expend federal awards from more than one agency totaling $500,000 or more in a year to undergo a “single” audit, conducted by an independent auditor.

We recommended that NIST take the following actions:

1. Disallow $3,409,409 in questioned costs and recover the federal portion of $1,136,736.
2. Require the recipient to ensure its subrecipients have appropriate budgets and written policies and procedures that meet financial system requirements prior to granting any future sub awards. The written procedures should direct subrecipients to comply with the Single Audit Act.
MEMORANDUM FOR: Laura Cesario  
Chief, Grants and Agreements Management Division  
National Institute of Standards and Technology

FROM: Judith J. Gordon  
Assistant Inspector General  
for Audit and Evaluation

SUBJECT: Final Audit Report No. ATL-18567  
South Carolina Manufacturing Extension Partnership  
NIST Cooperative Agreement Number: 70NANB5H1187

We are attaching a copy of the subject audit report for your actions in accordance with DAO 213-5, "Audit Resolution and Follow-up." The original report has been sent to the recipient, who has thirty (30) days from the date of the transmittal to submit comments and supporting documentation to you. A copy of this report, along with the response, will be posted on the OIG’s website pursuant to section 8L of the Inspector General Act of 1978, as amended.

Under DAO 213-5, you have sixty (60) calendar days from the date of this memorandum to reach a decision on the actions you propose to take on each audit finding and recommendation and to submit an Audit Resolution Proposal to this office. The format for the proposal is Exhibit 8 of the DAO. As applicable, your written proposal must include the rationale and/or legal basis for reinstating any questioned cost in the report and should reference any supporting documentation relied on. Your comments should also address the funds to be put to better use, if any, cited in the audit report. Under the DAO, the Office of Inspector General must concur with your proposal before it may be issued as a final determination and implemented. The DAO prescribes procedures for handling any disagreements this office may have with the Audit Resolution Proposal. Also, please copy us when the audit determination letter is sent to the auditee.

Any information or inquiry regarding this final report should be directed to me at (202) 482-2754 or Katie McKevitt at (404) 730-2063. All correspondence concerning this report should refer to our Final Audit Report No. ATL-18567.

Attachments
cc:  Steve Willet, NIST audit liaison
     J Michael Simpson, director, system operations, NIST/MEP
     Melinda Chukran, NIST audit resolution specialist
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INTRODUCTION

In September 2005, the National Institute of Standards and Technology (NIST) awarded Manufacturing Extension Partnership Cooperative Agreement No. 70NANB5H1187 to the South Carolina Manufacturing Extension Partnership to continue operating an existing MEP center. The South Carolina Manufacturing Extension Partnership (SCMEP) was one of the original three extension centers established in 1989 as part of the NIST Manufacturing Extension Partnership (MEP) program.

The center operated for several years—through June 30, 2005—under prior NIST cooperative agreements. In September 2005, NIST approved funding for SCMEP for the period July 1 through December 15, 2005. In subsequent amendments, NIST extended the award to June 30, 2007. Total estimated project cost for the period July 1, 2005, through June 30, 2007, was $13,608,015, with the federal government’s share not to exceed $4,536,005, or a third of allowable project costs.

During the period July 1, 2005, through March 31, 2007, SCMEP submitted financial reports to NIST claiming total project costs of $11,406,434. Based on these claims, SCMEP received federal reimbursements totaling $3,802,144.

In April 2007, we initiated an audit of SCMEP to determine whether the recipient complied with the award terms and conditions and NIST operating guidelines for MEP centers. The audit covered the 21-month period of July 1, 2005, through March 31, 2007. The primary objective of our audit, as further explained in appendix A, was to determine whether South Carolina MEP reported to NIST allowable costs in accordance with federal regulations and NIST policy. We also examined cost claims of four SCMEP subrecipients: the University of South Carolina Center for Manufacturing and Technology (USC), the Greenville Technical College Buck Mickel Center (Greenville Tech), Clemson University Apparel Research (Clemson), and the South Carolina Export Consortium (SC Export).
FINDINGS AND RECOMMENDATIONS

We questioned $3,409,409 of the $11,406,434 in costs claimed by South Carolina MEP. Specifically, we questioned $3,406,909 in subrecipient costs and $2,500 claimed for an employee bonus not allocable to the NIST/MEP project.

We examined financial records of four of SCMEP’s subrecipients and found that three of them, the University of South Carolina – Center for Manufacturing and Technology (USC), Greenville Technical College – Buck Mickel Center (Greenville Tech) and South Carolina Export Consortium (SC Export) failed to meet the federal requirements for financial management systems as spelled out in 15 CFR Section 14.21. These three subrecipients did not provide complete verifiable documentation to support actual costs incurred or program income earned under the SCMEP subawards. USC did not identify either specific projects for costs claimed or the program income related to the same projects. Greenville Tech prepared an after-the-fact accounting analysis but we were unable to verify it against the official college accounting records. SC Export reported expenditures that were not assigned to the MEP program in its accounting system and failed to identify the remaining expenditures with any specific project related to MEP. Clemson reported incurred costs outside the scope of the NIST award in nearly all instances. We also found that SC Export did not incur sufficient expenses to meet matching share requirements and did not obtain the required NIST advance approval for foreign travel expenses. In addition, we found procedural problems at all four subrecipients. None of the four had appropriate budgets or written policies and procedures in place.

Finally, we found the parent entities for three of the subrecipients had obtained required single audit reports, but two of the three failed to list the MEP subawards on the Schedule of Expenditures of Federal Awards (SEFA). Consequently, two of the three MEP subawards were not subjected to the required specific auditing techniques of the single audit process.

$3,406,909 IN QUESTIONED SUBRECIPIENT COSTS

SCMEP’s claimed subrecipient costs totaled $3,469,409 in three categories: (1) $485,516 in the contractual cost category; (2) $2,816,349 was claimed as partner match; and, (3) $167,544 was claimed as in-kind.

We questioned $3,406,909 of the $3,469,409 SCMEP claimed for subrecipient costs. Specifically, we questioned costs in three categories: (1) $423,016 in the contractual cost category; (2) $2,816,349 in partner match; and, (3) $167,544 in the in-kind category. (See table 1.) We accepted $62,500 of costs claimed.

<table>
<thead>
<tr>
<th>Category</th>
<th>Costs Claimed</th>
<th>Costs Questioned</th>
<th>Costs Accepted</th>
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<tr>
<td>Contractual</td>
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<td>$423,016</td>
<td>$62,500</td>
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<td>Partner Match</td>
<td>$2,816,349</td>
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</tr>
<tr>
<td>In-Kind</td>
<td>$167,544</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>$3,469,409</strong></td>
<td><strong>$3,406,909</strong></td>
<td><strong>$62,500</strong></td>
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</tbody>
</table>
Contractual Cost Category

We are questioning $423,016 of the $485,516 SCMEP claimed as subrecipient award amounts under the contractual cost category. We accepted only $62,500 of cost claimed for subawards to Midland and Trident colleges. We decided not to test these two subrecipients because of their relatively small size. (See table 2).

<table>
<thead>
<tr>
<th>Subrecipient</th>
<th>Amount Claimed</th>
<th>Amount Questioned</th>
<th>Amount Accepted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greenville Technical College</td>
<td>$113,016</td>
<td>$113,016</td>
<td>$0</td>
</tr>
<tr>
<td>Clemson University</td>
<td>120,000</td>
<td>120,000</td>
<td>0</td>
</tr>
<tr>
<td>SC Export Consortium</td>
<td>190,000</td>
<td>190,000</td>
<td>0</td>
</tr>
<tr>
<td>Midland College</td>
<td>37,500</td>
<td>0</td>
<td>37,500</td>
</tr>
<tr>
<td>Trident College</td>
<td>25,000</td>
<td>0</td>
<td>25,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$485,516</strong></td>
<td><strong>$423,016</strong></td>
<td><strong>$62,500</strong></td>
</tr>
</tbody>
</table>

We questioned all Greenville Tech and SC Export expenses because the financial management systems did not meet federal requirements. We also questioned all Clemson expenses because the work performed was predominately outside the scope of the award. SCMEP did not claim an amount in the contractual cost category for the award to USC.

Partner Match Category

We questioned the entire $2,816,349 South Carolina MEP claimed for subrecipient project costs in the partner match cost category for the period July 1, 2005, through March 31, 2007. SCMEP did not break down costs claimed for each subrecipient. The claimed amount, $2,816,349, is comprised of various items, including carryover amounts from prior periods and adjustments not specific to particular subrecipients. This prevented us from questioning costs for each subrecipient. Therefore, we modified our audit approach. We calculated the total eligible subrecipient project costs individually and in total and then compared the total to the amount SCMEP claimed to NIST.

SCMEP payments to the subrecipients determined how much of each subrecipient’s cost SCMEP could claim. If payments to a subrecipient were less than the amount awarded, we based required matching share and total project expenditures on the amount of actual payments.

In-Kind Category

We questioned the entire $167,544 SCMEP claimed under the in-kind category. SCMEP adequately supported only $17,940 (for Clemson) of the $167,544. However, since we questioned all of Clemson’s costs as out-of-scope (see page 5), that includes the $17,940. Neither SCMEP nor the subsidiaries supported the remaining $149,604 of the in-kind claim.
The Subrecipients:

1. USC

The accounting system at USC did not meet financial system requirements for a federally funded project. The director of operations for USC’s Center for Manufacturing and Technology told us the center exists only for SCMEP projects. The center identified expenditures related to its operations but did not connect the expenditures to specific projects related to the subaward and did not identify related program income. To determine whether the subrecipient met the cost requirements of the subrecipient agreement, all appropriate project costs must be identified. Without complete accounting and program income information, we could not accept any costs for the USC center.

NIST operating plan guidelines for MEP centers, issued in March 2005, require all MEP subawards to include the applicable administrative requirements and all general and special award conditions imposed on the recipient. Minimum requirements for recipient and subrecipient accounting systems, as established in 15 CFR, Sec. 14.21, include:

- accurate, current, and complete disclosure of the financial results of each federally sponsored project or program (Sec. 14.21(b)(1)),
- comparison of outlays with budget amounts for each award (Sec 14.21(b)(4)), and
- written procedures for determining the reasonableness, allocability, and allowability of costs in accordance with applicable cost principles and the terms and conditions of the award (Sec. 14.21(b)(6)).

USC should be able to identify its expenditures by project and determine the project-related program income. Since USC charges fees to seminar participants and consulting clients that likely exceed service costs, there could be excess program income. Excess program income would reduce expenses that could otherwise be claimed against the subaward.

If the accounting system issue is subsequently resolved, a secondary issue will involve $16,887 in excess fringe benefit cost claimed. For the nine months ended March 31, 2007, fringe benefit cost was claimed at an arbitrary rate of 28 percent. This resulted in a cost claim of $50,530, including indirect cost, compared with $33,643 in actual fringe amount, including indirect cost, shown in the financial record of the USC Management Monthly report. The difference, an excess of $16,887, was included in the amount claimed against the subaward by USC.

2. Greenville Tech

Greenville Tech claims project expenditures by simply designating a portion of its normal and ongoing operating expenses as costs of the SCMEP subaward. There is no separately defined project that is developed and conducted as a result of the SCMEP subaward. Greenville Tech reported a portion of its annual operating expenses to SCMEP as allowable costs under the subaward. But Greenville Tech’s accounting system did not provide a verifiable accounting record for the MEP award and did not meet the 15 CFR, Sec.14.21 requirements for a financial
system.
Greenville Tech personnel prepared an after-the-fact spreadsheet listing costs and program income for the courses and consulting engagements related to costs claimed on the SCMEP subawards for the six-months ended December 31, 2006. The spreadsheet contained a list of instructor fees, materials, and total amount billed for each course. Greenville Tech managers told us spreadsheet amounts should equal the college’s BMC Monthly Report for external instructors but for internal instructors only close estimates were available. We tested 71 items from the spreadsheet and found 22 missing from the monthly report and 11 with a different date. The spreadsheet of actual expenses and program income should be verifiable to the official accounting records of Greenville Tech to validate the spreadsheet. Greenville Tech did not provide us with a verifiable accounting of project expenses and revenues. Without a complete and verifiable accounting for costs and program income, we were unable to accept any costs claimed for Greenville Tech.

If the accounting system issue is ultimately resolved, a secondary issue for Greenville Tech will be a $7,319 charge for office furniture claimed as property and equipment. The invoice presented us did not agree with the amount claimed and Greenville Tech did not provide a basis for charging the MEP project.

Greenville Tech should be able to provide complete and verifiable accounting information and determine program income related to the projects that benefited from award expenditures. Since it charges fees to course participants and consulting clients that exceed the costs of services, excess program income will likely become an issue, because it would reduce expenses that could be claimed against the subaward.

