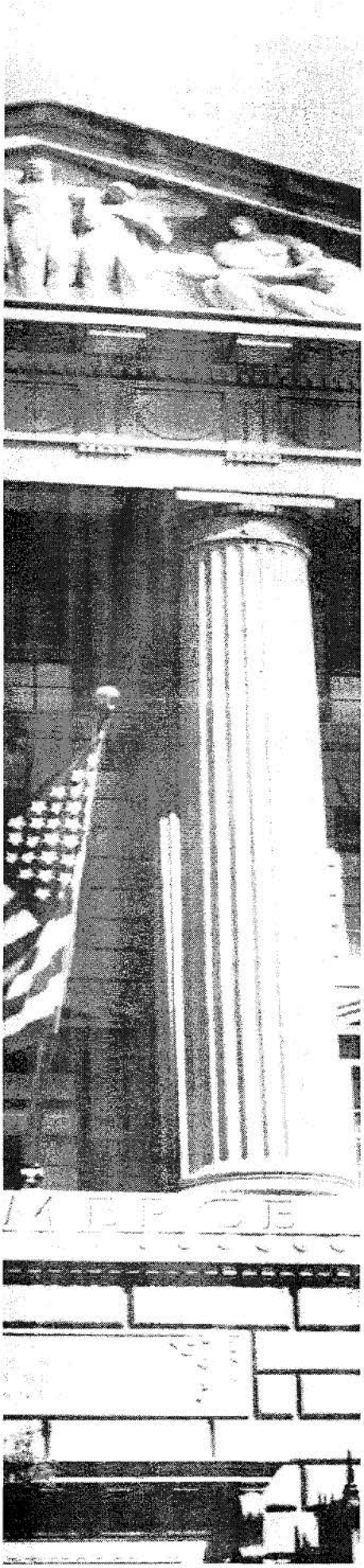

U.S. DEPARTMENT OF COMMERCE
Office of Inspector General

National Institute of Standards and Technology

California Manufacturing Technology Consulting MEP Award 70NANB5H1181

Final Audit Report No. DEN-18572
July 2010

Denver Regional Office of Audits

CONTENTS

INTRODUCTION

In September 2005, the National Institute of Standards and Technology (NIST) awarded Manufacturing Extension Partnership (MEP) Cooperative Agreement No. 70NANB5H1181 to California Manufacturing Technology Consulting (CMTC) to continue operation of an existing MEP center, with approved funding for the period of July 1, 2005, through December 15, 2005. The award was subsequently amended to provide for a 12-month performance period through June 30, 2006, and again to extend the award period for an additional 12 months, through June 30, 2007. Total estimated costs for the 24-month period were $59,946,418, with the federal government's share not to exceed $19,963,806, or 33 percent of allowable project costs.

In April 2007, the Office of Inspector General (OIG) initiated an audit of costs claimed by CMTC to determine whether the recipient complied with award terms and conditions and with NIST operating guidelines for MEP centers. The audit covered the 21-month period of July 1, 2005, through March 31, 2007, during which time the recipient claimed total project costs of $46,070,804 and received federal reimbursements totaling $15,355,400. In addition to examining claims for costs incurred by CMTC, we examined the cost claims of one subrecipient and five third-party in-kind contributors.

As stated in appendix A, the objective of our audit was to determine whether CMTC reported costs to NIST, including costs incurred by its subrecipient, that were reasonable, allocable, and allowable in accordance with applicable federal cost principles, cooperative agreement terms and conditions, and NIST policy, including the *MEP Operating Plan Guidelines* (dated March 2005). In our opinion, CMTC's claims included unallowable costs. Amounts questioned in this report reflect the results of our analyses.

On January 29, 2010, CMTC provided a written response to our November 30, 2009, draft report. We summarize CMTC's response in the appropriate sections of this report and have attached it in its entirety (excluding supplemental supporting data) as appendix D.

FINDINGS AND RECOMMENDATIONS

Our audit questioned $11,384,182 of the $46,070,804 claimed. Questioned costs include $4,800,000 claimed for CMTC's subrecipient Cerritos College, for which the college could not document actual costs incurred under its subaward, and $6,584,182 in claimed in-kind contributions from five outside organizations, for which CMTC could not provide evidence that the contributions met minimum MEP requirements.

I. Questioned Costs

A. Questioned Subrecipient Costs

CMTC's claim of $4,800,000 for costs incurred by subrecipient Cerritos College was not based on actual costs incurred by the college under its subaward, but rather on a calculation of a majority of costs incurred by the college's Technology Division. CMTC and Cerritos College had agreed that the college would provide support to CMTC's development and outreach programs for local manufacturing businesses; however, it was determined that that the Technology Division's cosmetology program was not related to manufacturing and could not be part of the MEP subaward. Therefore, the program's identifiable direct costs of $[redacted] were excluded from claims to CMTC. Technology Division salaries are not allocated by program, but an analysis by the college found that cosmetology instructors accounted for about [redacted] percent of salary costs. To be conservative in its estimate, the college excluded from its subaward claims [redacted] percent of the division's salary and benefits costs, or $[redacted]. Finally, the college reduced total expenditures by $[redacted] to remove advertising costs from its claim. The Technology Division's total expenses during the subaward period were $[redacted]; as a result of the reductions from total division expenditures, estimated subaward costs were $[redacted]. However, CMTC's approved award budget for the Cerritos College subaward was $4,800,000, so CMTC limited its cost claims to this amount.

CMTC's and Cerritos College's practice of claiming subaward costs based on estimates, rather than actual costs incurred under the subaward, violates several administrative principles contained in Title 15 of the Code of Federal Regulations (CFR), § 14.21. These principles are incorporated into CMTC's cooperative agreement with NIST and flow down to the college, pursuant to 15 CFR § 14.5. Specifically, the college's accounting system must provide

- accurate, current, and complete disclosure of the financial results of each federally sponsored project or program (§ 14.21[b][1]);
- a comparison of outlays with budget amounts for each award (§ 14.21[b][4]); and
- written procedures for determining whether costs are reasonable, allocable, and allowable in accordance with applicable cost principles and the terms and conditions of the award (§ 14.21[b][6]).

Cerritos College's claims fail to disclose current financial results of the subaward accurately and completely because they are based on an estimate, rather than actual costs incurred. And because the claims do not reflect actual subaward costs, these costs cannot be reviewed to determine

whether they are reasonable, allocable, and allowable. Although the subaward has a line-item budget, it does not appear that CMTC and its subrecipient used the budget as a management tool because subaward claims were based on broad categorical reductions from total division costs, rather than accumulations of actual costs according to budgeted line items.

We also found the subaward agreement between CMTC and Cerritos College lacked certain elements required by NIST's *MEP Operating Plan Guidelines*. The guidelines require that the subaward document list the Catalog of Federal Domestic Assistance category under which the prime award was made, the prime award number and performance period, and the federal awarding agency. The Cerritos College subaward mentioned only NIST/MEP as the federal awarding agency. In addition, the guidelines require the agreement to state applicable flow-down provisions and clauses from the prime award. These would include related administrative and cost principles, neither of which was incorporated into the subaward document.

Given that the claims related to the Cerritos College subaward were not based on actual costs incurred under the subaward, and given the other deficiencies we identified, we question the entire $4,800,000 of CMTC's claimed project costs.

B. Questioned Third-Party In-Kind Contributions

CMTC's cost claims included $[redacted] in third-party in-kind contributions from a total of 11 contributors. We selected a nonstatistical sample of five contributors, accounting for $6,584,182 in contributions, for further analysis. (See table 1.)

Table 1. Audit Sample of In-kind Contributors

Contributor	Location	Contribution Claimed
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
		$6,584,182

Source: CMTC documents

We found several deficiencies connected to these claims. None of the claims were for donations of goods and services to CMTC; rather, they represented costs incurred by the third-party organizations in the course of their regular activities. Also, none of the claims met the minimum requirements for in-kind contributions specified in the terms and conditions of CMTC's cooperative agreement. Furthermore, portions of the claims were related to activities that occurred prior to the MEP award period.

NIST's *MEP Operating Plan Guidelines* and the MEP general terms and conditions, incorporated into CMTC's cooperative agreement for the period beginning July 1, 2005, directed

MEP centers to maintain documentary evidence of contributions. To the extent that personnel time is contributed to an MEP center, as was claimed by all five of the contributors in our sample, the minimum required documentation includes

- a list of personnel,
- projects/tasks and dates on which they worked,
- the number of hours contributed,
- hourly salary rates and allowable fringe benefits paid, and
- certified time and attendance records.

None of the contributors provided documentation of projects/tasks and dates on which they worked or certified time and attendance records. Only two of the five—[redacted] and [redacted]—identified their contributed personnel. CMTC did maintain salary and benefits records and some details of hours contributed, in the form of percentages of staff time donated, for all five contributors.

We also found that portions of the contributions claimed for [redacted] and [redacted] occurred prior to the July 1, 2005, starting date of CMTC's award. [redacted]'s initial contribution statement, totaling $[redacted], showed a contribution date of January 1, 2005, through June 30, 2005. [redacted] submitted two contribution statements to CMTC, one for a total of $[redacted] contributed from May 1, 2005, through July 31, 2005, and a second in the amount of $[redacted], contributed from May 1, 2005, through April 30, 2006. OMB Circular A-122, Attachment B, Paragraph 36, states that preaward costs are only allowable to the extent they would have been allowable if incurred after the date of the award, and only with the written approval of the awarding agency. We found no evidence that CMTC requested or NIST provided written approval for in-kind contributions prior to the award date.

Our draft audit report included a finding that questioned the allowability of CMTC's claimed in-kind contributions on the basis that CMTC had not complied with generally accepted accounting principles (GAAP) in its accounting for the contributions it received. The main point of the finding was that if CMTC had received allowable in-kind contributions, it should have recognized the revenue associated with the contributions in its financial records, in accordance with GAAP. In its response to the draft audit report, CMTC conceded that it did not receive the in-kind contributions. Instead, the contributions involved one group of outside parties—the in-kind contributors claimed by CMTC—providing services to another group of outside parties—the manufacturers. Therefore, CMTC asserted that it had no obligation under GAAP to record the revenue. Based on CMTC's acknowledgement that it did not receive the in-kind contributions, and thus was not required to record the associated revenue, we adjusted our final report to remove specific reference to the violation of GAAP. We continue to question the in-kind contributions on the basis that CMTC did not receive the contributions, as well as for the reasons stated above.

Based on CMTC's failure to meet minimum requirements for documenting in-kind contributions, the inclusion of unapproved preaward activities in the claims, and CMTC's acknowledgement

that it did not actually receive the claimed contributions, we question $6,584,182 in claimed third-party in-kind contributions.

C. Recipient's Response

In its response to our November 2009 draft report, CMTC maintained that the $4,800,000 of claimed subrecipient costs and the $6,584,182 of in-kind contributions are allowable under its MEP award. In addition to responding to each OIG finding individually, CMTC contended that (1) federal law gives MEP centers the authority to determine whether costs incurred by their partners are allowable, and (2) changes in NIST's MEP policy should not be enforced.