3. Clemson

Projects outside South Carolina make up the majority of Clemson’s MEP work, with little direct benefit to South Carolina manufacturers. We examined $45,000 in invoices and found less than 3 percent were for South Carolina projects. We found a major cost category, The Marine Shop, accounts for work performed entirely for the U.S. Marine Corps base in Quantico, Virginia. Another major category, Miscellaneous Industrial Projects, supports projects in North Carolina, Ohio, and Georgia. We do not believe Clemson Apparel Research projects are consistent with the purpose of the award to SCMEP.¹

The award’s General Terms and Conditions, Item 6: Statement of Work, provides that the tasks to be performed by the recipient under this award are detailed in the original proposal as amended by the required operating plans. In turn, the SCMEP Operating Plans for the years ended June 30, 2006, and June 30, 2007, provided the purpose and nature of the cost share for Clemson. Specifically, it was to provide assistance to manufacturers within the Upstate Region of the State of South Carolina. In addition, SCMEP’s Subrecipient Agreements with Clemson for these two years each contain an identical statement of work. The opening sentences in each say:

¹ We conducted tests with a judgmental sample of items which cannot be projected to the entire universe. We did not attempt to test items for the entire audit period but based our position on our sample tests and conversations with Clemson and SCMEP officials.
“The mission of the South Carolina Manufacturing Extension Partnership (SCMEP) is to strengthen the global competitiveness of South Carolina small to mid-sized manufacturers.”

The Clemson projects underlying the cost claimed to NIST were outside the stated purpose of the award except for minor instances, and we did not accept any cost related to the Clemson subaward.

If the scope issue is subsequently resolved as appropriate under the MEP program, a secondary issue will be excess program income. According to its Director, the Clemson Apparel Research unit is not funded by Clemson University. Therefore, it charged fees to consulting clients which exceeded the cost of services. 15 CFR Sec.14.24 states program income can be used to meet required matching expenses with any remaining amount being designated as excess program income. Any excess program income would then reduce the otherwise allowable project expenses.

An additional secondary issue would be that maximum project expenditures eligible to be claimed should not exceed an amount based on actual payments from SCMEP to Clemson. Total project expenditures, per Clemson’s accounting records, was $682,765 and exceeded the maximum allowable amount of $360,000 based on $120,000 in payments from SCMEP and the resulting $240,000 in matching share.

4. SC Export

SC Export did not fully expend its award payments from SCMEP or meet its matching share requirement. SC Export received payments for the entire subaward from SCMEP totaling $295,000. This required a match of $395,000 for a total project expenditure requirement of $690,000. SC Export reported total project expenditures, including matching share, of only $258,703 to SCMEP. We were unable to accept any of the $258,703 in reported expenses. We found that SC Export (1) reported expenditures of $128,705, for the six months ended December 31, 2005, that were not assigned to the MEP program in its accounting system, and (2) failed to connect the remaining $129,998 in reported expenditures with any specific project related to MEP.

We also found that the $258,703 included $2,049 in foreign travel for which NIST had not provided the required prior approval. In the event that the other cost issues are subsequently resolved by NIST, the foreign travel would become a secondary issue. We did not attempt to identify all foreign travel for the audit period. However, if NIST does not allow the foreign travel costs, NIST should require SC Export to identify all foreign travel for the entire audit period and disallow all unapproved cost.

OMB Circular A-122 Attachment B, Paragraph 55.e, states:

“Direct charges for foreign travel costs are allowable only when the travel has received prior approval of the awarding agency. Each separate foreign trip must be approved.”
SC Export identified total program income of only $19,000. The ultimate disposition of the program income depends on the final resolution of the cost items. However, it is unlikely there would be any excess program income.

EXCESS PROGRAM INCOME

According to 15 CFR, Sec. 14.2 (aa), program income is revenue generated by a financial assistance recipient as a result of performing work under its award. Two common sources of program income in MEP centers include tuition or other fees paid by manufacturers who attend training classes sponsored by the center, and fees paid by manufacturers for services provided by MEP staff or contractors.

The award to SCMEP allows it to use program income to fund the nonfederal share of project costs. 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 the recipient. In the award to SCMEP, the same requirements flow down to subrecipients. Excess program income could reduce the amount of cost that can be claimed against subawards. Subrecipient costs and program income must be connected—the same projects claimed as costs must be the projects that generate program income.

We cannot determine program income for USC or Greenville Tech until they provide verifiable documentation of costs and income. Neither properly accounted for or reported program income to SCMEP; therefore, we could not determine excess program income.

A determination of program income and excess program income will have to be made at Clemson if the issue of scope of work is subsequently resolved.

SC Export had only $19,000 of total program income and even if its cost issues are resolved it is unlikely to have excess program income.

SCMEP reported to NIST program income of $4,687,067, excluding subrecipients. This is less than the matching share requirement of $5,331,350 based on our total accepted costs of $7,997,025 (see Appendix C).
SUBRECIPIENTS LACKED REQUIRED BUDGETS AND WRITTEN PROCEDURES

Although 15 CFR Sec 14.21 (b) (4) requires both a budget and a comparison of outlays with budget amounts, only two of the signed agreements contained budgets. Clemson’s agreement for the year ended June 30, 2006, included a budget only for the direct portion of the award, $90,000. Likewise, USC’s agreement for the year ended June 30, 2006, also included a budget only for the direct portion of the award, $275,000. Neither the Clemson nor USC budget included matching share amounts. None of the other subrecipients’ signed agreements contained any subaward budget based on estimated costs that could be compared to actual outlays. 15 CFR 14.21 (b) (4) requires subrecipients to have a comparison of project expenditures with budget and written procedures to determine the allowability of subaward charges.

None of the four subrecipients we tested had written procedures in place to determine whether amounts reported to SCMEP met allowability requirements established by applicable federal cost principles. All subrecipients should have had written procedures for expenses and program income related to the MEP award, as required by 15 CFR Sec. 14.21 (b) (6). Written procedures should also require subrecipients to ensure they meet the requirements of the Single Audit Act.

AWARDS TO SUBRECIPIENTS WERE NOT IDENTIFIED IN SINGLE AUDIT REPORTS

Single audit reports were required by OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, for three of the four subrecipients we tested. Only one of three MEP programs of subrecipients required to be listed—Greenville Tech—was actually shown on the Schedule of Expenditures of Federal Awards of the parent organization’s single audit report for the year ended June 30, 2006. Therefore, two of the three NIST-MEP related subawards were not subjected to the required specific auditing techniques of the single audit process. The Single Audit Act Amendments of 1996 established uniform requirements for state, local, and tribal governments and nonprofit organizations receiving federal assistance. Under the act, nonfederal entities that expend $500,000 or more in a year in federal awards from more than one agency must be subject to a “single” audit, conducted by an independent auditor, and the resulting audit report must be submitted to the Federal Audit Clearinghouse.

OTHER QUESTIONED COSTS

In June 2006, SCMEP paid a $2,500 bonus to an employee who worked for the Women’s Business Center from January to October 2006. The Women’s Business Center is not an MEP cost center. According to OMB Circular A-122, Attachment A, Section A(4)(a)(1), a cost is allocable to a grant if it is incurred specifically for the award.
GRANTEE RESPONSE

The grantee’s complete response is included, without exhibits, as Appendix D. A brief summary of the primary points made in the grantee’s response and our comments follows:

The grantee’s response sets forth three main bases for rejecting the findings contained in the draft report. First, the grantee states an August 2007 amendment of the MEP statute by the America COMPETES Act, P.L. 110-69, clearly and unambiguously places the responsibility for determining the reasonableness and allocability of contributions on the MEP centers. The grantee contends that this change constitutes a clarification of the MEP statute which should be applied retroactively to the audit period (which predated the enactment of the statute), as it does not impose a new penalty, a new liability or create a new right of action. Although the grantee does not say so directly, if the grantee’s interpretation of the change is applied retroactively, the MEP centers, not the OIG or NIST, would be allowed to make final determinations on the reasonableness and allocability of program costs.

The grantee also rejects the draft report’s finding that the four entities named in the report with whom it partnered were subrecipients and therefore subject to the flow-down provisions of 15 C.F.R. §14.5 (which include the requirement to maintain a financial management system consistent with 15 C.F.R. §14.21, to report program income pursuant to 15 C.F.R. §14.24, and to comply with the Single Audit Act as appropriate). According to the grantee, the statute which established the MEP program authorized the various MEP centers to establish relationships with partners as a way of expanding services to small and medium-sized businesses, and partners are not required to be subrecipients. Further, the grantee states that the four partners discussed in the draft report cannot be subrecipients, as defined in 15 C.F.R. §14.2, as they have received no federal funds or property. According to the grantee, given the MEP program’s national context, a partner may have the characteristics of a subrecipient, a contractor/vendor, or a third party in-kind contributor at various points in time.

With regard to the costs questioned as a result of noncompliant financial management systems, the grantee contends that in this case its partners should be treated as in-kind contributors, who are required to comply with 15 C.F.R. §14.23 instead of 15 C.F.R. §14.21, and that in fact all the partners actually did meet those standards. The grantee concludes this discussion by noting that although they are not required to do so, the partners’ actually do comply with 15 C.F.R. §14.21 because they: 1) maintain accurate, current and complete disclosures of the financial results of each project, 2) compare outlays/expenditures with budget amounts from within their accounting systems and as reported quarterly to SCMEP, and 3) have SCMEP written procedures for determining the reasonableness, allocability and allowability of the costs under the applicable cost principles of the award.

Finally, the grantee rejects the draft report’s questioning of contributions based on work performed for businesses outside the state of South Carolina as being outside the scope of the project. According to the grantee, the MEP program is a national program and as such there is no limit to the geographic service area under its awards. It further contends that projects undertaken by its partners outside the state of South Carolina benefit South Carolina manufacturers because they could be used in learning and demonstration of technologies for South Carolina companies and because components from South Carolina manufacturers could be used in out-of-state
projects.

In its response, the grantee also stated that the basis for the questioned cost categories and the numeric values contained in the draft report is unclear and that it cannot ascertain the sources for these amounts. In addition, the grantee commented that our modified approach for the $2,816,349 questioned under the partner match category is problematic in that it limits the allowable costs under the project by imposing cost share restrictions on each individual partner based on amount of funds received as a whole. The grantee states that this approach precludes SCMEP from counting costs that are otherwise eligible under cost principles and regulations. Finally, the grantee also expressed disagreement with the disallowance of a $2,500 bonus for an employee but did not provide any specific information as to why it disagreed with that action.

**OIG COMMENTS**

The grantee provided no information in its response that led us to change any of the findings and recommendations contained in the draft report. Our responses to the main issues raised by the grantee follow.

We found that the grantee’s belief that a change to the MEP statute resulting from the America COMPETES Act clearly places authority for determining the reasonableness and allocability of contributions on the centers is not supported by a straightforward textual analysis of the amendment in question. The critical sentence of the relevant change reads as follows:

> 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 U.S.C. §278k(c)(3)(C).

There is no question that this provision authorizes Centers to make determinations as to the reasonableness and allocability of contributions they receive. That those determinations are not final is evidenced by use of the permissive word “includable”, as opposed to mandatory language such as “shall be included” or “must be included.” Such determinations must also be made pursuant to MEP program procedures—a critical requirement that the grantee omitted when quoting this provision of the Act in its response to the draft report. MEP program procedures explicitly call for the Centers to make a determination of what costs to claim and not what costs to allow, state that the cost principles apply and provide for program review of a recipient’s claimed costs, with authority to make final determinations of reasonableness and allowability resting with the program. In light of the foregoing, the only reasonable construction of this sentence is that it recognizes that Centers make initial determinations about contributed costs that can be claimed by a Center, but that those determinations, pursuant to MEP program procedures, are subject to review by the program and do not mean that the costs must be allowed by the MEP program. Nothing in this language or any other provision of the Act gives the Centers authority to make final and unreviewable determinations of the reasonableness or allocability of costs contributed by third-parties with which Centers partner.
Because the relevant change to the MEP statute clarifies Congressional intent without materially altering the rights and obligations of grantees, the change can be retroactively applied. It should be noted that had the interpretation posited by the grantee been correct, then under well established principles of law it would not be eligible for retroactive application, as it would constitute a significant change in law and would materially alter grantees’ rights and obligations under the program.

The grantee’s conclusion that its partners are not subrecipients is undermined by its own actions. In its response the grantee acknowledged that at NIST’s direction it entered into subrecipient agreements with the entities it now seeks to characterize as partners, third party in-kind contributors, contractors and/or vendors. Those agreements were approved by NIST, contained a description of subrecipient responsibilities, and were signed by the partners as subrecipients. The subrecipient designation is used throughout the agreements with these entities and in SCMEP’s annual operating plans for the years ending June 30, 2006, and June 30, 2007, respectively. SCMEP has not provided evidence of any subsequent action by the grants officer to approve relationships with these partners as third-party in-kind contributors, rather than as subrecipients. Also, we do not see how subrecipients that receive project funds from SCMEP and do not identify expenditures above and beyond their normal operations as incurred for the NIST-MEP project can be considered to be contributors. The mere fact that the partners failed to uphold their responsibilities as subrecipients does not mean that they should not be treated as such.

With regard to the grantee’s statement that its partners received no federal funds, the grantee received an appropriation from the state of South Carolina and funding from the NIST-MEP program. Using those combined funds, the grantee made subawards, described as being part of the NIST-MEP program, to the subrecipients. The total expenditures by the subrecipients were subsequently claimed as project costs by SCMEP, thereby resulting in the receipt of federal funds by the grantee.

Insofar as the grantee’s contention that its partners complied with both 15 C.F.R. §14.21 and 15 C.F.R. §14.23 is concerned, it does not appear that the grantee met the requirements of either section. Throughout the draft report we described areas where the grantee failed to meet the requirements of §14.21, and none of the evidence presented by the grantee led us to change our conclusions on this point. Regarding §14.23, even if SCMEP’s contention that at some points its partners were third-party in-kind contributors was valid, it does not appear that any related cost claims would be allowable. 15 C.F.R. § 14.23 requires, among other things, third party in-kind contributions to be verifiable from the recipient’s records, shown as necessary and reasonable for accomplishment of the project or program objectives, allowable under the applicable cost principles, and adequately provided for in the approved budget. Our findings throughout this report show that the grantee did not meet these requirements. Also, the grantee discusses, at some length, comparison of actual outlays with budgeted amounts for each subrecipient. However, as we discuss on page 8 of the report, there was no complete project budget provided us for any of the subrecipient awards. As a result, there was no basis for comparing actual expenditures with budgeted amounts.
The grantee stated that the SCMEP partners received only state funds, and were therefore not required to participate in the single audit process with respect to the MEP award. Because they received NIST SCMEP project funds, which included money from both federal and state sources, the three subsidiaries were subject to including the MEP award in their single audits. We note that one of the three subrecipients, Greenville Tech, included the MEP award in its single audit. The remaining two subrecipients, USC and Clemson, did not include the awards in their respective single audits.

The grantee’s contention that the MEP program’s national scope means that awards made under the program have no geographic limitations is not supported by the documents associated with this award. As the audit report points out on pages 5 and 6, the subrecipient award says specifically that the award is to strengthen the global competitiveness of South Carolina small to mid-sized manufacturers. In addition, the pertinent SCMEP Operating Plans are even more restrictive, providing that the purpose of the award to Clemson is to provide assistance to manufacturers within the Upstate Region of South Carolina.

With regard to the concerns raised by the grantee about the cost categories and associated numeric values contained in the draft report, it should be noted that the grantee provided us the very cost categories and numeric values it now claims it has trouble understanding. The grantee provided us a spreadsheet accumulating, by cost category, the amount of costs claimed to NIST over the 21-month audit period. This spreadsheet agrees with the form 269s that SCMEP filed with NIST. These costs are listed in our draft report, APPENDIX C page 1.

Finally, with regard to the $2,500 employee bonus, we continue to question this amount because although the grantee disagreed with the disallowance of this cost, it provided no information to indicate that it should be allowed.
RECOMMENDATIONS

We recommend the Chief, NIST Grants and Agreements Management Division:

1. disallow $3,409,409 in questioned costs and recover $1,136,736 in excess federal funds, and

2. require the recipient to ensure that the subrecipients have appropriate budgets and written policies and procedures that meet financial system requirements prior to granting any future subawards. The written procedures should require subrecipients to meet the requirements of the Single Audit Act.
SUMMARY RESULTS OF FINANCIAL AUDIT

The results of our interim cost audit for the period July 1, 2005, through March 31, 2007, which are detailed in Appendix C, are summarized as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Funds Disbursed</td>
<td>$3,802,144</td>
</tr>
<tr>
<td>Costs Incurred</td>
<td>$11,406,434</td>
</tr>
<tr>
<td>Less Questioned Costs</td>
<td>$3,409,409</td>
</tr>
<tr>
<td>Costs Accepted</td>
<td>$7,997,025</td>
</tr>
<tr>
<td>Federal Cost Sharing Ratio</td>
<td>X 33.33%</td>
</tr>
<tr>
<td>Federal Funds Earned</td>
<td>$2,665,408</td>
</tr>
<tr>
<td>Refund Due the Government</td>
<td>$1,136,736</td>
</tr>
</tbody>
</table>

Judith J. Gordon  
Assistant Inspector General  
for Audit and Evaluation
APPENDIX A: OBJECTIVES, SCOPE, AND METHODOLOGY

The primary objective of our audit was to determine whether South Carolina MEP reported costs to NIST, including costs incurred by subrecipients that were reasonable, allocable, and allowable in accordance with applicable federal cost principles, cooperative agreement terms and conditions, and NIST policy, including MEP Operating Plan Guidelines. To achieve our objectives, we interviewed South Carolina MEP and NIST Grants Office officials, reviewed NIST award documents, and examined financial records of South Carolina MEP. We also interviewed officials and examined financial records of four South Carolina MEP subrecipients.

Our audit scope included a review of costs claimed by South Carolina MEP during the audit period of July 1, 2005, through March 31, 2007. Our audit objectives included determining the grantee’s progress compared with operating plan performance goals. We reviewed the NIST October 2006 annual assessment of the grantee’s progress that stated SCMEP was doing an outstanding job. We did not independently evaluate South Carolina MEP’s performance under the award. Additional questioned costs could result from subsequent performance audits. We determined the validity and reliability of computer-processed data by direct tests of the data to supporting documentation.

Our audit included an assessment of the MEP’s internal controls applicable to the award to evaluate the effectiveness of the control and accountability systems. We reviewed South Carolina MEP’s most recent single audit reports for the year ended December 31, 2005, and the six-months ended June 30, 2006, respectively. An independent certified public accounting firm conducted the audits in accordance with Office of Management and Budget Circular A-133. The report for June 30, 2006, disclosed material internal control weaknesses but stated that South Carolina MEP had implemented policies and procedures and developed plans to address the weaknesses. We did not rely upon the accounting firm’s internal control reviews but instead determined that we could better meet our audit objectives through testing of transactions. We also determined that only one of three eligible subrecipients of South Carolina MEP was listed in the parent organization’s single audit reports as required.

We reviewed compliance with laws and regulations as they applied to costs incurred, using as criteria Office of Management and Budget Circular A-21 Cost Principles for Educational Institutions, Circular A-122, Cost Principles for Nonprofit Organizations, Circular A-133 Audits of States, Local Governments, and Non-Profit Organizations, and 15 CFR, Part 14, Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, Other Non-Profit, and Commercial Organizations. We also assessed compliance with the Department of Commerce Financial Assistance Standard Terms and Conditions, MEP General Terms and Conditions, and the cooperative agreement Special Award Conditions. Instances of noncompliance with the above stated laws and regulations are noted in this audit report.
This audit was conducted under the authority of the Inspector General Act of 1978, as amended, and Department Organization Order 10-13, dated August 31, 2006. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We conducted our fieldwork during April and May 2007 at South Carolina MEP’s headquarters in Columbia, South Carolina, and at subrecipient offices in Clemson, Columbia, and Greenville, South Carolina.
APPENDIX B: SUMMARY OF SOURCE AND APPLICATION OF FUNDS

SOUTH CAROLINA MEP
NIST COOPERATIVE AGREEMENT NO.70NANB5H1187
JULY 1, 2005 THROUGH MARCH 31, 2007

<table>
<thead>
<tr>
<th>Source of Funds</th>
<th>Approved Budget (1)</th>
<th>Receipts &amp; Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal</td>
<td>$4,536,005</td>
<td>$3,802,144</td>
</tr>
<tr>
<td>Non-Federal</td>
<td>9,072,010</td>
<td>7,604,290</td>
</tr>
<tr>
<td>Total</td>
<td>$13,608,015</td>
<td>$11,406,434</td>
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</tbody>
</table>

APPLICATION OF FUNDS:

<table>
<thead>
<tr>
<th>Category</th>
<th>Approved Budget (1)</th>
<th>Receipts &amp; Expenses</th>
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</thead>
<tbody>
<tr>
<td>Personnel</td>
<td>$3,343,000</td>
<td>$2,786,603</td>
</tr>
<tr>
<td>Fringe Benefits</td>
<td>900,042</td>
<td>725,254</td>
</tr>
<tr>
<td>Contractual</td>
<td>5,068,760</td>
<td>4,049,575</td>
</tr>
<tr>
<td>Other</td>
<td>679,597</td>
<td>638,147</td>
</tr>
<tr>
<td>Supplies</td>
<td>150,000</td>
<td>55,368</td>
</tr>
<tr>
<td>Travel</td>
<td>400,000</td>
<td>167,594</td>
</tr>
<tr>
<td>Equipment</td>
<td>170,000</td>
<td>0</td>
</tr>
<tr>
<td>Partner Match (2)</td>
<td>2,047,994</td>
<td>2,816,349</td>
</tr>
<tr>
<td>In-Kind</td>
<td>0</td>
<td>167,544</td>
</tr>
<tr>
<td>Indirect Costs</td>
<td>848,622</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>$13,608,015</td>
<td>$11,406,434</td>
</tr>
</tbody>
</table>

1. The approved budget amounts are for the 2 years ended June 30, 2007. The receipts and expenditures are the actual amounts for the period of our audit, July 1, 2005 - March 31, 2007.

2. Partner Match in the amount of $2,047,994 for the 2 years ended June 30, 2007, was contained in the “Other” category in the original award budget.
APPENDIX C: SUMMARY OF FINANCIAL/COMPLIANCE AUDIT

SOUTH CAROLINA MEP
NIST COOPERATIVE AGREEMENT NO. 70NANB5H1187
JULY 1, 2005 THROUGH MARCH 31, 2007

<table>
<thead>
<tr>
<th>Description</th>
<th>Budget (1)</th>
<th>Claimed</th>
<th>Costs</th>
<th>Costs</th>
<th>Costs</th>
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<tr>
<td></td>
<td></td>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>Personnel</td>
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<td>$2,786,603</td>
<td>$2,500(a)</td>
<td>0</td>
<td>$2,784,103</td>
</tr>
<tr>
<td>Fringe Benefits</td>
<td>900,042</td>
<td>725,254</td>
<td>0</td>
<td>0</td>
<td>725,254</td>
</tr>
<tr>
<td>Contractual</td>
<td>5,068,760</td>
<td>4,049,575</td>
<td>423,016(b)</td>
<td>0</td>
<td>3,626,559</td>
</tr>
<tr>
<td>Other</td>
<td>679,597</td>
<td>638,147</td>
<td>0</td>
<td>0</td>
<td>638,147</td>
</tr>
<tr>
<td>Supplies</td>
<td>150,000</td>
<td>55,368</td>
<td>0</td>
<td>0</td>
<td>55,368</td>
</tr>
<tr>
<td>Travel</td>
<td>400,000</td>
<td>167,594</td>
<td>0</td>
<td>0</td>
<td>167,594</td>
</tr>
<tr>
<td>Equipment</td>
<td>170,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Partner Match (2)</td>
<td>2,047,994</td>
<td>2,816,349</td>
<td>2,816,349(b)</td>
<td>$2,456,349</td>
<td>0</td>
</tr>
<tr>
<td>In-Kind</td>
<td>0</td>
<td>167,544</td>
<td>167,544(b)</td>
<td>149,604</td>
<td>0</td>
</tr>
<tr>
<td>Indirect Cost</td>
<td>848,622</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$13,608,015</strong></td>
<td><strong>$11,406,434</strong></td>
<td><strong>$3,409,409</strong></td>
<td><strong>$2,605,953</strong></td>
<td><strong>$7,997,025</strong></td>
</tr>
</tbody>
</table>

**Results of Audit**

1. The approved budget amounts are for the 2 years ended June 30, 2007. The receipts and expenditures are the actual amounts for the period of our audit, July 1, 2005 - March 31, 2007.

2. Partner Match in the amount of $2,047,994 for the 2 years ended June 30, 2007, was contained in the “Other” category in the original award budget.

Federal Funds Disbursed $3,802,144
Costs Incurred $11,406,434
Less: Questioned Costs 3,409,409
Costs Accepted 7,997,025
Federal Cost Sharing Ratio x 33.33%
Federal Funds Earned 2,665,408

Refund Due the Government $1,136,736

Notes:

(a) SCMEP paid a $2,500 bonus in June 2006 to an employee who worked for the Women’s Business Center from January to October 2006. The Women’s Business Center is not an MEP cost center. According to OMB Circular A-122, Attachment A, Section A(4)(a)(1), a cost is allocable to a grant if it is incurred specifically for the award.
We questioned $3,406,909 of the $3,469,409 claimed by SCMEP for subrecipient cost. The $62,500 cost we accepted is for costs related to the two subrecipients we did not include in our tests, Trident and Midland Colleges (see page 2). Specifically, we questioned costs in three categories: (1) $423,016 in the contractual cost category; (2) $2,816,349 in partner match; and, (3) $167,544 under in-kind. The practices USC, Greenville Tech and SC Export used to report subaward costs to South Carolina MEP were not in compliance with the financial system requirements of 15 CFR, Sec. 14. The project costs reported by Clemson were outside the scope of the award. In addition, SC Export did not fully expend its award payments from SCMEP nor meet its matching share. SC Export also had unapproved foreign travel expense.

Of the $2,816,349 in questioned costs for the partner match category, only the Clemson maximum project costs of $360,000 were adequately supported. The balance of $2,456,349 was unsupported. Of the $167,544 in questioned costs for the in-kind category, only the Clemson cost of $17,940 was supported, leaving $149,604 unsupported.
bcc:    Judith J. Gordon, assistant inspector general for audit and evaluation
        Allison Lerner, counsel to the inspector general
        David A. Sheppard, deputy assistant inspector general for regional audits
        John Bunting, Denver regional inspector general
        Ron Lieberman, director, business & science division, office of audits
        Keith Teamer, special agent-in-charge, office of investigations Atlanta field office
        Greg Sebben, special agent in-charge, office of investigations Washington field office
        Annie Holmes, management analyst
        Jackie Day, auditor
        IG Office
        Editor
        McKevitt
        McMahan
        Scott
        Master file
VIA OVERNIGHT DELIVERY

Kathleen M. McKevitt
U.S. Department of Commerce
401 W. Peachtree St., NW Suite 2742
Office of Inspector General
Atlanta, GA 30303-5222

Re: Response to Draft Audit Report ATL-18567-8-0001

Dear Katie:

Please find enclosed the response to the draft audit report. We have many questions regarding the auditor's calculations and categorization of costs. With less than 30 working days to respond, we were not able to obtain all of the additional documentation requested from the four partners in time for this response. We request that you provide the audit work papers supporting the final audit report, so that we clearly understand the basis for the cost disallowances and can be fully responsive to your findings.