CMTC's response cites language in the America Creating Opportunities to Meaningfully Promote Excellence in Technology, Education, and Science (COMPETES) Act of 2007,[1] which states that in meeting its matching share requirement, an MEP 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 of the Federal investment made on behalf of small- and medium-sized manufacturing companies." The Act further states, "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." CMTC maintains that it determined the costs of its subrecipient and third-party contributors to be allowable; therefore, the Act provides that they are valid nonfederal matching share.

CMTC also stated its objections to NIST's *MEP Operating Plan Guidelines* and the revised MEP general terms and conditions. CMTC commented that NIST issued the guidelines just one month before renewal applications were due for the period beginning July 1, 2005, giving centers little time to structure their relationships with partners to conform to the new requirements. CMTC believes NIST's 2005 version of the MEP general terms and conditions should not be enforced on centers because the terms and conditions imposed new definitions on partnerships and subawards and required personnel recordkeeping requirements for partners that exceeded requirements in 15 CFR, Part 14. CMTC also stated that the general terms and conditions imposing these requirements were unilaterally incorporated into its MEP cooperative agreement in March 2006, 9 months into the award period, and it is unreasonable to expect to see records complying with the new requirements for the entire award period.

1. Questioned Subaward Costs

CMTC's response stated several reasons why it believes the costs claimed for subrecipient Cerritos College should be allowable. CMTC maintains the subaward agreement was reviewed and approved by several NIST officials, including the grants officer, MEP program officer, and NIST legal counsel.

CMTC disagreed with OIG's finding that the amounts claimed for the Cerritos subaward were estimates, rather than actual costs. According to CMTC, the claims were based on actual costs incurred by the college's Technology Division, but reduced to eliminate faculty salaries related

[1] Public Law 110-69, § 3003.

to the division's cosmetology program. The response stated that the college uses a state-mandated system that makes it nearly impossible to manually remove the cosmetology salaries from its claims to CMTC. The college calculated the portion of Technology Division salaries that relate to the cosmetology program; this percentage was then subtracted from the total Technology Division costs to arrive at the amount associated with the CMTC subaward. CMTC stated that its method for cost allocation is permissible under 2 CFR, Part 220, Appendix A, § J.10.b(2)(c).[2] The college submitted quarterly reports of actual Technology Division expenditures to CMTC, although the cost categories in the quarterly submissions did vary somewhat from the categories included in the budget submitted with CMTC's renewal application. However, CMTC stated that simple differences in the nomenclature used to describe cost categories did not prevent it from comparing the actual costs Cerritos reported quarterly with the annual budgets.

Regarding the draft audit report finding that the subaward agreement with Cerritos College was missing certain flow-down provisions, the Catalog of Federal Domestic Assistance category, and prime award numbers, CMTC claimed that these omissions did not have an impact on the validity of Cerritos's expenditures claimed as match. Based on the agreement, CMTC bore the burden of assuring that only costs allowable under the award terms were reported by the college and ultimately claimed by CMTC and reported to NIST as non-federal cost share.

2. Questioned Third-Party In-Kind Contributions

CMTC disagreed that the costs reported by five third-party in-kind contributors are unallowable. CMTC's response stated that OIG's draft audit report "ignored the statutory underpinnings of the MEP program" by questioning the in-kind contributions. According to CMTC, the MEP program statute "authorizes MEP centers to use the expenditures of like-minded local organizations to count toward the two-thirds non-federal cost share."

CMTC asserted that our draft report too narrowly defined in-kind contributions to include only contributions received by the MEP center. CMTC did not receive the in-kind contributions it claimed; rather, the donations were made by third parties directly to small- and medium-size manufacturers. CMTC's response stated its opinion that the definition of third-party in-kind contributions in 15 CFR § 14.2(nn) does not require goods and services to be directly donated to the recipient organization, but only that donated services "directly benefit and be specifically identifiable to further the mission of the MEP program." Furthermore, CMTC stated, the contributions need not be distinct from the third party's regular activities and operations. Finally, CMTC stated that the activities the contributors engaged in were identified in its operating plan and the respective memoranda of agreement, all of which were approved by NIST.

CMTC conceded that its in-kind claims included contributions made prior to the July 1, 2005, starting date of the award. However, CMTC stated that amounts claimed for in-kind contributions were less than actual contributions and these unclaimed amounts more than offset the preaward contributions noted in the draft audit report. According to the response, CMTC's unclaimed in-kind contributions were almost $[redacted].

[2] 2 CFR, Part 220, is the regulatory codification of OMB Circular A-21, Cost Principles for Educational Institutions.

CMTC contended that it maintained adequate records to document allowability of its claimed in-kind contributions. According to CMTC, as an MEP recipient it is responsible for determining allowability of contributions, which it did within the context of each contributor's accounting system. Each contributor established a methodology to identify costs for activities on behalf of manufacturers. CMTC complained that, rather than reviewing financial documentation maintained by CMTC and its contributors, OIG seemed more concerned with the relationships between CMTC and the contributor organizations. CMTC's response summarized the contribution documentation and valuation processes of the five contributors cited in the draft audit report.

CMTC stated that as a result of the OIG audit, it has made several improvements to the manner in which it evaluates third-party contributions. Among these improvements is a requirement for CMTC representatives to conduct on-site reviews with each contributor at least annually. In addition, CMTC reported that contributors have implemented better methods for allocating their costs to the MEP program.

CMTC disagreed with OIG's draft report assertion that CMTC's treatment of in-kind contributions did not comply with GAAP. CMTC stated that it prepares financial statements based on advice received from its independent auditor. The in-kind contributions had been disclosed in the notes to its financial statements; however, CMTC stated that recognition of in-kind contributions as revenue "is inconsequential as to whether the costs were allowable third party in-kind contributions." CMTC's response stated that since the contributions were not made to it, but rather to the manufacturers the contributors served, there was no GAAP requirement for CMTC to recognize revenue associated with the contributions.

D. OIG Comments

OIG does not agree with CMTC's assertion that the America COMPETES Act gave MEP centers complete and unchallengeable authority to determine allowability of cost claims for subrecipients and third-party in-kind contributors. At OIG's request, the Department's Office of General Counsel reviewed the Act, with emphasis on whether it passes authority to determine allowability of costs from the federal government to the MEP centers. The Office of General Counsel found that the legislation explicitly states that it was intended as a clarification of existing law. Since the law and practice prior to enactment of the America COMPETES Act had been that the federal government maintained final authority in determining allowability, reasonableness, and allocability of costs under financial assistance awards, to transfer this authority to the MEP centers would have required a new law creating an exception for the MEP program. Again, as the stated purpose of the America COMPETES Act was to clarify existing law—not create a new law—the argument that the Act gave the MEP centers authority to make final, unreviewable determinations of allowability of costs is in direct conflict with the clear purpose of the Act. Rather than transferring authority from the federal government to the MEP centers, the Act clarifies that the centers need to

- review third-party contributions within the context of stated MEP program procedures;
- independently assess the reasonableness, allowability, and allocability of contributions; and

- include only those claims found to comply with all standards as part of the required nonfederal matching share.

We do not agree that the MEP *Operating Plan Guidelines* and general terms and conditions should not be enforced. The *Operating Plan Guidelines* did not create new definitions for relationships MEP centers may have with other organizations, but rather defined existing relationships within the context of the three types allowed by OMB: contractor, subrecipient, or third-party in-kind contributor. "Partner" is not a class of relationship recognized and defined in the OMB regulations. If the *Operating Plan Guidelines* caused confusion, it was not because they imposed new definitions, but rather because NIST was informing the MEP centers that they needed to bring their relationships with other organizations into line with one of the three allowable types.

We do not agree that (1) the general terms and conditions imposed new recordkeeping requirements on third parties, (2) the alleged new requirements exceeded Office of Management and Budget (OMB) requirements, and (3) documentation requirements for in-kind contributions were not incorporated into CMTC's cooperative agreement until 9 months into the award period. The requirements to which CMTC objected did not impose time- and recordkeeping requirements on its third-party contributors, but rather stated the minimum NIST requirements for documenting that in-kind contributions were received and properly valued. If an MEP center claimed to have received a contribution of services from a third party, we do not consider it unreasonable to expect the center to retain supporting documentation of the type mentioned in the *Operating Plan Guidelines* and general terms and conditions; namely, a list of personnel whose services were donated; the dates, number of hours, and projects on which they worked; the donated employees' salary rates;[3] and a certified timesheet or other record that supports the hours and activities donated. Although these requirements were stated in both the *Operating Plan Guidelines* and the general terms and conditions, CMTC did not retain all the required records for any of its claimed in-kind contributors.

With respect to CMTC's assertion that it became aware of the in-kind documentation requirements when they were unilaterally imposed by NIST 9 months into the award period, this simply is not the case. Section III.F.(2) of the *MEP Operating Plan Guidelines*, issued more than 3 months prior to the July 1, 2005, starting date of CMTC's award, stated, "Centers must have documented evidence of the third party in-kind contribution from the contributor. This evidence must include documentation from the contributor that contains ..." The guidelines then list the required documentation cited previously in this report. Identical language also appeared in the June 2005 version of the MEP general terms and conditions, which were incorporated into CMTC's initial cooperative agreement for the award period beginning July 1, 2005.

OIG does not dispute that amounts reported by CMTC's subrecipient, Cerritos College, represent actual costs incurred by the college. Our concern in questioning the costs is that the college is not able to isolate its actual costs incurred under the CMTC subaward from other activities of the

[3] Salary information is necessary because 15 CFR § 14.23(e) states that when a third party donates the services of an employee, the allowable in-kind contribution is limited to the employee's actual salary, plus a reasonable allocation of fringe benefit costs.

college's Technology Division. Rather than establishing a compliant system for tracking subaward costs, the college's cost claims to CMTC are based on total expenses of the Technology Division, regardless of whether they were incurred within the scope of the subaward or as part of the college's regular instructional offerings, less an estimated amount to account for the portion of the Technology Division's operations that relate to the cosmetology program. As a result, CMTC claims that the entire non-cosmetology cost of Cerritos College's Technology Division was incurred under the subaward. We consider this to be an unreasonable assertion.

The subaward agreement between CMTC and Cerritos College states that the work the college performed in support of CMTC is "in addition to [its] degree and certificate programs." The subaward statement of work describes the program support Cerritos College will provide for CMTC as "an extensive Manufacturing Technology Program which performs outreach, customized training, technical assistance and technology demonstration to [its] region's manufacturing industry with focus on the small and medium-sized manufacturing companies in four key areas." The key technology areas listed are programs offered within the Technology Division, but Cerritos College offers degrees or certificates in each as well. As stated above, the college did not separately accumulate costs associated with the degree and certificate offerings within the Technology Division from the division's work in support of the CMTC subaward. The claims made by Cerritos College through CMTC include not only costs incurred under the subaward but also the Technology Division's costs associated with its other operations, such as degree and certificate programs. Therefore, we continue to question the costs on the basis that the claims do not accurately reflect actual costs incurred under the CMTC subaward.