If you have any questions regarding the response or enclosures, please do not hesitate to contact me. Please also advise us as to when you will be releasing the final audit report, if it will be in excess of 30 days. The SCMEP, of course, is most anxious to resolve this.

Sincerely,

Stacia Davis Le Blanc
Senior Counsel

Enclosures

cc: Judith Gordon
    Joyce Brigham
APPENDIX D

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South Carolina MEP Response to Draft Audit Report No. ATL-18567-8-0001

INTRODUCTION

The South Carolina Manufacturing Extension Partnership (SCMEP) submits this response to the Draft Audit Report No. ATL-18567-8-0001 August 2008 (Draft Audit Report). The audit is in reference to Award No. 70NANB5H1187 for the period of July 1, 2005 through March 31, 2007. The auditor questioned $3,409,409, in costs and attributes these costs to the SCMEP partners that receive only state funds under the program.

The records from SCMEP and its partners demonstrate that the reported costs were in fact reasonable, allocable, and allowable in accordance with applicable federal cost principles, cooperative agreements terms and conditions, NIST policy, as well as the MEP statute. As such, NIST should not seek to recover the full $1,136,736 as proposed in the recommendations of the Draft Audit Report. The SCMEP disputes the findings and recommendations outlined in the Draft Audit Report and explains the legal and factual basis for the dispute in detail below.

One general comment concerning the audit is that the twenty one-month audit period seems excessive and arbitrary. The audit period is particularly problematic in light of the fact that the auditor did a cursory review of one quarter of SCMEP’s accounting records and focused primarily on the documentation maintained by the SCMEP partners. The consequence of claiming an audit period that spans a twenty-one month period is the ability of the auditor to assert substantially larger disallowances after examining a relatively small portion of the documentation. If the audit period had been more reasonably limited in scope, the questioned costs for a six or twelve month period would have been half the amount now questioned.

The Draft Audit Report No. ATL-18567-8-0001 was issued August 21, 2008, but SCMEP was only provided thirty days with which to respond. The auditor had from the date of his last conference call and e-mail in February, 2008, to prepare the report, but it was not written and issued until six months later. We find it extremely unreasonable for the federal auditor to only allow the auditee less than 30 days to prepare a full blown response not only by the SCMEP, but each of its four partners. In fact, based on the last communication from the auditor, he stated that there would be no questioned costs related to South Carolina Export Consortium. It was quite a surprise to learn of this on the day the report was issued. Also, during this 30-day period, SCMEP’s A-133 audit was taking place. The accounting records were simultaneously being accessed by the outside audit firm which made it difficult to find the information quickly to respond to this audit report.

In order to clear up the questioned costs and maintain our good standing in the community, we want the agency to similarly meet the tight time requirements for this process. We requested additional time to be able obtain documentation from our partners, but it was denied. We have been unable to determine the source of many of the calculations that the auditor included in the report and were provided no audit work papers. We submit the Draft Audit Report Response postmarked on September 22, 2008 (the thirtieth day from the date of the letter not the receipt of
the letter. The IG, evidently has no time limitation for issuing the final report. If 30 days is a reasonable time period within which an auditee must respond, then the auditor should similarly meet the 30 day requirement for issuing the final report so we expect a response by October 22, 2008. SCMEP will again have only thirty (30) calendar days to respond. We note that at the same time, the auditee is only provided 30 days, NIST will have sixty (60) days to prepare an audit report action plan which must be approved or disapproved by the within fifteen (15) working days by the IG. The audit resolution should then be prepared by November __, 2008. If NIST has any disagreements with the audit action plan, the Assistant Inspector General for Compliance and Audit Resolution and the NIST audit resolution officer shall work to resolve any disagreements within 45 days. If agreement cannot be reached, the agency will convene a meeting of the Audit Resolution Council. If the Council does not reach a resolution, the matter will be referred to the Deputy Secretary for final decision. The Deputy Secretary is the only official in the entire Commerce Department that can make the “management decision.” SCMEP intends to enforce these timelines to the greatest extent possible in order to reach a resolution of these questioned costs in an efficient and expedient manner so that it may continue to operate and provide necessary services to its manufacturing clients. Much time, effort, and money has been expended by SCMEP that could have been spent towards work for small to medium sized manufacturers and would have resulted in a positive economic impact which is the mission of the MEP program.

OVERVIEW OF THE NATIONAL MEP PROGRAM

Many of the auditor’s comments appear to be based on a fundamental misinterpretation of how the MEP project works as a whole and how the parties interact. For example, the auditor frequently mentioned that partners failed to “connect the expenditures to specific projects” and considered work outside of scope merely because it takes place out of state. These statements do not acknowledge the global mission and national partnership structure of the MEP program and the critical role that the partners play in the National Manufacturer Extension Partnership. For that reason this response provides a background on the MEP program in general as well as how SCMEP works.

The overarching goal of the MEP program, as embodied in the authorizing statute, is to increase the global competitiveness of United States manufacturing by enhancing productivity and technological performance. Congress envisioned that MEP Centers would accomplish this goal by: (1) the transfer of manufacturing technology and techniques from NIST to Centers to manufacturing companies; (2) participation of individuals from industry, universities, State governments, other Federal agencies and NIST in cooperative technology transfer activities; (3) efforts to make new manufacturing technology and processes accessible and usable by small and medium-sized U.S. companies; (4) active dissemination of scientific, engineering, technical, and management information to industrial firms; and (5) utilization of expertise and capability that

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1 IG Draft Audit Report, Enclosure I at 1.
2 Id.
4 Id.
5 Id.
6 IG Act, 5 U.S.C.
exists in Federal labs other than NIST.\textsuperscript{8} Specific activities conducted by the Centers would include: (1) establishment of automated manufacturing systems and other advanced production technologies, based on research by the Institute, for the purpose of demonstrations and technology transfer; (2) the active transfer and dissemination of research findings and Center expertise to a wide range of companies and enterprises, particularly small- and medium-sized manufacturers; and (3) loans, on a selective, short-term basis, of items of advanced manufacturing equipment to small manufacturing firms with less than 100 employees.\textsuperscript{9}

MEP Centers are instructed, by statute, to achieve these objectives by forming partnerships with organizations such as private industry, universities, and State governments. The goal of these partnerships is three-fold: to accomplish programmatic objectives, to further the impact of the Federal investment, and to assist recipients in meeting their cost-share requirements.\textsuperscript{10} The partnering organizations take the knowledge shared by the MEP Center and, through their own activities, assist manufacturing firms, expanding the impact of the Federal investment.

As referenced in the draft audit report, SCMEP was established in 1989 as one of the original three MEP programs. The performance of SCMEP is reviewed by NIST on an annual basis with a bi-annual review that is more in-depth and performed by an independent panel of experts. Just a few months prior to this, NIST proclaimed that SCMEP was doing an outstanding job.\textsuperscript{11} Over the past twenty years, SCMEP has developed many strong partnerships. Working with these organizations and with manufacturers directly has led SCMEP to the realization that participating in the statewide and nationwide economic development networks is an efficient and effective way for SCMEP to accomplish its mission of improving the global competitiveness of South Carolina small and mid-sized manufacturers.

Partnerships, consistent with statutory mandates, add value to SCMEP by reducing the duplication of activities and by leveraging the partner's activities to increase SCMEP's mission effectiveness, penetration, and output.\textsuperscript{12} Partners use their own reputation and marketing and referral activities to promote the MEP efforts and services, resulting in increased market penetration and efficiencies in project execution. Partners also increase SCMEP's value and prevalence within the American manufacturing community by integrating MEP services into the partner's own services to enhance achievement and performance by small and medium sized manufacturers.

Activities performed by partners are mutually beneficial to the partner, its members, SCMEP's clients, and the Center itself. The goal of the MEP program, as embodied in its programmatic objectives, is not to bring other resources back into the Center (the typical paradigm of cost-share programs), but instead the goal is to push the technology, programs, and expertise as far out into the American manufacturing community as possible. The direct benefit the Center receives from its partnerships is the ability of another entity to provide the services and perform the education and outreach functions that would otherwise fall to the Center, allowing the Center to focus on

\textsuperscript{8} 15 U.S.C. § 278k(b).
\textsuperscript{9} 15 U.S.C. § 278k(c)
\textsuperscript{10} Id.
\textsuperscript{11} See Exhibit 1, 2006 NIST Annual Review Report.
\textsuperscript{12} America Competes Act, P.L. 110-69, Sec. 3003, 121 Stat. 587 (2007).
offering additional services, education, and outreach to SMEs.

Recently, in August 2007, Congress enacted a legislative amendment to clarify how the MEP Centers’ cost contributions should be determined. Clarification became necessary after the audits of 2003 and NIST’s misguided attempts to conform the program to grant rules that in reality frustrate the mission and purpose of the MEP program as conceived by Congress.

The provisions in the legislative clarification that replace the prior language of 15 U.S.C. § 278k(c)(3) clarify the nature and classification of non-Federal costs contributed by partnering organizations. The legislation further states that:

In meeting the 50 percent requirement, it is anticipated that a Center will enter into agreements with other entities such as private industry, universities, and State governments to accomplish programmatic objectives and access new and existing resources that will further the impact on the Federal investment. All non-federal costs, contributed by such entities and determined by a Center as programmatically reasonable and allocable are includable as a portion of the Center’s contribution. Id.

The amendment to the MEP legislation provided clarifications that first, all non federal costs contributed by partnering entities count as a portion as the Center’s cost contribution. Second, it defines “costs incurred” as “costs incurred in connection with the activities undertaken to improve the management, productivity, and technological performance of small- and medium-sized manufacturing companies.” America Competes Act, Pub. L. 110-69, § 3003(a)(3)(C).

Third, the statute clearly places the authority for determining which costs are allocable and reasonable on the Center. Fourth, the amendment encourages Centers to utilize the partners’ existing resources in accomplishing the MEP mission. Without these partnerships, the Centers would not meet their cost share requirements. The statute contemplates that not all partnerships will involve the transfer of federal dollars and therefore to classify the relationship between Centers and partners as anything other than a partnership would be inaccurate and inconsistent with the authorizing statute.

The legislative history is clear that contributions by industry, universities, and state governments, which frequently act as partners, (i.e. the partners of SCMEP) “may be included as a portion of the Center’s 50 percent or greater funding obligation if it is determined by the Center to be programmatically reasonable and allocable.” H. Rept. 110-289 at 16 (emphasis added).

The auditor dismisses the value of the partnership by arguing that these partners would exist whether there is an MEP Center or not. However, in doing so the auditor dismisses the statutory requirement that partners offer their existing resources to finance their programmatic activities. Contrary to the auditor’s interpretation, the MEP Center is mandated to establish partnering relationships with existing organizations in order to draw down federal funds. These partnerships will assist the MEP Center to efficiently and economically promote the transfer of technology.

In determining whether an amendment clarifies or substantively changes a prior law, a court may
consider several factors. One such factor is whether the enacting body has stated its intent to clarify the prior enactment. Here we have such a declaration by Congress, not just in the text of the act itself, but also in the legislative history. Congress titled the section “Clarification of Eligible Contributions in Connection with Regional Centers Responsible for Implementing the Objectives of the Program.” Clarification should be given its ordinary meaning and should be treated as a declaration by Congress of its intent for the amendment to serve as a clarification.

Another factor courts may consider is whether a conflict or ambiguity existed with respect to the interpretation of the relevant provision when the amendment was enacted. The prior provision on a Center’s federal share stated only that “applicant shall provide adequate assurances that it will contribute 50 percent or more of the proposed Center’s capital and annual operating and maintenance costs for the first three years and an increasing share for each of the last three years.” The regulations enacted by the Department of Commerce (illegally) elaborated on this provision, but amendment was necessary in light of conflicting interpretations as to sources of the applicant’s contributions. The opposing interpretations arose after a series of audits of MEP Centers where they disputed the sources of cost share, claiming that contributions from partnering organizations were not allocable to the MEP Centers because these organizations would have carried out these activities without the MEP partnership. Despite claims by the Center and their partners regarding the value and mutual benefit of these partnerships, the auditor still fail recognize their expenditures as valid sources of matching funds. As explained above in Section I.B, the new legislation clarifies Congress’ intent for a Center to include a partner’s expenditures determined to be reasonable and allocable to meet the cost share requirement.

Where there is no explicit instruction from Congress as to whether a statute is applied retroactively, courts are generally reluctant to allow such an effect. See Bowen v. Georgetown University Hospital, 488 U.S. 204, 208 (1988). In its retroactivity analysis, the Supreme Court quotes Professor Llewellyn for his recognition of the tension between retroactive application and remedial statutes. The amendment in this case has none of the characteristics that would bar retroactive application and is much more akin to the remedial statutes which ought to be applied retroactively to “promote the ends of justice.” In Landgraf v. USI Film Products, 511 U.S. 244, 270 (1994) the Supreme Court announced that “the court must ask whether the new provision attaches new legal consequences to events completed before its enactment.” The amendment does not impose a new penalty, a new liability, or create a new right of action. Concerns about

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14 Id. at 1284 (Courts may rely upon a declaration by the enacting body that its intent is to clarify the prior enactment.).
17 America Competes Act, Pub.L. 110-69, § 3003, 121 Stat. 587 (2007) (non-Federal assets obtained from the applicant and the applicant’s partnering organizations will be used as a funding source to meet not less than 50 percent...”).
18 Landgraf v. USI Film Products, 511 U.S. 244, 264 n. 16 (1994), quoting Llewellyn, Remarks on the Theory of Appellate Decisions and the Rules or Canons about How Statutes are to be Construed, 3 Vand.L.Rev. 395 (1950) (a statute imposing a new penalty or forfeiture, or a new liability or disability, or creating a new right of action will not be construed as having a retroactive effect; [r]emedial statutes are to be liberally construed and if a retroactive interpretation will promote the ends of justice, they should receive such construction.).
19 See also Piamba Cortes, 177 F.3d at 1283 (“We first look to see whether the amendment effects a substantive change in the legal standard or merely clarifies the prior law.”).
the retroactive effect are absent in cases where an amendment is deemed to clarify the relevant law. Therefore the harms in applying the amendment retroactively are inapplicable in this case.

PARTNER COSTS

The auditor proposes disallowance of these costs because the auditor determined that the partners were subrecipients, should have been subject to the flow down provisions of 15 C.F.R. §14.5 and therefore required to meet the Financial Management Standards applicable to recipients, set forth in 15 C.F.R. § 14.21, and that none of the four questioned partners had met these requirements. SCMEP rejects the auditor's characterizations of partners as subrecipients. Nevertheless the partners have accounting systems in place and records that meet the requirements of 15 C.F.R. § 14.21. Furthermore, the auditor's determination that the partners are subrecipients fails to give the full picture. All four partners have multiple characteristics that make it difficult to fit them into one particular category for every type of transaction. For example, SC Export, for the most part, seems like a vendor/contractor, but is also a partner. USC might be categorized as a third party contributor because it receives its funds directly from the state but is a key partner in fulfillment of the MEP mission.

As noted in the Overview section, the authorizing statute requires MEP Centers to form a network of partnering organizations to assist them in reaching small- and medium-sized manufacturers, thereby furthering the impact of the Federal investment. The statutory emphasis of the program is on forming strategic partnerships to use existing resources and avoid duplication of services. Partnering organizations of an MEP Center can be entities in private industry, universities, and State governments. The Centers' partnerships are integrated with existing state economic development, community college, and trade or industry association programs. This statutory partnering model is unique to the MEP program; it couples the partners' work with that of the MEP Centers so that the provider of services to manufacturers is indistinguishable between the partner and the Center. The Centers' partners have the same overall mission objectives and share common values, approaches, and targeted market segments. A Center may not expend federal dollars unless it has met the statutory requirement that it partner with other entities.

The work of the partners is integrated with the MEP Centers to increase the efficiency and success of the MEP program. MEP partners work with the Center in reaching additional manufacturers, providing additional services, and transferring technology to SMEs to fulfill the core mission of the MEP Centers stated in 15 U.S.C. § 278k. The partners' work has been added to achieve the desired synergies, and the partners' output is beyond the partners' "normal" or "regular" operations, demonstrating a direct benefit from the partnership. Together the MEP Center and the partner are able to coordinate and collaborate on activities that each would conduct entirely on its own if it were not for the partnership. In this way the Center uses the existing resources of the partner to further the impact of the Federal investment by reaching manufacturers it would not, on its own, have the ability to reach and to provide additional

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20 See Id.
21 America Competes Act, P.L. 110-69, Sec. 3003(a)(3)(C).
22 Id.
services the Center could not otherwise offer. Using a network of partners, the MEP Center can concentrate its resources on serving clients and on technology transfer. Without such a network, Federal resources would be diverted from providing direct services to SMEs and instead expended on marketing and outreach to recruit clients. In this manner the activities of the partners are essential to the efficiency and effectiveness of the MEP Center and its ability to accomplish the programmatic objectives set forth in the statute and regulation. See 15 U.S.C. § 278k and 15 C.F.R. § 290.3.

OVERVIEW OF SCMEP AND PARTNERS

As one of the original MEP programs, SCMEP’s unique structure, and general mission to make South Carolina’s SME’s more globally competitive. The Draft Audit listed questioned costs of four partners including the University of South Carolina Center for Manufacturing and Technology (USC), Greenville Technical College—Buck Mickel Center (Greenville Tech), South Carolina Export Consortium (SC Export), Clemson University’s Clemson Apparel Research (Clemson). In efforts to fulfill this mission, SCMEP has developed partnerships with these key players involved with the South Carolina manufacturing industry to have not only geographic coverage, but also to form partnerships with entities with particular areas of expertise that can assist SME’s in a variety of substantive issues as well.

SCMEP has used the same basic contract for more than twenty years with its partners. Initially, these contracts took the form of memoranda of understanding. More recently, at the direction of NIST, SCMEP has tried to structure their contracts to characterize the partners as subrecipients. The subrecipient format does not fit, because as explained earlier, in the national context, one partner may have characteristics of a subrecipient, a contractor/vendor, or even a third party contributor at various points in time. A key factor in analyzing the relationship between SCMEP and its partners is that none of the SCMEP partners receive federal funds. The source of the partners’ funds is the state of South Carolina which makes them look even less like subrecipients and more like a third party contributors or vendors of the SCMEP program. Because the only funds that SCMEP partners receive from SCMEP are state funds, there is no

23 The program regulation, 15 C.F.R. Part 290, directs Centers to leverage their resources by concentrating on approaches that are broadly applicable to a range of organizations and regions. 15 C.F.R. § 290.3(e). The regulation defines leverage as “the principle of developing less resource-intensive methods of delivering technologies (as when a Center staff person has the same impact on ten firms as was formerly obtained with the resources used for one, or when a project once done by the Center can be carried out for dozens of companies by the private sector or a state or local organization).” Id.

24 See Draft Audit Report pg 3, note the auditor initially suggested disallowance of costs for Midland College, and Trident College but ultimately decided not to test them because of their relatively small size, and therefore suggested allowing their costs. These partners are not discussed in this response.

25 15 C.F.R. 14.2 (jj) (defining a subrecipient as an entity that receives a subward and is accountable to the recipient for use of the funds).

26 15 C.F.R. 14.2 (i) (defining contractor).

27 15 C.F.R. 14.2 (nn) (defining third party in-kind contributions as a non-federal non-cash contribution that directly benefit and are specifically identifiable to the project such as goods and services).

28 See Cerebral Palsy Center of the Bay Area, DAB No. 1468 (1994) (holding that although an entity does not have to have knowledge that it is receiving federal assistance, the receipt of federal funds either directly or through another recipient, makes an entity a recipient and therefore, subject to the relevant responsibilities).
subaward made and there should not be a flow down of all the terms and conditions.29

The SCMEP program was originally housed at the University of South Carolina and later separated into its own entity, a non-profit organization with its own identity. The USC’s Center for Manufacturing and Technology (CMAT) continues to carry on activities as an MEP partner the program’s purpose is to support the mission of SCMEP by providing many similar services as the MEP Center. Additionally, it provides a great deal of direct support through the students such as assisting client manufacturing companies in building websites, and providing marketing support. The parties often work together as joint ventures by referring clients to each other and sharing information and technology. One example of how the partnership works is that CMAT may refer a larger client to the SCMEP Center, while the Center will refer smaller clients to the CMAT program so because CMAT, with its state funding, provides services to clients at no cost to the client. USC receives state funding directly from the South Carolina Higher Education Commission, not from the SCMEP (i.e. money for USC never even touches SCMEP’s bank account). This is a perfect example of a partnership relationship contemplated under the MEP statute.

Greenville Tech houses one of the three SCMEP offices at the Buck Mickel Center, the continuing education division of the community college. The center offers courses and training of particular interest to SMEs and also caters to the specific needs of smaller companies by providing flexible schedules and accommodating the financial needs of smaller companies. In its partnership Greenville Tech and SCMEP provide classes that assist SMEs that meet MEP requirements. Those classes are listed on the quarterly report to include training in 5S, Lean 101, Lean Six Sigma Overview, etc. Greenville Tech also provides marketing support to SCMEP and refers companies to the SCMEP Center. Like USC, money for MEP activities allotted to Greenville Tech comes from the South Carolina Higher Education Commission as well except that this money does go through SCMEP’s bank account prior to disbursement to Greenville Tech.

Clemson University’s contribution to the SCMEP project is the work with Clemson Apparel Research (CAR). The work under this program provides vastly specialized expertise in a specific manufacturing area that benefits the program with technological information as well as the client companies with its highly esteemed national reputation. CAR provides consulting, manufacturing and pattern design services and the program was established with the mission of revitalizing the domestic sewn-products industry by applying advanced technology and management practices.30 The work is especially important because the fast turn manufacturing and supply chain optimization solutions have been applied to industries outside of the textile industry. Just as with Greenville Tech, money allotted to CAR for MEP activities comes from the South Carolina Higher Education Commission through SCMEP.

SC Export is a key partner that has provided export expertise for manufacturing clients for over a decade. SC Export, a 501(c)(3) that has a close partnership with the South Carolina Chamber of

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29 Subaward is defined in 15 C.F.R. § 14.2(ii) as “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.” An award is cash that originates from the federal government. See 15 C.F.R. § 14.2(f).
30 See http://car.clemson.edu/
Commerce. Their specialty is to assist companies in the development and implementation of business, marketing and global trade strategies. This has been a successful partnership where they have provided consultation services to assist companies export their products in foreign markets allowing SCMEP to further achieve its mission of improving the global competitiveness of South Carolina manufacturers. Over the course of the audited period, SC Export contracted to provide a deliverable for a set price (i.e. not on an hourly basis) over several contracts. Payment for the contracted work comes from South Carolina Higher Education Commission through SCMEP.

The relationship between SCMEP and its SC Export is not that of recipient and subrecipient, but instead that of recipient and a contractor/vendor. Section .210(d) of A-133 states the recipient must use its judgment in determining the appropriate relationship with entities:

(d) **Use of judgment in making determination.** There may be unusual circumstances or exceptions to the listed characteristics. In making the determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement. It is not expected that all of the characteristics will be present and judgment should be used in determining whether an entity is a subrecipient or vendor.

Guidance on determining whether the relationship is that of recipient-subrecipient or recipient-vendor can be found in OMB Circular A-133, § __210:

(b) **Federal award.** Characteristics indicative of a Federal award received by a subrecipient are when the organization:

1. Determines who is eligible to receive what Federal financial assistance;
2. Has its performance measured against whether the objectives of the Federal program are met;
3. Has responsibility for programmatic decision making;
4. Has responsibility for adherence to applicable Federal program compliance requirements; and
5. Uses the federal funds to carry out a program of the organization as compared to providing goods or services for a program of the pass-through entity.

(c) **Payment for goods and services.** Characteristics indicative of a payment for goods and services received by a vendor are when the organization:

1. Provides the goods and services within normal business operations;
2. Provides similar goods or services to many different purchasers;
3. Operates in a competitive environment;
4. Provides goods or services that are ancillary to the operation of the Federal program; and
5. Is not subject to compliance requirements of the Federal program.
SC Export operates independent of SCMEP and meets the requirements of subsection (c). It provides goods and services that are

Clearly under this guidance SC Export is either a vendor and/or a third party contributor to SCMEP based on the parties’ actual interactions and the substance of the relationship meeting more of the criteria under .210 (c) rather than 210 (b). It is the responsibility of SCMEP to determine the relationship and it is the substance of the relationship not the name on the agreement. SCMEP’s documentation of SC Export’s cost contributions meets the necessary criteria. The cost contributions from SC Export are verifiable in SCMEP’s records, are not counted toward any other federal grant, and are necessary and reasonable for proper and efficient accomplishment of NIST MEP objectives given the nature of SC Export’s activities and the cost share agreement between SCMEP and SC Export.

CATEGORIES OF QUESTIONED COSTS

The draft report first outlines the categories in which it questioned reported costs by 1) contractual category 2) partner match category, and 3) in-kind category. Next the audit evaluated each issue by partner. The basis for these categories of costs and the specific numeric values assigned to each category is unclear. The twenty-one month audit period and the frequency of financial and performance reporting may have played a factor in the confusion, because costs are incurred, but may be paid in advance or after events and activities. In general, the award period was one year and the financial and performance reports were quarterly. The distinctions among these three categories are unhelpful in analyzing the costs reported and we cannot ascertain the sources for the amounts. Because of the audit period and the lack of information regarding how the auditor arrived at any given figure, there is no way to compare apples to apples in the analysis. For that reason, it is difficult to respond in the manner presented by the auditor. Consequently, SCMEP’s response will address the logic, authority, and conclusions reached by the auditor with the questioned costs as a whole. If the auditor will provide his audit work papers, perhaps we can better understand the calculations.

Contractual Category

The Draft Audit Report questions $423,016 in contractual costs for three partners: Greenville Tech, Clemson and SC Export. Because of the small size of Midland and Trident Colleges, the auditor chose not to test the costs claimed by these partners and therefore accepted the costs claimed by them in an amount totaling $62,500. It is not clear where the $423,016 figure is derived as “contractual costs.” This amount may represent the amount claimed by SCMEP in reimbursements to its partners, but it may not have actually reflected costs for the audited period since quarters are reported after the fact. For example, a partner might have reported costs from June of 2005 but requested reimbursement July, August or even September. This is because SCMEP cannot claim a cost until it is incurred.