The strongest evidence in support of our questioning of CTMC's third-party in-kind contribution claims is found in CMTC's own response to the draft audit report. By CMTC's own admission, it did not actually receive any of the contributions included in its cost claims. The only apparent connection between CMTC and the claimed contributors is that they share a common mission of serving manufacturers. Yet, as the relationships are structured within CMTC's operations and cost claims, CMTC believes it should qualify to receive federal funds[4] as a result of one group of outside organizations providing services to other outside organizations, even though CMTC is not involved in arranging for or providing the services. We maintain that the in-kind contributions are not allowable MEP costs because they were neither incurred directly or indirectly by CMTC, nor contributed to CMTC in lieu of amounts CMTC otherwise would have had to pay.

With respect to CMTC's claim that its actual in-kind contributions were greater than amounts claimed, this would have no effect on our calculation of allowable project costs. For the reasons stated above, we consider all similar in-kind contribution claims to be unallowable, regardless of the amount.

CMTC's assertion that it did not deviate from GAAP in its accounting treatment of the in-kind contributions has no bearing on our decision to question the claims. In fact, one of the bases CMTC cites for not reporting the contributions as revenue is that it did not actually receive the

[4] Because CMTC's cooperative agreement included a one-third federal sharing ratio, for each $1,000 claimed as an in-kind contribution to the award, CMTC qualified to receive $333 from NIST, even though CMTC had no out-of-pocket expenditures associated with the claimed contribution.

contributions. As we state above, this only supports our contention that CMTC should not have claimed the in-kind amounts.

We reaffirm our findings that CMTC claimed unallowable subrecipient costs of $4,800,000 and unallowable third-party in-kind contributions of $6,584,182.

II. Undisbursed Program Income

The draft audit report pointed out that CMTC had requested and received NIST approval to carry more than $[redacted] of undisbursed program income from the award year ended June 30, 2006, into the subsequent award year. Although our concerns about the magnitude of the undisbursed program income remain—the amount approved for carry-forward exceeded CMTC's approved federal funding under the MEP cooperative agreement—CMTC pointed out in its response to the draft audit report that it did obtain necessary approval from NIST to retain the undisbursed funds for use in the subsequent period. OIG agrees with CMTC's assertion that any concerns we might have regarding approval of CMTC's carry-forward of undisbursed program income should be addressed with NIST, not CMTC. We have adjusted our final report on CMTC accordingly.

III. Recommendation

We recommend that the chief of NIST's Grants and Agreement Management Division disallow $11,384,182 in questioned costs and recover $3,794,349 in excess federal funds, as calculated below in our summary.

SUMMARY RESULTS OF FINANCIAL AUDIT

The results of our interim cost audit for the period July 1, 2005, through March 30, 2007, which are detailed in Appendix C, are summarized as follows:

Federal Funds Disbursed		$15,355,400
Costs Incurred	$46,070,804	
Less Questioned Costs	11,384,182	
Costs Accepted	34,686,622	
Federal Cost Sharing Ratio	x 33.33%	
Federal Funds Earned		11,561,051
Refund Due the Government		$3,794,349

APPENDIX A: OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of our audit was to determine whether CMTC 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 the *MEP Operating Plan Guidelines*. The audit scope included a review of costs claimed by CMTC during the award period of July 1, 2005, through March 31, 2007.

We performed our audit fieldwork during April and September 2007 at CMTC's headquarters in Torrance, California; at the subrecipient's campus in Norwalk, California; and at third party in-kind contributors' offices in the cities of San Diego, Montrose, Irwindale, and Los Angeles, California. To meet our objective, we interviewed CMTC and NIST Grants Office officials, reviewed NIST award documents, and examined CMTC's financial records. We also interviewed officials and examined financial records of CMTC's subrecipient and third-party in-kind contributors.

We reviewed the following laws, regulations, and award requirements:

- Office of Management and Budget Circular A-122, *Cost Principles for Nonprofit Organizations*
- 15 CFR, Part 14, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, Other Non-Profit, and Commercial Organizations*
- Department of Commerce *Financial Assistance Standard Terms and Conditions, MEP General Terms and Conditions*
- Special Award Conditions

We verified the validity and reliability of computer-processed data supplied by CMTC by directly testing data against supporting documentation. Based on our tests, we concluded the computerized data were reliable for use in meeting our objectives.

We analyzed nonstatistical samples of CMTC, subrecipient, and third-party in-kind contributor transactions, generally focusing on the highest-dollar-value transactions and line items. Since we did not attempt to extrapolate findings from sample analyses to all transactions, we believe our sampling methodology represented a reasonable basis for the conclusions and recommendations included in our report.

We obtained an understanding of the management controls of CMTC by interviewing CMTC officials; examining policies, procedures, and CMTC's most recent single audit report; and reviewing written assertions of CMTC officials. Our report contains specific recommendations to address CMTC's reporting of undisbursed program income.

The 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, and 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 objective. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX B: SUMMARY OF SOURCE AND APPLICATION OF FUNDS

CALIFORNIA MANUFACTURING TECHNOLOGY CONSULTING
NIST COOPERATIVE AGREEMENT NO. 70NANB5H1181
JULY 1, 2005, THROUGH MARCH 31, 2007

	Approved Budget (a)	Receipts & Expenses (b)
SOURCE OF FUNDS:		
Federal	$19,963,806	$15,355,400
Non-Federal	39,982,612	30,715,404
Total	$59,946,418	$46,070,804
APPLICATION OF FUNDS:		
Personnel	$[redacted]	$[redacted]
Fringe Benefits		
Travel		
Equipment		
Materials		
Subcontracts		
In-Kind		
Construction		
Other		
Indirect Costs		
Total	$59,946,418	$46,070,804 (c)

Notes:

(a) The approved budgeted costs are for the period of July 1, 2005, through September 30, 2007.
(b) The receipts and expenses are for the period of July 1, 2005, through March 31, 2007.
(c) Total does not sum to $46,070,804. $1 rounding error is not material.

APPENDIX C: SUMMARY OF FINANCIAL/COMPLIANCE AUDIT

CALIFORNIA MANUFACTURING TECHNOLOGY CONSULTING
NIST COOPERATIVE AGREEMENT NO. 70NANB5H1181
JULY 1, 2005, THROUGH MARCH 30, 2007

			Results of Audit		
Description	Approved Budget	Costs Claimed	Costs Questioned	Costs Unsupported	Costs Accepted
Personnel	$[redacted]	$[redacted]	$0	0	$[redacted]
Fringe Ben.	[redacted]	[redacted]	0	0	[redacted]
Travel	[redacted]	[redacted]	0	0	[redacted]
Equipment	[redacted]	[redacted]	0	0	[redacted]
Materials	[redacted]	[redacted]	0	0	[redacted]
Subcontracts	[redacted]	[redacted]	4,800,000 (a)	0	[redacted]
In-Kind	[redacted]	[redacted]	6,584,182 (b)	0	[redacted]
Construction	[redacted]	[redacted]	0	0	[redacted]
Other	[redacted]	[redacted]	0	0	[redacted]
Indirect	[redacted]	[redacted]	0	0	[redacted]
Total	$59,946,418	$46,070,804 (c)	$11,384,182	$ 0	$34,686,623

Federal Funds Disbursed		$15,355,400
Costs Incurred	$46,070,804	
Less Questioned Costs	11,384,182	
Costs Accepted	34,686,622	
Federal Cost Sharing Ratio	x 33.33%	
Federal Funds Earned		11,561,051
Refund Due the Government		$ 3,794,349

Notes:

(a) Questioned cash match which consists of costs claimed by CMTC's subrecipient, Cerritos College, for which the college could not provide evidence that the claims involved actual, allowable costs.

(b) Questioned third-party in-kind contributions include amounts for [redacted] ($[redacted]), [redacted] ($[redacted]), [redacted] ($[redacted]), [redacted] ($[redacted]), and [redacted] ($[redacted]).

(c) Total does not sum to $46,070,804. $1 rounding error is not material.

APPENDIX D: CMTC RESPONSE TO DRAFT AUDIT REPORT

CALIFORNIA MANUFACTURING TECHNOLOGY CONSULTING®

January 29, 2010

Ms Marie Burton
Acting Regional Assistant Inspector General for Audits
United States Department of Commerce
Office of Inspector General
Denver Regional Office of Audits
999 18th Street, Suite 765
Denver, Colorado 80202-2499

Dear Ms Barton:

Thank you for the opportunity to comment upon the Draft Audit Report No. DEN-18572. This letter responds to the proposed findings, questioned costs, and recommendations regarding whether we complied with the award terms and conditions and operating guidelines for MEP centers for the period July 1, 2005 through March 31, 2007. Our position is that the issues cited in the audit report were not due to undocumented costs, but were due to the aforementioned NIST issuances imposing unreasonable and unsuitable requirements for documenting partnership costs. CMTC's multiple partners' systems had inherent limitations which prevented identifying these costs exactly as prescribed. We maintain that the entire amount of $11,384,182 in questioned costs was properly supported. Attached are two documents supporting CMTC's position regarding the draft findings, questioned costs, and recommendations. Most, if not all, of the documents in Attachment B were available to the auditors during the on-site review.

The discrepancies reported in the audit are largely resulting from 1) partnerships being an integral and necessary part of the MEP/CMTC program, and 2) the requirements in the MEP Terms and Conditions not being compatible with CMTC partner cost accounting systems. NIST terms and conditions and the audit assumed we could compel our partner to change their systems, and as such, the NIST Terms and Conditions were more suited to reporting for contractors, not as partners for 3rd party in-kind contributors and sub-recipient. Consequently, the audit reported discrepancies that were a consequence of the peculiarities of the MEP Terms and Conditions. So, while the financial reports support the matching cost claims made during the period were available, they were essentially ignored because they did not meet the formats sought by the auditors.

Recently, in November 2009, NIST MEP, recognizing the necessity to make terms and conditions more suitable for partnering, modified them. Since these revised Terms and Conditions are more reasonable for partners, we request that for the audited period the costs documented in the attachments now be accepted. It has long been recognized that the NIST Terms and Conditions needed to be modified to allow MEP centers to work with partners'

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systems, which are designed to capture only data and reports required for their operations and audit requirements. For example, neither state law nor community college regulations require timesheets for exempt employees, as was required in the General Terms and Conditions. Since our partners were not contractors, we could not compel them to report costs consistent with NIST General Terms and Conditions. However, the US Congress, in the America Competes Act passed in August 2007; and NIST MEP, with promulgated changes in late 2009 to the MEP General Terms and Conditions, both addressed these problematic NIST General Terms and Conditions with a more appropriate reporting requirement for partners. As documented in the Attachments A and B, during the audit period, CMTC had, in fact, reasonable financial reports detailing the costs claimed for the work performed by our partners, consistent with the modified NIST General Terms and Conditions.

As indicated in Attachment B, the Manufacturing Extension Partnership (MEP) Centers were not established to operate independently, but instead to leverage new and existing resources to transfer its knowledge and technology to as many small and medium-size manufacturers as possible. As documented in Attachment B, the partnering policy is both emphasized and a well established integral part of the MEP program execution. In addition, the MEP Program policy requires a two-thirds (2/3) cost share burden, meaning that for every dollar of federal funds used, CMTC must document two dollars in eligible matching costs. To meet each of these requirements, CMTC relies heavily on working with like-minded organizations, i.e., partners, whose expenditures may be claimed as non-federal cost share. Given the low percentage of federal dollars provided under the program, CMTC partnering organizations provide their own sources of funding for their activities.