Our understanding of “contractual costs” would be based on the relevant partner agreements for the audit period. In each of the respective partnership agreements for the audited period SCMEP
agreed to provide state funding in the amount of $185,000 to Greenville Tech, $180,000 to Clemson and $320,000 to SC Export. USC was not included in this analysis because “SCMEP did not claim an amount in the contractual costs category for the award to USC.” It should be noted that the contract periods do not match up exactly with the audit period. Furthermore, USC’s cost share agreements stated it would receive a total of $550,000 directly from the South Carolina Commission on Higher Education.

Each partner maintained records for all of its expenditures of funds pursuant to the cost share agreements and reported them to SCMEP in their quarterly reports. The auditor claims that the basis of the questioned costs included failure to meet financial management system requirements, and attributing costs to work outside the scope of the project. SCMEP and its partners have demonstrated that they meet financial management system requirements and that all reported costs are within the scope of the project. These issues are discussed in more detail below.

**Partner Match Category**

The Draft Audit Report also questions $2,816,349 in costs under the “partner match” category for a variety of reasons. It is unclear where this sum is derived from and whether the “partner match” in fact is solely from the partners. Our understanding of the “partner match” would be the total of the amounts reported to SCMEP of all of the partners’ quarterly reports for the audit period.

In this section the auditor notes that SCMEP failed to break down this category by partner when it reported cost share to NIST. Accordingly the auditor decided to “modify [the] audit approach” as follows:

> We calculated the total eligible subrecipient project costs individually and in total and then compared the total to the amount SCMEP claimed to NIST. SCMEP payments to the subrecipients determined how much of each subrecipient’s cost SCMEP could claim. If payments to a subrecipient were less than the amount awarded, we based required matching share and total project expenditures on the amount of actual payments. (Draft Report, Page 3)

This “modified approach” is problematic for two reasons. First, it limits the allowable costs under the project by imposing cost share restrictions on each individual partner based on amount of funds received as a whole. Essentially, this approach precludes SCMEP from counting costs that are otherwise eligible under the federal cost principles, cooperative agreements terms and conditions, NIST policy, as well as the MEP statute. We could find no requirement that a recipient separately itemize and report cost contributions based on the same ration as the

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31 See Exhibit 2 Greenville Tech Agreements (7/1/05-6/30/07 and 7/1/06-6/30/07)
32 See Exhibit 3 Clemson Agreements (7/1/05-6/30/07 and 7/1/06-6/30/07)
33 See Exhibit 4 SC Export Agreements (7/1/07-6/30/07, 7/1/06-12/31/06, 7/1/06-6/30/06, 7/1/05-12/31/05)
34 Draft Audit pg 3
35 See Exhibit 5 USC Agreements (7/1/05-6/30/07 and 7/1/06-6/30/07)
recipient. The recipient has the right to contract with its partners to determine requirements. SCMEP had the discretion to determine which partner cost contributions would be claimed on the SF 269 and there was no requirement imposed under the cooperative agreement with NIST that each partner contribute a certain ratio of cost share. SCMEP sets goals for its partners, but realizes that sometimes partners may not reach the goals and sometimes may exceed the goals. For that reason, the partner share reported by SCMEP in a given quarter may not match the amount reported by the partner. Instead, the partners reported their costs to SCMEP and SCMEP evaluated each report and determined the amount necessary to meet its cost share obligation under the cooperative agreement as well as determining whether it was reasonable, allocable and allowable prior to including it in its reports to NIST.

Second, this approach does not take into account that NIST grant officers discouraged recipients from being “over matched,” or reporting it on SF 269’s. That meant that even if a particular partner well exceeded the goal for expenditures in a particular quarter, SCMEP only reported their expenditures up to the amount necessary to meet its federal matching requirements in that quarter under the terms of its cooperative agreement.

In-Kind Category

In the third category, “in-kind,” the auditor disallows $167,544 of in-kind costs claiming that the costs were unsupported and/or out of scope. Again, it is unclear where the sum of $167,544 is derived from as well as the reason for differentiating in-kind match from other types of match. This distinction may be a result of the manner in which one of the partners reported its cost share to SCMEP prior to the change in the form for quarterly reports. The total of “partner match” and “in kind,” $2,983,893, is more $58,864 more than what SCMEP actually reported over the audited period ($2,925,029). In any event, all costs reported were reasonable, allocable and allowable under the project. All reported costs were adequately supported and within the scope of the program.

This response will further address each of the cited reasons for disallowing the partner costs in the contractual, partner match and in-kind categories. This will be done based on 1) financial management system requirements, 2) scope of the project 3) partner cost share 4) program income, and 5) other costs.

FINANCIAL SYSTEM MANAGEMENT REQUIREMENTS

The auditor claimed that accounting systems of SCMEP’s partners did not meet financial management system requirements for a federally funded project. The auditor specifically questions adherence to 15 C.F.R. § 14.21 subsections (b)(1), (4) and (6).

Appropriate Standard is 14.23 not 14.21

As discussed earlier, for a variety of reasons, SCMEP’s partners are not in fact subrecipients as

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36 Section .210(d) of A-133
defined by 15 C.F.R. § 14.2 (jj). Without federal funds or property, there is no nexus to require SCMEP partners to meet the financial management standards of 15 C.F.R. § 14.21. Instead, the appropriate standard to address their costs is 15 C.F.R. 14.23, and not 15 C.F.R. § 14.21. A third-party contributor is not required to meet the terms of 15 C.F.R. Part 14, or the cost principles at 2 C.F.R. Part 230. 15 C.F.R. §14.23(a)(4) states that the cost contributions must be "allowable under the applicable cost principles." This does not mean that a third party contributor must change its accounting practices and procedures or document its salary expenditures as required under the cost principles or the terms of the cooperative agreement. The standard that the recipient must meet in documenting third party in-kind contributions is "to the extent feasible" by the same methods generally used by the recipient for its own employees." The basis for the "valuation for personal service, material, equipment, buildings and land shall be documented." 15 C.F.R. § 14.(h)(4). The SCMEP partners met these standards. The recipient is responsible for determining the allowability of the cost contributions as permitted under the cost principles. SCMEP excludes any partner expenditures that are not allowable under the cost principles and maintains the documentation supporting all other costs it claims as non-federal share under its cooperative agreement.

SCMEP identifies the partner operating costs that support activities that benefit all of its clients. SCMEP partners do not track its costs related directly to its activities on behalf of manufacturers; many of the services provided to its entire membership directly benefit its manufacturing members. The The method of allocation was reviewed by and received approval from the NIST Program Officer, Grants Officer, and legal counsel. SCMEP established a reasonable basis for the valuation and meets the documentation standard for in-kind contributions under 15 C.F.R. § 14.(h)(4).

**NIST Review and Approval of Partnership Agreements**

Although the statutory authority considers costs deemed by the Center to be allocable, NIST has its own review and approval procedures. The NIST-approved SCMEP Operating Plan for the audited period clearly outlines the collaborative activities of SCMEP and its partners and describes the costs that its partners were to incur (and did, in fact, incur) in furtherance of the Center’s mission. This Operating Plan, including the description of the partnership s, was reviewed and approved by the NIST Grants Officer, the Program Officer, and legal counsel prior to issuing the awards. Approval from the Grants Officer is additional support for the proper inclusion of the costs incurred as part of the Center’s cost share. OMB Circular A-122, codified at 2 CFR Part 230, defines "prior approval" as:

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37 15 C.F.R. 14.23 which 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 (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.
[S]ecuring the awarding agency's permission in advance to incur cost for those items that are designated as requiring prior approval by this part and its Appendices. Generally this permission will be in writing. Where an item of cost requiring approval is specified in the budget of an award, approval of the budget constitutes approval of that cost.

Partners Meet 14.21

Nevertheless, SCMEP and its partners also meet the requirements of 15 C.F.R. § 14.21 with respect to the subsections cited by the auditor because they maintain accurate, current and complete disclosures of financial results of each project, compare outlays/expenditures with budget amounts within their accounting systems and as reported quarterly to SCMEP, and have SCMEP written procedures for determining the reasonableness, allocability and allowability of the costs under the applicable costs principles of the award. Each partner and the budget categories were approved at the issuance of the award.

USC, Clemson, and Greenville Tech, the three institutions of higher education receive other federal funds and are regularly subjected to OMB Circular A-133 audits. These entities have financial management systems that meet federal requirements, written policies and procedures governing the use of federal dollars, accurately report their costs to SCMEP, and comply with all federal requirements for documenting their expenditures in furtherance of the MEP mission-which they provided to the auditors. SC Export is a 501(c)(3) non-profit organization that has a close partnership with the South Carolina Chamber of Commerce. Pursuant to the partnership, all of the accounting is done by the Chamber of Commerce and SC Export's financial records are subject to regular audit by state auditors along with all of the financial records with the Chamber. In addition, SC Export receives federal funding for other projects, that are not included with the SCMEP activities, and has policies and procedures in place for accurately reporting the use of federal dollars. In sum, the auditor's conclusion that the SCMEP partners failed to meet the financial system management requirements is without merit. In the analysis, the auditor also seems to ignore the fact that the funds allocated to each partner under the SCMEP award are solely state funds.

Accurate Disclosure of Actual Costs Incurred

Each partner entered into a "cost share contract" with SCMEP that outlines the partner's role in the project and requires quarterly reporting of expenditures. Pursuant to the cost share contracts, partners receive state funding for the MEP project and each partner agrees to report its eligible program expenditures to SCMEP on a quarterly basis. Next, SCMEP then reports those expenditures to NIST as non-federal cost share on the SF 269.

In the Operating Guidelines, NIST directed that the partner budgets must align with the MEP Centers' budgets. Each partner has its own existing accounting system that tracks all of the expenditures allocable to the SCMEP project. However, each partners' pre-existing system may not have accounting codes, columns or categories that directly correlate to those used by NIST. The partners, therefore, must identify the costs using the accounting codes for its accounting system, correlate them to NIST budget line items, and total them each quarter. The auditor, for
some reason, did not understand this process.

SCMEP never required the partners to establish an SCMEP cost center because just like SCMEP, most all of their operating costs are eligible cost share.\textsuperscript{38} The partners rely on their own accounting systems already in place for tracking all of their MEP expenditures. In order to create the quarterly reports they then tally up all eligible MEP expenditures under the categories provided on the SCMEP quarterly financial reports.

SCMEP developed a financial report along with instructions to be used by all of its partners and reached an agreement with each partner regarding which expenditures by accounting class code would be reported in the categories provided on their form.\textsuperscript{39} The partners identify the reasonable, allocable, and allowable costs within their existing accounting systems used for their operations and tracked by their accounting class codes that could then be reported in the budget categories stipulated by SCMEP.

The documentation submitted by SCMEP partners follows detailed procedures to allow SCMEP to determine that the costs are reasonable, allocable, and allowable. SCMEP is the recipient and is ultimately financially responsible for ensuring the allowability of costs.\textsuperscript{40} This procedure, to which the parties agreed to in writing, and the results of which were made available to the auditors, is sufficient to show that the non-federal dollars expended by SCMEP partners were expended to further the MEP statutory mission. It is the parties to the Agreement who are in the best position to know what they intended by the Agreement.\textsuperscript{41} As noted above, SCMEP is responsible for determining whether the costs are reasonable, allowable, and allocable.\textsuperscript{42}

\textbf{Comparison of Actual Outlays with Budgeted Amounts}

As mentioned earlier in the section on “partner match,” at times, some partners report more costs than are needed for SCMEP to meet its non-federal cost share for a particular quarter. Often, SCMEP had its own cost share, such as from program income, to be included in the quarterly SF 269s. In those cases, if SCMEP did not need to include all eligible cost share from its partners, it would only report a portion. That is why the quarterly report totals for all of the partners’ eligible expenditures do not match the totals reported on the SF 269s. Again, the federal government imposes a standard report using broad categories that require the recipient to be able to explain how those numbers were calculated.

Since the auditor was unable to understand how partners’ costs were accounted for and reported

\textsuperscript{38} See 15 U.S.C. § 278k (c)(D) (“All no-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.”)

\textsuperscript{39} See Exhibit 6 SCMEP form and instructions.

\textsuperscript{40} 15 C.F.R. § 14.2(ff) “Recipient means an organization receiving financial assistance directly from the DoC to carry out a project or program.” 15 C.F.R. § 14.2(j) “Subrecipient means the legal entity to which a subaward is made and which is accountable to the recipient for the use of the funds provided.”

\textsuperscript{41} See \textit{National Urban League, Inc., United States Department of Health and Human Services Departmental Appeals Board, No. 294 (April 30, 1982) (DAB adopted Grantee’s interpretation as reasonable, and gave it more weight than the Agency’s interpretation since the Grantee was a party to the agreement.)}

\textsuperscript{42} \textit{America Competes Act, P.L. 110-69, Sec. 3003, 131 Stat. 587 (2007).}
and to illustrate how cost share is reported and accounted for, it is helpful to analyze one quarterly submission. Using the quarter of January – March 2007, USC reported a total of $42,948 in actual and $19,541 in match for a total of $62,489. These figures include personnel costs, (salaries and fringe benefits) and operating costs (travel, office supplies, project supplies, equipment, rent and utilities). In the same quarter, Greenville Tech reported $8,751 in actual and $273,860 in match with a total of $282,611. Clemson reported $15,783.01 in actual and $60,417.47 in match with a total of $76,200.48. SC Export reported $30,340 in actual and $0 in match with a total of $30,340. Hence there was a total of $97,822.01 in actual and $353,818.47 in match for a total partner cost share of $451,640.48. The partners maintain the supporting documentation such as invoices, bills, expenditure reports for expenditure in its accounting systems. SCMEP lists a small portion of these expenditures from the partner quarterly reports on the SF 269. The next section outlines the process for creating the quarterly report for each partner.

**USC Comparison of Actual Outlays with Budgeted Amounts**

At the end of each quarter, a USC CMAT staff person creates the SCMEP quarterly report by pulling all relevant expenditures from USC’s accounting system, which is called USC Management Report (also known as Datawarehouse). Pursuant to the cost share agreement, those expenditures are entered into the financial report form. The quarterly report is divided into two major sections: personnel costs and operating costs. Reporting of those expenditures are broken down into “Actual” and “Match” representing the expenditures from the payments from SCMEP and cost contributions to non-federal share respectively.

The first section of the form is “Personnel Costs” which are comprised of salaries and fringe benefits. The salary portion is compiled by using monthly reports that include a total of all salaries paid out during the month for the MEP project. The payroll department completes the monthly report. Staff previously entered their time into a separate program that codes the input based on the department number, the type of staff and the unit of work. The sum of the salaries for the three month period is added into a lump sum that includes salaries and time for students, staff, temporary and full time employees. Next, the fringe benefit rate is applied to the total salaries. The personnel cost is the sum of total salaries plus fringe benefits.

The next section on the form is “Operating Costs” which is comprised of eight sub categories including travel-mileage, office supplies, project supplies, other supplies, equipment, rent, utilities, and other costs. Like personnel costs, operating costs come from the Datawarehouse program. Each expenditure has been assigned to an object code and has been previously coded for the MEP grant.

The object codes do not match up exactly to the subcategories listed on the SCMEP reporting

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43 See Exhibit 7 USC quarterly report
44 See Exhibit 8 Greenville Tech quarterly report
45 See Exhibit 9 Clemson quarterly report
46 See Exhibit 10 SC Export quarterly report
47 See Exhibit 11 SCMEP SF 269
form, therefore, prior to input, the existing object codes are assimilated to the categories on the form. For example, under USC’s accounting system, there are several subcategories for travel, therefore, all travel coded for the MEP project is pulled into one sum in order to enter it into the financial report form. The back up documentation for the travel is maintained including the request for reimbursement for any travel. The USC CMAT program does not make a reimbursement unless the request is in compliance with the university’s policies and procedures. Similarly there is no object code for “project supplies.” Therefore, CMAT staff has assigned items such as materials for creating a brochure or other marketing items under this subcategory. “Rent” includes expenditures for renting a booth at a trade show for a client. Because space from the university is donated to the program, this category is rarely utilized on the form. The last line of the form “Grand Totals for Budgeted and Actual Expenses” is the sum of the personnel costs and operating costs.

The Draft Audit Report claims that the twenty-eight percent interest rate for fringe benefits was an arbitrary amount. This rate was used because it is based on an agreed upon term between SCMEP and its partners. The application of the twenty-eight percent for fringe benefits was due to a misunderstanding. SCMEP thought that it was required to apply the twenty-eight percent rate to its partners for activities under the cost share agreement. We have obtained the fringe benefit rates from USC and will apply the proper rate to the charges based on the type of employee. Quarterly reports will be corrected and include the proper fringe benefit rates. However, because SCMEP had substantial eligible costs share that was in excess of its required match, SCMEP would likely find it unnecessary to claim any fringe.

Greenville Tech Comparison of Actual Outlays with Budgeted Amounts

Greenville Tech uses a similar procedure as USC in completing the SCMEP report by including expenditures that were previously coded in their financial accounting system. However, Greenville Tech’s expenditures for the SCMEP well exceeded the necessary amounts under its cost share agreement. The college has its own accounting system called Datatel in which a department number is assigned for the SCMEP grant. This department number tracks expenditures of the funds provided to Greenville Tech from SCMEP. A separate number tracks the expenditures for the cost share and represents Greenville Tech’s out of pocket expenditures. At the end of the quarter, the expenditures are pulled for those particular account numbers and entered into the SCMEP form in a similar manner as in USC.

The auditor questioned $7,319 in charges for office furniture claimed as property and equipment by Greenville Tech. This cost was perhaps included in error merely because it was likely reported in the inappropriate quarter. However, the classroom furniture was a budgeted cost for the work with the SCMEP classes and only a portion of the cost was actually charged to the SCMEP grant. Even if this cost is ultimately disallowed, there were more than enough costs to substitute.

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See Exhibit 12 USC fringe rate
Clemson Comparison of Actual Outlays with Budgeted Amounts

Clemson also uses a similar procedure as USC and Greenville Tech in the production of the SCMEP quarterly reports. Clemson staff first set up account numbers in the university wide accounting system to track direct charges to the agreement as well as a cost share account. In addition, Clemson staff set up individual accounts to track miscellaneous industrial projects, small production, Marine Shop production, NIB projects, seminars and trainings. These are all used for match.

Clemson staff use Budget Status Reports for Expenditures, end of month reports, from the three relevant months for a given quarter to complete the SCMEP quarterly report. Each quarter, each Program Delivery Staff employee is required to report activity for SCMEP on projects they have completed during the time period. If someone is still working with a client, the work is not reported until completed. This is also submitted on a provided format form from SCMEP. A manual process is used to separate each Program Delivery staff's salary costs and input that information into the SCMEP quarterly report form. All invoices and receipts related to SCMEP expenditures that have been sent and received are tracked through an inquiry on the Clemson financial system. Invoices for the match accounts are hand calculated using the actual invoices prepared during the particular quarter.

Receipts recorded for the match accounts are also hand calculated, as noted on each actual document prepared as to the receipt date available in the Clemson financial system. This date is acquired through a daily receipt report that is available for the entire department. This information cannot be retrieved by account. The receipts often do not match the invoices each month because under Clemson accounting policies invoice amounts are credited as received when invoiced, despite the collection period. This is different from the SCMEP reporting requirements. Only the actual expenditures for the period are counted as match.

SC Export Comparison of Actual Outlays with Budgeted Amounts

The procedure for SC Export to complete the SCMEP quarterly reports on the other hand is different from the other partners for a few reasons. First, SC Export a small non-profit organization and is not a large educational institution like the other partners. Second, the creation of the reports involves the input of the South Carolina Chamber of Commerce, a separate entity. The most significant difference however, is that SC Export has more of a vendor/contractor relationship with SCMEP. In efforts to comply with NIST's insistence that partners fit the subrecipient model, SCMEP and SC Export attempted to structure its agreements and reporting based on the subrecipient model, even though the relationship between SC Export and SCMEP did not change fundamentally. The services included activities such as providing consultation to SCMEP or companies on exportation issues, marketing research, research projects for example, research regarding hydrogen fuel cells and working with a specific number of small to medium sized manufacturers for a given period.

Every expenditure made by SC Export is tracked in the South Carolina Chamber of Commerce
accounting system. At the end of the quarter, Dorette Coetssee would work closely with SCMEP staff to ensure that calculations input into the quarterly report complied with all relevant procedures. Based on employee time sheets and time spent on SCMEP activity, a percentage of expenditures were attributed to the SCMEP grant. She also worked with staff at South Carolina Chamber of Commerce to pull the financial data from their accounting system. Ms. Coetssee is no longer working for SC Export because she was recently hired to work for the US Export Assistance Center, office of US Department of Commerce International Trade Division.

SC Export incurred foreign travel expenses without prior approval from NIST. SC Exports understanding of the parties' relationship, there was no need for prior approval because they were operating as a contractor providing a service for a fixed fee. As such, OMB Circular A-122 is not applicable. The SC Export received a fixed price to provide a service and therefore as long as the service was necessary for objectives of the program, is irrelevant how the vendor expended those funds. The parties will revise the operative contracts to more accurately reflect their legal relationship.

**Written Procedures for Determining Allowability**

SCMEP makes its determination of allowability using its written procedures that apply applicable federal cost principles. SCMEP worked closely with its partners through the steps described above, to ensure that the costs claimed by SCMEP were reasonable, the cost share agreement and quarterly reporting form, clearly required AME, under 15 C.F.R. Part 14, to provide documentation sufficient for SCMEP to determine the allowability of costs pursuant to its own written procedures and the applicable cost principles. This procedure complies with the authorizing statute, which prevails over the general administrative provisions in the event of a conflict. See *United States v. Coates*, 526 F. Supp. 248 (E.D.Cal Nov. 19, 1981), *aff’d in part, reversed in part*, 692 F.2d 629 (9th Cir. Nov. 19, 1982). The authorizing statute states the following:

> In meeting the 50 percent requirement, it is anticipated that a Center will enter into agreements with other entities such as private industry, universities, and State governments to accomplish programmatic objectives and access new and existing resources that will further the impact on the Federal investment. All non-federal costs, contributed by such entities and determined by a Center as programmatically reasonable and allocable are includable as a portion of the Center's contribution.

Emphasis added; P.L. 110-69, Sec. 3003(a)(3)(C). The statute does not require that partners be subrecipients, nor does it require that partners abide by the Financial Management Standards in 15 CFR Part 14. To the contrary, the statute explicitly and unambiguously places the responsibility of determining reasonableness and allocability on the Centers themselves. Like all of the other partners, USC utilizes its exiting policies and procedures to determine the allowability of costs for the SCMEP program. Because CMAT operates in a manner similar to

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50 Id.
the SCMEP Center, its financial records are maintained in a similar manner and most of its costs are allocable to the program. There is generally no specific project to link expenditures to as expected by the auditor. Any failure to link expenditures to a particular project does not mean that expenditure is not allowable.

USC has several policies and procedures for the university that are applicable to the CMAT program. Those policies applicable to the MEP program include the Cost Accounting Standards, the Cost Sharing Policy the Contract and Grant Accounting Policy and the Contracts and Grants: Personnel Activity Reporting System.51

Single Audit Reports

The auditor commented that “two of the three NIST MEP related subawards were not subjected to the required specific auditing techniques of the single audit process.” Because the SCMEP partners only receive state funds, they were not required to participate in the single audit process with respect to the MEP award. As the auditor notes, under the Single Audit Act applies to the expenditure of “federal awards.”

SCOPE OF MEP PROJECT

The Draft Audit Report contends that Clemson “incurred costs outside the scope of the NIST award in nearly all instances.” The auditor points to the fact that Clemson is designated to cover manufacturers in the northern portion of the state in the SCMEP operational plan. The Draft Audit Report goes on to argue that there was no “direct benefit to South Carolina manufacturers.” Consequently, the auditor disallows all costs claimed by Clemson. At the very least, the costs in which projects that were within scope should have been allowed. There was no indication in the report as to which portions of the costs were within scope and to what extent. In any event, contrary to the assertion that the work was outside the scope, Clemson demonstrated the relationship of its activities to the auditor and explained how those activities in fact not only related to the project, but also successfully furthered its objectives.

According to the GAO Redbook, the scope of a grant stems from the grant’s purpose.52 In a discussion regarding the scope of a grant, the Redbook cites 58 Comp Gen at 681 which states:

The scope of a grant grows out of the grant purposes. These purposes must be referred to in order to identify those aspects of a grant that make up the substantial and material features of a particular grant which in turn fix the scope of the government’s obligation.53

The case further advises that “in order to determine the scope of [a] grant we must look at the authorizing legislation, the interagency agreements, as well as the actual grant documents.54. The case gives additional guidance by saying,

51 See Exhibit 13 USC Policies and Procedures (for more policies for USC see http://www.sc.edu/policies/)
52 See GAO Redbook, Ch 10, page 10-107-10-108 9 (explaining how to determine the scope of a particular grant).
53 Id.
54 58 Comp Gen 676
"If the scope of the grant is considered from the standpoint of the government need and purpose in making it, the precise geographic boundaries would not appear to be a material aspect of the grant— one upon which approval or disapproval depended."\textsuperscript{55}

Moreover, the implementing statute for the MEP program does not limit the geographic service area for its award. Here, the activities reported by Clemson were within the Scope of Work portion of the cost share contract and are also well within the scope of and complementary to the objectives of the MEP program, stated in 15 C.F.R. § 290.3(b), Program Objective, and the enabling statute, 15 U.S.C. § 278k. As stated in the regulation, the objective of the MEP program is "to enhance productivity and technological performance in United States manufacturing." As noted in the Overview for the MEP program, the out of state activities that the auditor suggests be disallowed fall perfectly within the goals of the statute which include:

\begin{quote}
"(2) participation of individuals from industry, universities, State governments, other Federal agencies and NIST in cooperative technology transfer activities; (3) efforts to make new manufacturing technology and processes accessible and usable by small and medium-sized U.S. companies; (4) active dissemination of scientific, engineering, technical, and management information to industrial firms; and (5) utilization of expertise and capability that exists in Federal labs other than NIST.\textsuperscript{56}
\end{quote}

Even the Draft Audit Report quotes that, "The mission of the South Carolina Manufacturing Extension Partnership (SCMEP) is to strengthen the global competitiveness of South Carolina small to midsized manufacturers." In response to the auditor's questions, Dr. Christine W. Cole explained that the projects outside of South Carolina benefited South Carolina manufacturers because they could be used in learning and demonstration of technologies for South Carolina companies.\textsuperscript{57} Additionally, components from South Carolina manufacturers could be used in out of state projects.