The auditors' assertion that there is no direct financial benefit received by CMTC from its partnering ignores the leverage value between CMTC and its partnering organizations. The value received by CMTC is derived from our enhanced capabilities and reduced costs from partnering (i.e., leverage) to provide services to the largest total number of manufacturers in the U.S., within the 3rd largest service area. In short, the partnering value translated into considerable cost savings and increased number of manufacturers served in CMTC's service areas. Consequently, the contributions of these partner organizations are made to CMTC's program and mission, through increasing its ability to reach small and medium-sized manufacturers in its very diverse and large service area.

The Draft Audit Report questions third-party in-kind costs "because their goods and services were not provided to CMTC, were costs incurred by the partners in the course of performing their regular activities, were not documented in accordance with generally accepted accounting principles, and portions were incurred prior to the award period". In addition, it states that the contributors' personnel time was not documented in accordance with the MEP General Terms and Condition 14.A. As CMTC states above, while our financial documentation may not have been consistent with that normally available to *contracted work*, CMTC did in fact have adequate documentation for the total partner *costs* claimed on Attachment A. As shown on Attachment A, during the audit, CMTC collected official signed records from its partners, detailing partner costs and services. While, for the most part these records are not cited or referenced in the audit report, they do show the details for all claimed costs and were provided to the auditors.

Our position is that the in-kind contributions meet the requirements for matching costs under 15 C.F.R. §14.23 and meet the intent of reasonableness, These official records are consistent with the 2009 modified MEP General Terms and Conditions, which allow for "on-going resources" and recognize the limitations of the partnering organizations' reporting systems. Further, our position is that CMTC and its partners should not be subject to changed terms and conditions that are retroactively and unilaterally imposed by NIST during an award period (the auditors used unilaterally changed terms and conditions during their examination, which exceed 15 C.F.R. §14.23). While CMTC accepts the auditor's finding regarding pre-award costs of two partners, CMTC disagrees with the finding that any amount is due back. CMTC has ample available and allowable in-kind to substitute costs, as more matching costs were reported to CMTC by their partners than reported and claimed under the award. Lastly, CMTC's financial statements did not include the in-kind donations as revenue because it was not the direct recipient of the contributions.

The Draft Audit Report questions the Sub-recipient reported costs of Cerritos College Technology Division because they were estimated costs. Our position is that the costs reported to NIST were reasonable, allocable, and allowable in accordance with the federal cost principles and other laws and regulations applicable to MEP recipients. As shown in Attachment B, Cerritos College Technology Division costs claimed by CMTC were not based upon "estimates," but on actual costs incurred as reported in their quarterly financial reports. Cerritos relied upon its existing accounting system to record its expenditures, and would subtract costs that were not allocable to the MEP program or unallowable under the cost principles and the terms of the cooperative agreement. A comparison of those actual expenditures against the proposed budgeted amounts and a determination as to whether those costs were reasonable, allocable, and allowable *was made by CMTC, on a quarterly basis, during the period of performance.*

The Draft Audit Report criticizes this methodology in determining the Sub-recipient reported costs. Based upon these findings *of minor missing information*, the Draft Audit Report questions all of Cerritos matching costs reported in the amount of $4.8 million as if none of them had been documented. As discussed in the paragraphs above, CMTC believes that the audit findings related to Cerritos are based on form over substance and the result of an unreasonable requirement for partners. CMTC therefore attaches supporting documentation in Attachment B, and demonstrates how Cerritos' total sub-recipient expenditures of $4.8M should be allowed as non-federal match.

With regard to the audit findings on Excess Program Income, our position is that this is an opinion without foundation. In fact, CMTC acted in accordance with 1) the CMTC Board of Directors fiduciary responsibility and direction, and 2) properly sought and received NIST approval to carry forward Excess Program Income. CMTC's Board of Directors has fiduciary responsibility for assuring adequate financial reserves for the stable operation of CMTC. Documentation supporting the Board's position was made available to NIST, and CMTC acted with NIST's full knowledge and approval. In fact, events following the audit have shown the wisdom in the decisions to carry an ample reserve, as the level of reported Excess Program Income has since declined by several million dollars, mainly due to the economic challenges experienced. It should also be noted that CMTC acknowledges that Excess Program Income is to be spent in furtherance of the MEP program, and that any Excess Program Income carried over should be used consistent with good non-profit company practices and economic conditions.

In closing, we contend that the CMTC program and cost records, while not in strict accordance with the NIST prevailing General Terms and Conditions, were adequate for partnerships as reflected in the America Competes Act and the updated NIST MEP General Terms and Conditions. CMTC's 3rd party in-kind and sub-recipient's costs are documented. In addition, CMTC recognizes the value in the audit, and has taken management steps to strengthen its partner reporting further to assure well documented program costs.

Sincerely,

John J. Van Buren

John J. Van Buren
Vice President and CFO

Enclosure

cc: Laura A. Ceasario, Chief, NIST Grants and Agreements Management Division

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Attachment A

Summary of Documented Detail For In-kind Expenditures
During OIG Audit Period

Partners	In-kind Budget Approved by NIST	In-kind Reported to NIST and questioned by OIG	Actual Amount of Allowable In-kind Received	Additional Match Available[1]	REPORT SUBMITTED & SIGNED BY PARTNER (Report has multiple sections)				Payroll Register from Partner's Accounting System	Detail General Ledger from Partner's Accounting System for Non-Payroll Expenses
					Activities Accomplished for Period	In-kind Contribution by Expense Category	Personnel & Pay Detail by Employee	Effort Spent on MEP Mission by Employee		
Cerritos Community College	$4,800,000	$4,800,000	$[redacted]	$[redacted]	Provided to OIG	Provided to OIG	Provided to OIG	[redacted]	Provided to OIG	Available
[redacted]	$[redacted]	$[redacted]	$[redacted][2]		Provided to OIG	Provided to OIG	Provided to OIG	[redacted]	TBD [5]	Available
[redacted]	$[redacted]	$[redacted]	$[redacted]	$[redacted]	Provided to OIG	Provided to OIG	Provided to OIG	[redacted]	IRS Quarterly Payroll Form 941 available	Available
[redacted]	$[redacted]	$[redacted][3]	$[redacted][4]		Provided to OIG	Provided to OIG	Provided to OIG	[redacted]	TBD [5]	TBD [5]
[redacted]	$[redacted]	$[redacted]	$[redacted]	$[redacted]	Provided to OIG	Provided to OIG	Provided to OIG	[redacted]	TBD [5]	TBD [5]
[redacted]	$[redacted]	$[redacted]	$[redacted]	$[redacted]	Documented by CMTC	Provided to OIG	Provided to OIG	[redacted]	TBD [5]	n/a - Contributed personnel cost only. No non-payroll expenses.
Total	**$11,617,200**	**$11,384,182**	**$12,181,352**	**$1,486,807**						

Notes:

1. Additional match available from Partners that were not previously reported to NIST and can be used to cover any in-kind disallowed by the OIG.
2. Of the $[redacted] reported by [redacted], $[redacted] is from months prior to the audit period. Therefore actual amount available is $[redacted] ($[redacted]2 - $[redacted]).
3. CMTC over reported in-kind from [redacted] due to incorrect reading of performance period. The correct in-kind amount should be $[redacted].
4. Of the $[redacted] reported by [redacted] for the period in question, $[redacted] is from months prior to the audit period. Therefore actual amount available is $[redacted] ($[redacted] - $[redacted]).
5. TBD (To be determined). CMTC is in discussion with Partners to obtain documents.

Attachment B

CMTC's Response to Draft Audit Report

Attachment B

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CMTC Response to Draft Audit Report No. DEN-18572

This responds to the proposed findings and recommendations identified in Draft Audit Report No. DEN-18572 of California Manufacturing Technology Consulting ("CMTC" or the "Center") Cooperative Agreement Award No. 70NANB5H1181 for the period July 1, 2005 through March 31, 2007 (the "Agreement"). As discussed in detail below, the audit report seems to challenge NIST's implementation of the Manufacturing Extension Partnership ("MEP") as understood by all of the MEP Centers, the value of the partnerships in the extension of services and knowledge to manufacturers, and the statutory mandate that the expenditures, whether in cash or in-kind, of those partnering organizations be accepted as part of the MEP Centers' matching costs.

Attached to this Draft Audit Response are documents supporting CMTC's position regarding the draft findings and recommendations—documents that were available to the auditors during the on-site review. We anticipate producing additional documentation from our partners after the final report is issued. We note that during the audit, there was little focus on the financial management and records of CMTC and no recognition of the many accomplishments of CMTC in providing high quality services to the small- and medium-sized manufacturers it serves throughout California. Furthermore, throughout the Draft Audit Report, the auditors focused on the form rather than the substance of CMTC's agreements and supporting documentation submitted by its partners.

Additionally, it is important to note that CMTC has built strong partnerships in spite of the fact that they offer few federal dollars to their partners. We believe that our arguments and supporting documentation illustrate that CMTC implemented the partnership agreements exactly as contemplated under the statute and implemented by NIST. We would like to note that as a result of the audit, CMTC has been able to make some improvements to its practices and procedures. It is also significant that in this past award year, CMTC was able to obtain approval by NIST's Grants Officer of the methodology by which all of our partners allocate and document their costs.

I. MEP PROGRAM PARTNERING ENTITIES AND ALLOWABLE COSTS

A. The MEP Statute

The MEP statute states the purpose of the program is "to enhance productivity and technological performance in the United States."[1] MEP Centers are directed to accomplish this goal through: (1) the transfer of manufacturing technology and techniques from NIST to Centers to manufacturing companies; (2) participation of individuals from industry, colleges, State governments, other Federal agencies and NIST in cooperative technology transfer activities; (3) efforts to make new manufacturing technology and processes usable by small- and medium-size U.S. companies; (4) active dissemination of scientific, engineering, technical, and management information to industrial firms, including small- and medium-sized manufacturing companies; and (5) utilization of expertise and capability that exists in Federal laboratories other than NIST.[2]

[1] 15 U.S.C. § 278k(c).
[2] *Id.*

In 2007, Congress clarified its intent regarding the eligibility of partnering organizations' expenditures as matching costs. Section 278k(c) of Title 15 of the United States Code states in relevant part:

> (3)(B) In order to receive assistance under this section, an applicant for financial assistance under subparagraph (A) shall provide adequate assurances that 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 of the costs incurred for the first three years and an increasing share for each of the last three years. For purposes of the preceding sentence, the costs incurred means the costs incurred in connection with the activities undertaken to improve the management, productivity, and technological performance of small- and medium- size manufacturing companies.
>
> (C) 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 of the Federal investment made on behalf of small- and medium- size manufacturing companies. **All** non-Federal costs, contributed by such entities and determined by a Center as programmatically reasonable and allocable under MEP program procedures **are** includable as a portion of the Center's contribution.[3]

B. The Programmatic Purposes of the MEP as Communicated by the Government

The Department of Commerce, through the National Institute of Standards and Technology ("NIST"), has communicated its interpretation of this statute to the public in multiple formats. For example, the *Catalog of Federal Domestic Assistance* ("CFDA" No. 11.611) description of MEP states the objective of the MEP program is "[t]o establish, maintain, and support manufacturing extension centers and services, the functions of which are to improve the competitiveness of firms accelerating the usage of appropriate manufacturing technology by smaller U.S. based manufacturing firms, and partner with the States in developing such technical assistance programs and services for their manufacturing base."[4] It further provides under Uses and Use Restrictions: "Federal funding provided under this program shall be used for the creation and support of manufacturing extension services, or used by the States to plan for and pilot test state-wide extension services. It may also be used to plan for and pilot test services

[3] Exhibit 1, America *Competes Act*, Pub. L. No. 110-69, Sec. 3003, 121 Stat. 587 (2007).