The auditor's findings with respect to scope are also in contradiction to the recommendations of NIST itself. In the Observations and Recommendations of the 23\textsuperscript{rd} Year Review Panel which stated:

\begin{quote}
"The Panel encourages SCMEP to reach out to other Centers within the National MEP System as SCMEP continues to grow. The Panel feels that the other MEP Centers in the region can provide additional capacity, resources and skills to assist SCMEP, particular for projects that involve facilities in other states.... In addition, the Panel encourages SCMEP to examine performance measurements used at other Centers within the National MEP System."\textsuperscript{58}
\end{quote}

CAR has not only allowed SCMEP to meet its statutory requirements, but has also allows

\textsuperscript{55} Id.
\textsuperscript{56} 15 U.S.C. § 278k(b).
\textsuperscript{57} See Exhibit 14. Letter from Christine Cole dated 10/12/07
\textsuperscript{58} See Exhibit 15 NIST annual report 2007
SCMEP to follow the recommendations of the annual panel. The most notable benefits of CAR’s out of state activities to SCMEP and SME’s is that the reputation of the program is enhanced and gains a larger stage in which to demonstrate the strengths of SCMEP program. This has had an indirect benefit by attracting huge contracts for large corporations to bring projects to South Carolina such as Boeing, DuPont, BMW, and Honda.

The auditor ignored all of the factual information as well as the legal authority by focusing on the geographic region in which Clemson agreed to cover under the cost share agreement. Clemson agreed to cover that region but to also meet the more global mission and objectives of the cooperative agreement and the SCMEP program. Therefore, based on the legal authority and its application to the factual situation at hand, despite the auditor’s suggestion, all of Clemson’s costs should be allowed.

NO SPECIFIC MEP PROJECT

The auditor seems to similarly ignore the overarching legal authority and factual circumstances when it criticized USC, Greenville Tech, and SC Export because some of their expenditures were not assigned a specific project related to MEP. The authorizing statute anticipates that partnerships will involve existing entities who claim costs for activities that are not separately identified as an MEP projects. The partners’ missions are aligned with SCMEP and they already serve SME’s. As expressed earlier in this response, because the partners already provide these services, the federal investment is furthered by them also collaborating and sharing information among each other to ultimately benefit SMEs. Essentially more work is done under without additional expenditures of federal dollars. In fact, NIST commended SCMEP in the Observations and Recommendations of the 23rd Year Review Panel, stating:

The Panel recognizes SCMEP for its strong partnerships. The Panel notes that through its partnership referral, SCMEP has been able to grow the center with limited marketing expenditures. (Paragraph 5 of Observations and Commendations).

MEP activities are tracked when services are provided to qualifying companies and partners report those services to SCMEP who then reports that activity to NIST. Each partner has either a precise account, object numbers and/or object codes specifically assigned to SCMEP in their individual accounting systems. In addition, although the reporting was not done based on individual MEP projects, USC offered to run their numbers to assign everything based on project or client. However, the auditor did not accept this offer.

PERCENTAGE OF PARTNER MATCH

The auditor imposes federal cost share requirements on the partners by saying Clemson provided too much match in relation to the state funds it received and SC Export did not provide enough. As stated earlier, the relationship between SCMEP and the partners is not a subrecipient relationship.

60 See Exhibit 15 NIST annual report 2007
The SCMEP cost share agreements set a goal of minimum cash expenditures and calls for SCMEP partners to provide a matching contribution; however, the agreement never places a limit on expenditures. According to the MEP statute and the applicable regulation for cost share, all of partner's costs could be included as cost share for SCMEP as long as the center otherwise determined the cost was reasonable and allocable to the program. The statute imposes a minimum requirement on the Center, but not on its partners.

Furthermore, as also mentioned earlier, the amount of expenditures varies from quarter to quarter. The amounts listed in the agreements are merely goals and not conditions. Additionally, because SCMEP had more than enough eligible cost share contributions from its other partners to meet its federal cost share requirements, it was unnecessary to impose the disproportionately high cost share objectives on its partners.

Even viewed under the subrecipient construct, the failure of a subrecipient to meet its matching share requirement under an agreement with the recipient is no basis for the grantor to disallow costs to the grantee as long as the grantee otherwise meets its federal matching requirements.

PROGRAM INCOME

The auditor questioned SCMEP partner costs because they failed to report program income. SCMEP’s partners were not required to report program income because their activities were not supported by federal financial assistance funds. NIST MEP officials have caused considerable confusion over the years regarding the treatment of program income. The MEP regulation defined “fees for services” as “host contribution” defining it to be cost share. At one time there was a special task group formed by NIST with the participation of several MEP Centers to address the treatment of program income, but it was disbanded before the work was completed. Program income is defined as “gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award,” including fees for services performed. As the auditors noted, most program income generated under the SCMEP award results from the fees paid by private manufacturing firms and individuals for services, tuition charges, or for fees paid by conference participants or sponsors. These fees are not paid with federal dollars.

Program Income is key to the MEP Centers in order to meet the 2/3 non-federal cost share and to provide “unrestricted” funds vital to maintaining operations during times of uncertain funding, either from the State or from NIST. SCMEP has been in the fortunate situation of having State funding that was “unrestricted,” enabling it to use State funds as a reserve and to cover costs.

61 See 15 U.S.C. § 278k (c)(D) ("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."). See also 15 C.F.R. § 14.23 (similarly allowing inclusion of “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 otherwise meet the seven criteria of the regulation). 62 Id. 63 14.2 (jj) subrecipient is accountable to the recipient as to use of funds provided. 64 The program regulation defined two types of program income as “cost share.” 15 C.F.R. § 290.4(c)(2) and (3). 65 15 C.F.R. §14.2(aa). 66 Id.
otherwise not allowable under the MEP award. SCMEP never considered its partners to be subrecipients or responsible for reporting the revenue they received for the services to small and medium size manufacturers. The partners' costs were reimbursed by State funds, they did not produce income subject to federal restrictions under the terms of the cooperative agreement and the grant administrative regulations (15 C.F.R. §14.24). If the partners realized any surplus revenue because the fees they charged exceeded the costs incurred, they expend it in furtherance of the MEP mission to assist small and medium size manufacturers. This is a permissible use of program income as clearly set forth in a decision by the Department of Health and Human Services Departmental Appeals Board which states that the recipient can expend program income even on expenses that are "not otherwise permissible as charges to federal funds."

Anchorage Neighborhood Health Center, U.S., HHS DAB No. 561 (August 6, 1984). If used to add activities to the award, the program income funded activity need only further the program purpose, and is not subject to the cost principles. Id.

It is well-established in law, that program income does not automatically acquire a federal character and is not required to be deposited in the Treasury as miscellaneous receipts. Under a cost-share grant, the federal government's interest is limited to the extent of its participation. To the extent that federal dollars paid the costs of the activities that generated the program income, it may direct the recipient as to how it may expend that income. That does not give the federal government the legal right direct how SCMEP partners spend any of their earned surplus revenue generated by State dollars. Many federal agencies that anticipate that a cost-share grant program will generate program income, address it specifically in their program regulations. In those regulations, federal agencies clearly acknowledge that the federal government may only direct the recipient on the use of the program income to the extent of the federal share, i.e., one-third of the income under an MEP cooperative agreement. Neither NIST nor the Department of Commerce have issued such a regulation regarding program income produced under cost share grants, despite the fact that MEP clearly anticipated fees for services to be charged by recipients (as do other programs at Commerce, such as the Minority Business Development Administration). For this reason, one must look to other federal agency regulations for guidance.

During 2006, NIST was implementing changes to its operating plan guidelines and general terms and conditions with respect to: the calculation of program income, undisbursed program income, the impact of state and other funding on the calculation of program income, the restrictions of all or a portion of program income, the amount that could or should be carried forward by a center, and the process and procedures for approval. The MEP General Terms and Conditions were not


68 This interpretation has been adopted by the Department of Justice, Financial Guide, Office of Justice Programs, U.S. Department of Justice, Chapter 4, available at http://www.ojp.usdoj.gov/fguide06/part5/part3chap4/part3chap4.htm (Where a program is only partly funded by Federal funds, the Federal portion of program income must be accounted for up to the same ratio of Federal participation as funded in the project or program.), the Department of Housing and Urban Development, 24 C.F.R. § 570.489(e)(1) (When income is generated by an activity that is only partially assisted with CDBG funds, the income shall be prorated to reflect the percentage of CDBG funds used.), and the Department of the Interior, Office of Surface Mining, Federal Assistance Manual, Office of Surface Mining, Department of the Interior, available at http://www.osmre.gov/fam/defin.htm.

69 Id.
actually incorporated into the 2006 cooperative agreements until February 2006. Once the procedures were clearly established, SCMEP continued to believe that its partners were not truly subrecipients expending federal financial assistance funds, and never required its partner to report program income on its quarterly reports. NIST should not now, at this late date, require MEP partners to report program income and the auditor should eliminate this finding.

SCMEP does account for its program income generated under the award and generally expends any program income earned through the award period and reports it on quarterly SF 269s submitted to NIST. SCMEP expends its federal dollars and revenues first, to be sure that it retains the "unrestricted" state funds it needs to maintain a reserve and spend on unallowable costs. By only retaining state funds as its "reserve," and making sure to expend its federal dollars and program revenues first, SCMEP never has any "excess" or "undisbursed" program income to report. This is done precisely for the purpose of maintaining unrestricted assets.

**OTHER QUESTIONED COSTS**

This section deal with the only cost that the auditor questioned that did not pertain to the SCMEP partners, the bonus to an SCMEP employee.

**Bonus**

SCMEP disputes the disallowance of the $2,500 bonus for its employee, Brittney Godfrey-Whiddon. The bonus was of $2,500 was for the performance period of January 2006-June 2006 while Ms. Godfrey-Whiddon was an SCMEP employee. Ms. Godfrey Whiddon was initially employed with the Women's Business Center then worked with the SCMEP Center and subsequently returned to work for the Women's Business Center.

**CONCLUSION**

SCMEP has a strong MEP program with several long-time NIST approved partners and continues to provide important services to its clients throughout South Carolina. SCMEP has consistently followed the direction of NIST and abided by the applicable statutes and regulations in carrying out its MEP program.

The methodology used by the auditor in basic matters such as the selection of the audit period and the categories in which to disallow costs are difficult to understand as well as respond to. SCMEP and its partners opened their financial books up to the auditors and repeatedly asked for clarification on what information the auditor wanted and frequently offered evidence to show that they could in fact provide source documentation of the expenditures listed in the quarterly reports and demonstrate that the expenditures are reasonable, allocable and allowable to the MEP program. Much of the documentation has already been made available to the auditor, but evidently has been completely rejected. We are working with the partners to again provide supporting documentation.

The auditors' insistence that there are not valid partner costs on the basis of the financial management standards is plainly inaccurate. SCMEP and its partners have demonstrated that they clearly meet the relevant financial systems requirements for managing federal dollars, even
though they receive no federal dollars from SCMEP. Although the auditor applied the inappropriate standard of 15 C.F.R. § 14.21 as it applies to subrecipients, SCMEP demonstrated that its partners meet those criteria. All of the partners are subject to strict regular audits because they are either educational institutions receiving other federal funds subject to OMB Circular A-133 audits in the case of USC, Greenville Tech, and Clemson, or subject to the scrutiny of the state auditors like SC Export.

Based on the true nature of the relationship between the parties, the auditor should have evaluated the partners based on the statutory standards of the MEP statute as set forth above, and instead applied the criteria of 15 C.F.R. § 14.23. The auditor fails to even mention in the analysis that the state of South Carolina was the sole source of funds for all partners in which it examined. Even so, the SCMEP partners can demonstrate that they meet the requirements as if they were subrecipients.

Similarly the auditor’s claim that the majority of the work conducted by the Clemson Apparel Research is out of scope is not only inaccurate but completely contrary to the NIST MEP statute, but disregards NIST’s recommendations to SCMEP in the most recent annual report. The auditor’s recommendations of disallowance of costs seem to be based in a fundamental misinterpretation and misunderstanding of how the MEP program should operate as a whole both nationally as well as for SCMEP on an individual level.

Correspondingly, the comments regarding the failure to tie expenditures to specific MEP projects and a failure to report of partner program income seem to stem from misinterpretation of the authorizing statute and overarching regulations.
EXHIBIT LIST

Exhibit 1 2006 NIST Annual Report
Exhibit 2 Cost Share Contracts for Audit period Greenville Tech
Exhibit 3 Cost Share Contracts for Audit period Clemson
Exhibit 4 Cost Share Contracts for Audit period SC Export
Exhibit 5 Cost Share Contracts for Audit Period USC
Exhibit 6 SCMEP Instructions for Quarterly Report
Exhibit 7 Quarterly Report for 1/07-3/07 USC
Exhibit 8 Quarterly Report for 1/07-3/07 Greenville Tech
Exhibit 9 Quarterly Report for 1/07-3/07 Clemson
Exhibit 10 Quarterly Report for 1/07-3/07 SC Export
Exhibit 11 SF 269
Exhibit 12 USC Fringe Rates
Exhibit 13 Policies and Procedures USC
Exhibit 14 Letter from Christine Cole
Exhibit 15 2007 NIST Annual Report
Exhibit 16 South Carolina Statute Authorizing Payment to USC