[4] CFDA is a database of Federal funding opportunities. Each program is assigned a number; 11.611 is the number assigned to MEP. The description of MEP can be found at: https://www.cfda.gov/index?s=program&mode=form&tab=step1&id=dbac0019832dbeba154f6cfeab641d4d (last accessed Jan. 27, 2010).

within a multi-state region which has sufficient regional linkages to justify such services. Extension service providers shall be affiliated with a U.S. based nonprofit institution or organization or group thereof. Funds may be used for demonstrations, technology development, active transfer and dissemination of research findings and extension service expertise to a wide range of companies and enterprises, especially small manufacturers with fewer than 500 employees."[5]

NIST MEP website[6] further clarifies the intent of the program:

> MEP's strength is in its partnerships. Rather than creating products, services, and programs from scratch, MEP works with partners to leverage resources and bring those resources to manufacturing clients. The MEP nationwide network, with its direct reach to the nation's manufacturers, has proven to be invaluable to numerous federal government partners who utilize the network to distribute valuable, cutting-edge information and resources in areas of workforce, technology adoption, environment and energy, quality, and more. In addition, using partnerships, MEP leverages the federal government's investment in other programs through awareness, education, collaboration and implementation.

It also emphasizes the importance of leveraging resources, stating that "[c]reatively using existing resources and partnering to extend them through the MEP network to the nation's manufacturers puts MEP in a unique position to help the nation's manufacturers access invaluable resources that might otherwise have gone unknown and unutilized."[7] Thus, the government itself has indicated that partnerships and the ability to leverage all available resources are essential to the continued success of the program in assisting small- and medium-sized manufacturers.

A National Strategy for Manufacturing Excellence, a report presented to and endorsed by the NIST's Visiting Committee on Advanced Technology, states:

> The Partnership is not hierarchically-organized, and it is not exclusive. Its strength is based on linking a widely-diverse and evolving collection of entities, some of which are funded and directly assisted by NIST and others which originate locally or with other Federal or state agencies. It is built on state and local understanding of the needs of the manufacturers, and on the creative energy of the individual organizations that make up the network.
>
> The **MEP Guiding Values** include "Leveraging all available resources. We believe that investments in infrastructure, new product development, and market research should be continuously leveraged across the system in order to enhance the services to all manufacturers, and on the creative energy of the individual organizations that make up the network."

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[5] *Id.*
[6] http://www.mep.nist.gov./partners/index.htm (last accessed Jan. 27, 2010).
[7] *Id.*

C. 2009 MEP General Terms and Conditions Revision

NIST recently issued revisions to its Operating Plan Guidelines and MEP General Terms and Conditions[8], which implement the legislative clarification that was enacted to clarify the partnering entities' value to the MEP Centers. The 2009 General Terms and Conditions state in relevant part:

> 8. INTERACTIONS WITH NIST AND OTHER MANUFACTURING EXTENSION PARTNERSHIP ORGANIZATIONS
>
> 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 of the Federal investment made on behalf of small- and medium-sized companies [Public Law 110-69, America COMPETES Act, Sec. 3003(a)].[9]

CMTC's Director, with full knowledge and acceptance of NIST officials, recognized the value of California community colleges' participation in the MEP program and found their activities as programmatically reasonable and allocable to the MEP program. Thus, their expenditures are included as a portion of CMTC's matching costs. The auditors did not comprehend fully how the statutory authorization and implementation supports the expenditure of funds by partners. This lack of understanding led to the questioning of the contributions of CMTC's partners. The statute supports technology transfer from NIST, through its Centers and their partnering organizations, to small- and medium-size manufacturers. We request that NIST, in its final audit resolution process, apply the MEP statute as enacted by Congress.

The MEP Program imposes a two-thirds (2/3) cost share burden, meaning that for every dollar of federal funds used, the grantee must document two dollars in eligible matching costs and/or program income[10] to be applied as non-federal cost share. To meet this requirement, Centers rely heavily on working with like-minded organizations whose expenditures may be claimed as non-federal cost share. Given the small percentage of federal dollars provided under the program, CMTC partnering organizations must have their own sources of funding for their activities. While entering into subrecipient agreements and giving subawards to partners would transfer responsibility for compliance with Federal requirements to the partners, CMTC cannot do so because it has no Federal funds to award to its partners. Therefore, CMTC bears the primary responsibility for assuring that the partners' expenditures comply with the terms of its award. The Draft Audit Report incorrectly concludes that the CMTC did not have adequate

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[8] *See* Exhibit 3C.

[9] *Id.*

[10] Program income is gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award. Program income includes, but is not limited to, income from fees for services performed, the use or rental of real or personal property acquired under federally-funded projects, the sale of commodities or items fabricated under an award, license fees and royalties on patents and copyrights, and interest on loans made with award funds. Interest earned on advanced of Federal funds is not program income. 15 C.F.R. § 14.2.

financial documentation. During the audit, CMTC and its partners produced hundreds of records, almost none of which are cited or referenced in the Draft Audit Report.

Consistent with statutory mandates, partnerships add direct value to CMTC by reducing the duplication of activities and by leveraging the partner's activities to increase MEP mission effectiveness, penetration, and output. Partners use their own reputation and marketing and referral activities to expand MEP efforts, resulting in increased numbers of small- and medium-size manufacturers receiving needed assistance and increased efficiencies in project execution. Partners also integrate MEP services into their own service offerings to increase CMTC's value and prevalence within the community. Whether the manufacturers first contact the Center or one of its partners should not affect the allocability of the costs contributed to the MEP program. Furthermore, the statute clearly rests the determinations of reasonableness and allocability of matching costs upon the Centers. The Centers' determination of the allocability and reasonableness of matching costs should not be overturned, unless careful analysis determines they are not related to the program or without basis in fact (unsupportable).

The goal of NIST MEP, as embodied in its programmatic objectives, is not to bring outside resources into the Center (the typical federal paradigm of cost-share), but instead the goal is to engage additional intermediary organizations to push the technology, programs, and expertise as far out into the community as possible. *See* 15 C.F.R. § 290.3(e). The direct benefit CMTC receives from its partnerships is the ability of another entity to provide the services and perform the education and outreach functions that enhance and further CMTC's mission, allowing CMTC to focus on offering additional services, education, and outreach to small- and medium-size manufacturers. Further, partnerships allow Centers maximize their geographic reach, thereby increasing the number of manufacturers they can serve. CMTC works with its partners to best allocate resources and facilities to serve manufacturers while reducing any duplication of effort.

II. NIST 2005 OPERATING PLAN GUIDELINES AND MEP GENERAL TERMS AND CONDITIONS

The Draft Audit Report relies upon revised Operating Plan Guidelines[11] ("Guidelines") issued one month before renewal applications for continued participation in the MEP program were due to NIST and the MEP General Terms and Conditions ("GTCs") that were not authorized, properly issued, or incorporated into the cooperative agreements issued during the audited period. The Guidelines and GTCs imposed new definitions for partnerships and subawards, and required personnel recordkeeping requirements on partners that exceeded the requirements in 15 C.F.R. Part 14 and the federal cost principles, and restricted partner cost share. These new GTCs were incorporated unilaterally into the awards in March 2006, almost nine months into the award period, yet the auditor expected to see records complying with those unauthorized heightened standards for the entire audit period.

Those revised 2005 Guidelines and GTCs strained relationships with partnering organizations, precipitating a legislative clarification (having retroactive effect) of the MEP authorizing statute to clearly and unambiguously state that *all* non-federal costs contributed by

[11] *See* Exhibit 4A.

partnering organizations are to be counted as a portion of the Center's required cost contribution. Second, the statute defines "costs incurred" as "costs incurred in connection with the activities undertaken to improve the management, productivity, and technological performance of small- and medium-size manufacturing companies."[12] Third, the discretion for determining which costs are programmatically allocable and reasonable is given to the Center.[13]

The legislative history is clear that all contributions by industry, universities, and state governments, which frequently act as partners, "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."[14] Senator Snowe stated on the floor that "[b]y teaming with [partners], . . . the centers can and do leverage their Federal resources and avoid duplicating services."[15] Without these partnerships, the Centers could not meet their extraordinary cost share requirements.

The auditor claimed that the reported matching costs of CMTC's partners did not meet the requirements of the GTCs. Section 14(A) of the GTCs ("GTC #14") imposes very detailed document requirements for all in-kind contributions.[16] The new term provided in relevant part:

> **Documenting Third Party In-Kind Contributions Under 15 CFR Part 290.4(c)(4) and (5):**
>
> Per 15 CFR 14.2(nn), Third party in-kind contributions means the value of non-cash contributions provided by non-Federal third parties. Third party in-kind contributions may be in the form of real property, equipment, supplies and other expendable property, and the value of goods and services directly benefiting and specifically identifiable to the project or program. Centers must have documented evidence of the third party in-kind contribution from the contributor. This evidence must include documentation from the contributor that contains:
>
> - A list of the type of third party in-kind contribution.
> - Value of each third party in-kind contribution (see 15 CFR Part 14.23 or 15 CFR Part 24.24 and the applicable cost principles, OMB Circular A-21, A-87 or A-122).
> - If personnel time is being contributed:
> - List of personnel
> - Projects/tasks worked
> - Dates worked
> - Number of hours
> - Hourly salary rate and allowable fringe benefits paid
> - Certified time and attendance records
> - Any necessary scopes of work and contracts that include price or cost information.

[12] Exhibit 1, *America Competes Act*, Pub. L. No. 110-69, § 3003(a)(3)(C), 121 Stat. 587 (2007).
[13] *Id.*
[14] H. Rept. 110-289 at 16 (emphasis added).
[15] *See* 153 Cong. Rec. S5074 (Apr. 25, 2007).
[16] *See* Exhibit 3A at 5-6, 2005 MEP General Terms and Conditions.

- Percentage of time that the contribution was used to support the MEP Project. If the percentage of time is 100%, 40 hours per week dedicated to the MEP project, it is considered to be a full time personnel under 15 CFR Part 290.4(c)(4). Therefore, the 50% in-kind limitation under 15 CFR Part 290.5(c)(5) does not apply.

Third Party In-Kind Contributions must be evidenced by written documentation that is signed by the contributor and Center that describes the contribution, its value, when and for what purpose it was donated. The Center must provide an acknowledgement of the contribution and include all the information required by IRS Instructions for Form 8283.[17]

Imposing the standards listed above is inappropriate for two reasons. First, GTC #14 was not incorporated in to the award until July 11, 2006.[18] Second, the GTCs were outside the scope of NIST's authority because they impose more stringent requirements than the government-wide grant administrative common rules without prior OMB approval, in violation of 15 C.F.R. § 14.4, and are more restrictive than the federal cost principles. In November 2009, NIST removed these onerous time-keeping provisions.[19] Given that NIST lacked authority to issue a term inconsistent with government-wide requirements, it should not be enforced against CMTC.

The GTCs should not be enforced legally or contractually against CMTC. The audited period of July 1, 2005 through March 31, 2007, covers three separate performance periods: 1) July 1, 2005 through December 15, 2005, 2) December 15, 2005-June 30, 2006, and July 1, 2006 through June 30, 2007. NIST imposed the GTCs unilaterally and retroactively through the entire audited period even though the term was issued in the middle of the second performance period. New contract terms cannot be unilaterally imposed by the government and applied retroactively.[20] Therefore, the term cannot be applied to CMTC by the auditor for the period when there was no regulatory or contractual obligation to comply with the additional requirements.

GTC #14 dictates how Centers must document in-kind contributions for purposes of their matching requirement and requires more information than specified in 15 C.F.R. § 14.23(h)(5). The new term required that claimed personnel time include a list of personnel, specific projects and tasks, dates on which the individual worked, the number of hours contributed, hourly and salary rate, allowable fringe benefits paid, and certified time and attendance records. This term essentially attempted to compel third parties who received no federal funds to significantly alter their existing accounting systems in order to comply with unauthorized requirements. The Cost Principles provide for a number of different methods to account for time and effort according to

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[17] *Id.*

[18] *See* Exhibit 2C, Cooperative Agreement Award No. 70NANB5H1181, Amendment # 3.

[19] *See* Exhibit 3C, 2009 MEP General Terms and Conditions.

[20] *See* Pennhurst State School & Hospital v. Halderman, 451 U.S. 1 (1981) (refused to recognize conditions and obligations not expressly stated on the face of the relevant assistance statutes, regulations and forms of agreement.) Bennett v. New Jersey, 470 U.S. 632 (1985) (holding that changes in substantive requirements for federal grants generally should not be applied retroactively).

the type of organization.[21]

The documentation requirements in the revised 2005 MEP General Terms and Conditions deviate from the requirements of 15 CFR § 14.23 and the federal cost principles without OMB approval and are stricter than the applicable regulations. Pursuant to 15 CFR § 14.4, when the agency requires more restrictive requirements than the common rules, it must first obtain OMB approval. No such OMB approval was granted. In fact, in the November 2009 MEP General Terms and Conditions these very requirements were removed. These latest changes followed lengthy discussions with Centers, including CMTC, during which the Centers explained that it was impracticable for Centers to compel third parties to comply with the GTCs as written. Thus, the GTCs were stymieing the Centers' ability to work with partners as policy dictated and mission requirements necessitated.[22]

Finally, the third-party contributor agreements and the Subrecipient Agreement were included in CMTC's Operating Plan. NIST imposes its own review and approval procedures in the Operating Plan Guidelines.[23] Generally, third party contributors are not required to have agreements with recipients nor are their contributions required to be approved in advance by the agency. The A-110 provisions relating to prior approval specifically enumerate the instances in which prior approval is required.[24] They include: (1) change in the scope or the objective, (2) change in a key personnel, (3) prolonged absence or 25 percent reduction in time by the approved project director or principal investigator, (4) need for additional Federal funding, (5) transfer of amounts budgeted between direct and indirect costs and vice versa, (6) inclusion of costs that require prior approval in accordance with the applicable cost principles, and (7) transfer of funds allotted for training allowances (direct payment to trainees) to other categories of expense.[25] Additionally, the regulation states, "For nonconstruction awards, no other prior approval requirements for specific items may be imposed unless a deviation has been approved by OMB."[26] Subrecipient agreements, third-party in-kind contributor agreements, and vendor contracts are not included in the list and to our knowledge, no deviation has been granted by OMB.

Nevertheless, the NIST-approved CMTC Operating Plan for the audited period clearly outlines the collaborative activities of CMTC and its partners and describes the costs that its partners were to incur (and did incur) in furtherance of the Center's mission. This Operating Plan, including the description of the partnerships, was reviewed and approved by the NIST Grants Officer, the Program Officer, and legal counsel prior to issuance of 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 C.F.R. Part 230, defines "prior approval" as:

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[21] *See* 2 C.F.R. Part 230 App. B ¶ 8(m) (outlining allowable methods for non profit organizations to account for personal services), 2 C.F.R. Part 220 App. A ¶ J.10. (discussing compensation for personal services for institutions of higher education).

[22] *See* Exhibit 3C, MEP General Terms and Conditions, November 2009 #18 (outlining the documentation requirements for third party in-kind contribution in the most recent set of general terms and conditions).

[23] *See* Exhibit 4A, MEP Operating Plan Guidelines (2005).

[24] 15 C.F.R. § 14.25(c)(1)-(7).

[25] *Id.*

[26] *Id.* at § 14.25(d).

> [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.

2 C.F.R. § 230.25. If the reported expenditures fall within the "approved costs" they should be accepted.

III. QUESTIONED SUBRECIPIENT COSTS

Cerritos College Technology Division ("Cerritos"), through its agreement with CMTC, furthers the MEP mission by providing specialized, in-depth training to meet the needs of manufacturers in California. Cerritos has more than fifty full-time and part-time faculty members in its Technology Division, which allows the school to offer a wide array of manufacturing courses, many of which are not available at other schools in the area. Cerritos' unique programs include training in composites and plastics, computer integrated manufacturing, tooling and product development, welding, heat treating of metals, testing applications and procedures, and woodworking. Working with Cerritos, CMTC utilizes the existing resources of Cerritos rather than duplicating efforts by creating its own training programs and student base.

The Draft Audit Report questions the entire amount of the $4,800,000 in claimed project costs for Cerritos. The Draft Audit Report recommends the disallowance of the entire amount of cost share claimed on the grounds that Cerritos and CMTC "fail to disclose current financial results accurately because they are based on estimates rather than actual costs, and there is no process in place for reviewing specific costs incurred under the subaward to determine whether they are reasonable, allocable and allowable."[27] The Draft Audit Report asserts that these costs are unallowable because they were not kept in accordance with the financial management standards of 15 C.F.R. § 14.21, made applicable to Cerritos through the flow-down provision of 15 C.F.R. § 14.5.[28] The Draft Audit Report further asserts that CMTC failed to include certain prescribed provisions in its agreement with Cerritos.[29]

A. Required Provisions for Subrecipient Agreements

According to the Draft Audit Report, CMTC failed to include a number of required provisions found in the MEP Operating Plan Guidelines, dated March 2005, that applied to subrecipients.[30] First, the Draft Audit Report notes that CMTC failed to include in its agreement with Cerritos the CFDA category, the prime award number and performance period as required by the guidelines. The Draft Audit Report also asserts that CMTC failed to include "applicable flow-down provisions and clauses from the prime award."

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[27] Draft Audit Report at 3.
[28] Draft Audit Report at 2.
[29] Draft Audit Report at 3.
[30] *See* Exhibit 4A at 14, MEP Operating Plan Guidelines (2005).

As discussed in Section II, *supra*, NIST released new Operating Plan Guidelines that redefined partnership agreements in March 2005. The MEP Center renewal applications were due in April 2005, giving CMTC exactly one month to absorb and implement the new guidelines, which substantially differed from previous program guidance. Specifically, the new guidelines eliminated CMTC's ability to create "partnership" agreements by memorandum of understanding, as done in past years, instead limiting Centers to a choice between third-party in-kind contributors ("TPCs") and subrecipients ("SRAs"). Due to the unique and extremely close relationship between Cerritos and CMTC, and the fact that CMTC provided some financial support to Cerritos, CMTC felt that it should choose "subrecipient." Since the audited period, Cerritos and CMTC have clarified their relationship, and as a result, Cerritos is now designated as a third-party in-kind contributor.

While certain flow-down provisions, the CFDA category, and prime award number are missing from the subrecipient agreement, these omissions did not have an impact on the validity of Cerritos' expenditures claimed as match. Regardless of the label or the missing terms of the agreement, CMTC and Cerritos maintained sufficient documentation to support the claimed costs. Based on the parties' agreement, CMTC bore the burden of assuring that only costs allowable under the terms of its award were reported by Cerritos and ultimately claimed by CMTC and reported to NIST as non-federal cost share.

B. Cerritos' Costs Claimed by CMTC Meet Financial Management Standards

The Cerritos agreements in effect for the award period clearly outline the collaborative activities of CMTC and Cerritos, describing the specific costs that Cerritos will incur in furtherance of the MEP mission.[31] As discussed in Section II, *supra*, the agreement was subject to prior approval. As such, the agreement was reviewed and approved by authorized NIST officials including the NIST Grants Officer, the NIST Program Officer, and legal counsel.[32] The Draft Audit Report does not, however, recognize or address this prior approval, despite the fact that it was brought to the auditors' attention during the on-site review.

The Cerritos proposed budget was developed using the budget categories similar to those contained in the Operating Plan Guidelines.[33] However, the auditor criticized Cerritos' budget because it was based on "broad category reductions from total division costs, rather than accumulations of actual costs according to budgeted line items." This criticism appears to relate to the subtraction of the salary costs for cosmetology faculty from the overall costs of the Technology Division salaries. The courses Cerritos offers to manufacturers as part of the MEP program are within the Technology Division, as is the cosmetology program. As cosmetology is unrelated to manufacturing and the MEP program, the salaries for cosmetology program faculty and $[redacted] of identifiable direct costs associated with the cosmetology program were removed from Cerritos' expenditures. Because Cerritos was using a state-mandated proprietary software system that made it nearly impossible to manually remove the cosmetology salary costs, Cerritos

[31] *See* Exhibit 5 at 51-54, CMTC Operating 2006 Operating Plan and Exhibit 6 at 61-67, CMTC Operating 2007 Operating Plan.
[32] *See* Exhibit 2A, Amendment #1 to Award.
[33] See Exhibit 4A at 17, MEP Operating Plan Guidelines (Mar. 2005).

conducted a study to determine the proper allocation of salary costs and reduced the division costs accordingly. This method for allocating salary costs is permissible pursuant to 2 C.F.R. 220 App.A Section J.10.b.(2)(c).

However, based on the fact that Cerritos made a "broad category reduction" from the salary component of its budget, the auditors seem to assume that the same practice was used to determine other costs. The Draft Audit Report questioned Cerritos' expenditures on the ground that its "practice of claiming subaward costs based on estimates, rather than actual costs incurred under the subaward, violated administrative principles." While the budget, out of necessity, was developed based on estimates, past experience, and projections for the coming year, Cerritos' expenditures reported to CMTC are based on actual costs and supported by underlying documentation. Cerritos submitted quarterly expenditure reports from its accounting system using cost categories which varied somewhat from the cost categories in the budget submitted with the renewal application.[34] Nevertheless, the costs claimed as match by CMTC were based on the financial reports generated by Cerritos, which were actual expenditures, not budget "estimates."[35]

Based on the erroneous assertion that the claimed costs were merely "estimates" the auditor also asserts violations of several administrative principles contained at 15 C.F.R. §14.21." Draft Audit Report at 2. The Draft Audit Report alleges that Cerritos did not maintain:

- Accurate, current, and complete disclosure of the financial results of each federally-sponsored project or program (Section 14.21(b)(1));
- Comparison of outlays with budget amounts for each award (Section 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 (Section 14.21(b)(6)).

Each of these items is addressed below.

1. Accurate Disclosure of Actual Costs Incurred

As noted above, authorized NIST officials reviewed and approved the agreement and the proposed budget submitted by CMTC and Cerritos. The agreement included a detailed Scope of Work (Schedule A), a detailed description of Financial and Programmatic Monitoring (Schedule B), Subrecipient Standard Terms and Conditions (Schedule C), and Federal Funding Compliance Assurance and Certification (Schedule D). [36] Schedule B requires Cerritos College to submit the following documentation to CMTC each quarter:

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[34] *Compare* Exhibit 7. Cerritos Budget *with* Exhibit 8B at 2. Cerritos Quarterly Expenditure Report and Supporting Documentation.
[35] See Exhibit 8A-8G. Cerritos Quarterly Expenditure Report and Supporting Documentation.
[36] *See* Exhibit 9. Cerritos Subrecipient Agreements.

(1) Financial documentation including validation of payroll costs associated with the activities and other services not otherwise recorded;

(2) Portions of the general ledger as related to the activities described herein; and/or

(3) Invoices, purchase orders, or related documentation verifying incurred costs.

Cerritos submitted documentation of actual expenditures incurred by Cerritos in furtherance of the MEP mission. Using the supporting documentation submitted by Cerritos, including but not limited to, general ledgers, vendor invoices, and purchase orders, CMTC followed detailed procedures to ensure that the costs were reasonable, allocable, and allowable. CMTC also conducted periodic site visits to ensure that records were being kept by Cerritos in accordance with the agreement.

Cerritos used state funds and fees paid for courses to support its costs. To verify the costs incurred by Cerritos in carrying out the subrecipient agreement, CMTC compared Cerritos' quarterly reports to Cerritos' general ledger. Cerritos' system assigned a number code to each MEP program component: 02600 for state-paid training, 77000 for Manufacturer-paid training, 077320 for Center for Applied Competitive Technologies (CACT)-paid training and 77700 for its largest manufacturing client. In this manner, Cerritos (and CMTC) can easily see the funding source and recipients of the trainings. The costs under each code are then broken out according to budget line items, such as personnel (the instructor), supplies, etc. The total costs are then compared to detailed sections of the general ledger reflecting only one program component (e.g., state-paid training, coded as 02600).

The quarterly expenditure report from October 2005-December 2005 demonstrates this process.[37] The quarterly report breaks down the expenditures for manufacturer-paid training by budget line items. To verify Cerritos' costs, CMTC took the costs incurred for the budget line item (e.g., Instructional Salaries, Non-instructional Salaries, Supplies and Materials, Other Operating Expenses and Services) and compared them to the costs in the detailed section of the general ledger corresponding to that program component (*e.g.*, state-paid training, manufacturer-paid training, CACT-paid training, largest manufacturing client). For instance, Cerritos expended $[redacted] for supplies and materials for manufacturer-paid training (coded as 77000) during this quarter. CMTC compared the entries for expenditures for supplies and materials in the detailed general ledger section against a random sampling of the invoices and purchase orders from that quarter.[38] CMTC also questioned Cerritos about the invoices, purchase orders, and other randomly sampled documentation. This process was repeated for each budget line item, resulting in a thorough, accurate review of actual expenditures of Cerritos in fulfilling its obligations under the subrecipient agreement.

This procedure, to which the parties agreed in writing and the results of which were made available to the auditor, reasonably demonstrates that the non-federal dollars expended by Cerritos were actually incurred and expended to further the MEP statutory mission. It is the parties to an agreement who are in the best position to know what they intended by the

[37] *See* Exhibit 8B, Cerritos Quarterly Expenditure Report and Supporting Documentation.
[38] *See* Exhibit 8B at 39-52 and 70-90. Cerritos Quarterly Expenditure Report and Supporting Documentation.

agreement.[39] During site visits, CMTC verified that the claimed costs were actually incurred, that the activities benefited the CMTC Center consistent with its Agreement with NIST, and are in furtherance of the MEP mission.

2. Comparison of Actual Outlays with Budgeted Amounts

The Draft Audit Report states that CMTC and Cerritos failed to use the subrecipient's line item budget as a management tool because "subaward claims were based on broad category reductions from total division costs, rather than accumulations of actual costs according to budgeted line items."[40] The line item budget included in the Cerritos agreement acts as a guideline for the parties and NIST; it is merely a projection of expenditures to be incurred in the coming months. The proposed budget is used to identify cost categories, estimate the expenditures, and to ensure that there are no significant changes to the budget that might require agency approval or fall outside the scope of the approved agreement.[41]

CMTC acknowledges that the line item budget used in Cerritos' quarterly reports is not identical to the line item budget included in the subrecipient agreement. Cerritos' expenditure reports were produced using its own accounting system that used categories different from those used in the subrecipient budget and CMTC's budget. However, the costs claimed by CMTC were those contained in the quarterly reports that evidenced actual expenditures. Cerritos' financial management systems are not precluded from meeting the requirement of §14.21 simply because the budget line items contained in the agreement do not use exactly the same nomenclature as in the quarterly expenditure reports. To the contrary, Cerritos provided CMTC documentation of actual costs, which it provided to the auditor, and CMTC has a process in place for determining that those specific costs are reasonable, allocable, and allowable.

CMTC monitored Cerritos' actual expenditures, or "outlays," against the budget in the subrecipient agreement by reviewing the quarterly expenditure reports. Before entering into the subrecipient agreement, CMTC met with Cerritos to review Cerritos' annual operating budget and to identify specific cost categories allocable to the MEP activities under the agreement. Cerritos' budget contained the following categories: Salaries (instructional and noninstructional), Employee Benefits, Travel, Supplies and Materials, Marketing & Outreach, Subcontracts, Equipment (Purchase/Lease), and Facilities. Cerritos' budget was different from CMTC's budget is several insignificant ways.[42] First, Cerritos had a "Salaries" category rather than "Personnel." Second, Cerritos had "Marketing & Outreach" as its own category. Third, the Cerritos "Subcontracts" section was not broken down as was CMTC's "Contracts" section.

Cerritos submitted quarterly program expenditure reports that clearly stated the total expenditures by cost category: Instructional Salaries, Noninstructional Salaries, Employee Benefits, Supplies and Materials, Other Operating Expenses and Services, Capital Outlay, and

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[39] *See National Urban League, Inc.*, United States Department of Health and Human Services Departmental Appeals Board, No. 294 (April 30, 1982) (adopting grantee's interpretation as reasonable, and giving it more weight than the Agency's interpretation since the Grantee was a party to the agreement).
[40] Draft Audit Report at 3.
[41] *See* Exhibits 2A and 2I, Amendments to Award (providing approval for subrecipient agreement, which included proposed budgets).
[42] Compare Exhibit 7, Cerritos Budget with Exhibit 6 at 46, CMTC 2007 Operating Plan.

Other Outgo. CMTC then compared those expenditures against the budget incorporated into the subrecipient agreement. Despite the differences in budget line items, Cerritos' cost categories represent costs allocable to its MEP activities. Thus, the assertion that CMTC did not compare actual outlays to budgeted amounts is without merit.

3. Written Procedures for Determining Allowability

The Draft Audit Report asserts that Cerritos had "no process in place for reviewing expenditures under the subaward to determine whether they are reasonable, allocable, and allowable."[43] In fact, CMTC and Cerritos agreed that CMTC would retain primary responsibility for reviewing Cerritos' costs for allowability. This procedure complies with the authorizing statute, which prevails over the general administrative provisions in the event of a conflict.[44] As discussed in Section I., *supra*, the statute explicitly and unambiguously places the primary responsibility of determining reasonableness and allocability on the Centers themselves. Additionally, the NIST Grants Officer specifically approved the reasonableness and allocability of expenditures on the proposed activities.[45] The determinations made by CMTC and approved by NIST should not be overturned unless the costs are completely irrelevant to the program or have no basis in fact.

CMTC determined cost allowability using written procedures that apply federal cost principles.[46] CMTC included the written procedures for reviewing Cerritos' costs in the subrecipient agreement and maintained a policy and procedure addressing the review of contributions.[47] As discussed in Section III.B.1, *supra*, Schedule B of the Subrecipient Agreement required Cerritos to produce financial documentation quarterly and to certify that costs claimed were "derived from non-federal sources." CMTC's written policy regarding in-kind contributions required that the department heads verify that expenditures were directly related to CMTC's mission.[48] Based on the policies in place, CMTC reviewed Cerritos' program expenditure reports for cost allowability at least quarterly. Through the steps described above, CMTC worked closely with Cerritos to ensure that expenditures claimed by CMTC were reasonable, allocable, allowable, and derived from non-federal sources.

Furthermore, the costs claimed in Cerritos' budget were allowable under the cost principles. Cerritos follows generally accepted accounting principles ("GAAP"), undergoes an independent financial audit annually, and maintains close contact with CMTC. Consistent with this process, CMTC determined that the expenditures of Cerritos on behalf of small- and medium manufacturers were "programmatically reasonable and allocable" and were therefore "includable as a portion of the Center's contribution."[49] Therefore, there is no basis for the auditors' questioning the entire amount, or $4,800,000, of subrecipient cost contributions.

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[43] Draft Audit Report at 3.
[44] *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) (stating that regulations should not contradict the plain language of the underlying statute).
[45] *See* Exhibit 2A, Amendment #1 (2006) and Exhibit 2I, Amendment #9 (2007) (showing NIST approvals).
[46] *See* Exhibit 9 at 11 (Schedule B), Cerritos Subrecipient Agreements.
[47] *See* Exhibit 10, CMTC's Written Policy for In-Kind Contributions.
[48] *Id.*
[49] Exhibit 1, *America Competes Act*, P.L. 110-69, Sec. 3003, 121 Stat. 587 (2007).

IV. QUESTIONED THIRD PARTY IN-KIND CONTRIBUTOR COSTS

The auditors reviewed the costs of five third party in-kind contributors: [redacted] ("[redacted]"), [redacted], [redacted] ("[redacted]"), [redacted] ("[redacted]") and [redacted] ("[redacted]").[50] The total questioned costs for third party contributors was $6,584,182. The auditors made four separate contentions with respect to the third party in-kind contributions: 1) the costs for the in-kind contributions were not donations to CMTC and were merely the regular activities of the partners, 2) the partners did not meet the requisite documentation and reporting requirements under the General Terms and Conditions, April 2006, 3) a portion of the costs were attributable to a period prior to the award period, and 4) CMTC had a questionable accounting treatment of third party in-kind contributions. It is unreasonable given the activities that were carried out that the auditor questions one hundred percent of the matching contributions of the partners.

Despite the auditor's assertions, the costs from the third party in-kind contributions are allowable. The allowability of costs should be determined in accordance with criteria under 15 C.F.R. §14.23. Third parties that do not receive federal funds are not subject to the administrative regulations or the cost principles. CMTC is responsible for compliance with these provisions. First, each CMTC partner provided goods or services that benefited small- and medium-size manufacturers in a manner that furthered the MEP mission. Second, CMTC provided all necessary documentation to comply with the applicable documentation and reporting requirements. Third, although costs incurred prior to the award period are disqualified, CMTC has additional in-kind match from partners for the same period that were not previously reported to NIST. Finally, CMTC followed GAAP in its treatment of in-kind contribution on its audited financial statements.

A. Overview of Third Party In-Kind Contributors

1. [redacted] ("[redacted]")

The partnership with [redacted] furthers the MEP mission by providing education and certification to students interested in manufacturing and marketing of CMTC services to small- and medium- size manufacturers.[51] [redacted], as part of the California Community College system, has been designated by the state of California as the regional center to assist manufacturers in southern California by providing consultation, education, customized training and technical assistance. [redacted] receives most of its funding from the State of California and receives no federal funding. CMTC continues to receive third party in-kind contributions from [redacted].

2. [redacted]

[50] *See Draft Audit Report* at 3-4. The auditors note that a nonstatistical sample of five contributors was selected and the total in-kind contribution for the audited period from third parties was $[redacted]. The auditors questioned the entire amount of costs supplied by the five selected contributors.

[51] *See* Exhibit 11, [redacted] Memoranda of Understanding FY06 at 1-2 and FY07 at 1-2.

As a CMTC partner, [redacted] provides marketing and outreach services to biotech and biomedical manufacturers in San Diego and Orange County, California. [redacted] is a trade association of 540 member companies devoted to the life science industry and is tax-exempt under § 501(c)(6) of the Internal Revenue Code. [52] [redacted]'s primary source of funding is membership dues and it does not receive federal funds. [redacted] continues to serve as a third party in-kind contributor to CMTC.

3. [redacted] ([redacted])

Through its partnership with CMTC, [redacted] provides a variety of services to medium and small manufacturers for free or at low cost.[53] [redacted] is a non-profit local economic development and business leadership organization that provides a variety of services to businesses in southern California with the goal of assisting those businesses to grow and retain jobs. In connection with its charitable purpose, [redacted] is tax-exempt under section 501(c)(3) of the Internal Revenue Code. [redacted] is still provides third party in-kind contributions to CMTC.

4. [redacted] ([redacted])

Through the work of [redacted]'s Economic and Business Development group, its partnership with CMTC furthered the MEP mission by providing services to small- and medium-size manufacturers to promote their energy efficiency, productivity and profitability.[54] [redacted] is an investor-owned utility company offering guidance, resources, and assistance to manufacturers and other businesses. [redacted]'s in-kind partnership with CMTC ended June 30, 2007.

5. [redacted] ([redacted])

The [redacted] partnership with CMTC benefited small- and medium- size manufacturers by providing consulting and training services to promote world trade. [redacted] is a tax-exempt § 501(c)(6) member organization comprised of small- and medium-size manufacturers, businesses and other organizations committed to world trade.[55] During the audited period, [redacted] received no federal funding. [redacted]'s in-kind partnership with CMTC ended June 30, 2009.

B. CMTC's Third Party In-Kind Contributions are Allowable Costs

The auditor concluded that the cost contributions were not donations to CMTC but merely were the regular activities of the third parties. Audit Report at 4. The auditor ignored the

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[52] *See* Exhibit 12, [redacted] Memoranda of Understanding FY05 at 1-2, FY06 at 1-2 and FY07 at 1-2.

[53] *See* Exhibit 13, [redacted] Memoranda of Understanding FY05 at1-2 and FY07 at 1-2 (note these agreements cover the entire audited period).

[54] *See* Exhibit 14, [redacted] Memoranda of Understanding FY05 at 1-2 and FY07 at 1-2 (note these agreements cover the entire audited period).

[55] *See* Exhibit 15, [redacted] Memoranda of Understanding.

statutory underpinnings of the MEP program, specifically clarified by Congress in 2007 that outline how partnering relationships should work. MEP Centers are required by statute to form a network of partnering organizations to assist them in reaching small- and medium-size manufacturers, thereby furthering the impact of the Federal investment.[56] CMTC fulfills this statutory requirement in part by partnering with other intermediary organizations whose mission is aligned with MEP and whose expenditures are eligible as third party in-kind contributions.[57] The program statute authorizes CMTC to use the expenditures of like-minded local organizations to count toward the two-thirds non-federal cost share. Partnering organizations of an MEP Center may be entities in private industry, universities, and State governments.[58] The Centers' partners have the same overall mission objectives and share common values, approaches, and targeted market segments with the Center. Without "regular" activities that benefit manufacturers, a partner's expenditures would not be allocable to the program.

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 to reach additional manufacturers, provide additional services, and transfer technology to small- and medium- size manufacturers to fulfill the core mission of the MEP Centers stated in 15 U.S.C. § 278k. The partners' work is enhanced through its relationship with CMTC and vice versa. Together CMTC 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. Rather than expend resources on finding and recruiting manufacturers to participate in the program, CMTC joins with partners who have established networks of manufacturers ready to benefit from MEP. In this manner, 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 services the Center could not otherwise offer.[59]

The Draft Audit Report applies a narrow view of third party in-kind contributions. During the audit exit interview, the auditor repeatedly stated that he did not see a specific invoice to the MEP program for the services provided and therefore, there was no true donation of goods or services to CMTC. The "donations" of the intermediaries is <u>not</u> to the federal recipient organization, but to the manufacturers. The regulation defines a third party in-kind contribution as,

> The value of non-cash contributions provided by non-Federal third parties. Third party in-kind contributions may be in the form of real property, equipment, supplies and other expendable property,

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[56] *See supra* Section I.

[57] *America Competes Act*, P.L. 110-69. and Sec. 3003(a) (3)(C). *See also* Senator Snowe's statements at *supra* II.

[58] *Id.*

[59] 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. See also* 15 U.S.C. § 278k and 15 C.F.R. § 290.3 (regarding "leveraging" federal resources).

> and the value of goods and services ***directly benefiting and specifically identifiable to the project or program***.[60]

This standard in no way requires that goods and services go directly into the Center as the auditor suggests. Instead, the regulatory definition, similar to the statute, only requires that services directly benefit and be specifically identifiable to further the mission of the MEP program. Moreover, the contribution need not be distinct from the third party's own regular activities and operations. For example, if the third party contributor allowed a recipient to use facilities the third party was already required to pay for in its regular operating costs, the contribution of using the space would still meet the criteria of the regulatory definition of third party in-kind contribution.[61] The only relevant inquiry would be whether the recipient would have had to pay for the use of a space had the third party not provided its space. Each third party in-kind contributor tailored their regular activities, to specifically serve small- and medium-size manufacturers in furtherance of the MEP mission and at no cost to CMTC. The activities that the partners engaged in for the benefit of the MEP program were identified in the CMTC Operating Plan and the Memoranda of Agreement, all of which were approved by NIST.[62]

C. Costs Prior to the Award Period

The auditor noted that portions of the contributions claimed for [redacted] and [redacted] were costs that were incurred prior to the start date of the award period.[63] The auditor's support for the questioned cost of $[redacted] is an in-kind expenditure report from [redacted] that covers the period January 1, 2005 to June 30, 2005, which is prior to the start of the award period on July 1, 2005. CMTC concedes that the period during which these costs were incurred is outside the audit period but that the costs were posted during the audit period. Therefore, CMTC concurs in the auditor's finding that these costs should not be charged to the award period in question.

Regarding the pre-award costs for [redacted], in the amount of $[redacted], CMTC concedes that the amount was counted twice for [redacted]'s cost share – once in the pre-award period and again in the annual report from [redacted]. CMTC further concedes that a portion of those costs were incurred prior to the award period. The quarterly report covered the months of May, June, and July, 2005. The award began July 1, 2005. Assuming an equal amount of costs was incurred in each month, $[redacted] should not be charged to NIST.

However, CMTC had sufficient additional matching costs from other partners that were not reported to NIST during the award period. These costs can now be used as substitute matching costs to resolve the deficiency that would otherwise exist as a result of the disqualification of the pre-award costs. CMTC has excess match available in the amount of $[redacted], which is more than sufficient to cover the $[redacted] from [redacted] and the

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[60] 15 C.F.R. §14.2(nn) (emphasis added).

[61] *Id.*

[62] *See* Exhibit 5 at 48-50, Appendices 6-B, 6-D, 6-I, 6-J, CMTC Operating 2006 Plan, *See* Exhibit 6 at 58-60, Appendices 6-B, 6-D, 6-E, 6-K, 6-L, CMTC Operating 2007 Plan, *see also supra* Section II. (outlining the significance of agency pre-approval of specific costs).

[63] Draft Audit Report at 3.

$[redacted] from [redacted]. A table of the excess match and the providing partners is included in this report at Section IV.E, *supra*.

D. CMTC'S Third Party In-Kind Contributors Maintained Adequate Records for Reporting Match

1. The Appropriate Standard is 14.23

CMTC uses the correct standard for reporting the matching costs of its third party contributors. [64] The appropriate standard to address the third party in-kind costs is 15 C.F.R. 14.23.[65] 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 in accordance with procedures described in 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." 15 C.F.R. § 14.23(h)(5). The basis for the "valuation for personal service, material, equipment, buildings and land shall be documented." *Id.* CMTC met these standards. The recipient is responsible for determining the allowability of the cost contributions as permitted under the terms of its award. CMTC 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.

CMTC identifies the partner operating costs that support activities benefiting manufacturers within the mission of MEP. CMTC partners use their existing accounting systems, but establish a methodology to identify only costs related directly to its activities on behalf of manufacturers; many of the services provided to its entire membership directly benefit its manufacturing members. CMTC established a reasonable basis for the valuation and met the documentation standard for in-kind contributions under 15 C.F.R. § 14.23(h)(5).

When the auditor visited each third party, he was more concerned with the relationship between the party and CMTC rather than reviewing the detailed financial documentation maintained by CMTC and the third party contributors. The auditor seemed to ignore the quarterly expenditure reports and did not inquire about any back-up documentation, or ask about the policies and procedures utilized to produce the quarterly financial report. Nor did he accept the process CMTC applied to determine the reasonableness, allowability, and allocability of each cost prior to including the in-kind contributions in CMTC's SF-269.[66] Each partner utilized its

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[64] *See supra* Section II. (discussing the improper application of GTC #14 by auditor).

[65] 15 C.F.R. 14.23 that 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; and (7) Conform to other provisions of this part, as applicable.

[66] *See* Exhibit 16, CMTC Form SF-269s from audited period.

own internal methodology to produce the quarterly financial reports documenting their expenditures in furtherance of the MEP program for the given period. The next sections provide a brief summary of those methodologies.

a. [redacted]

[redacted] is subject to an annual audit under OMB Circular A-133. It complies with the administrative requirements for Institutions of Higher Education, as well as the Cost Principles for Educational Institutions 2 C.F.R. Part 220. Although [redacted] receives federal funds, [redacted] is a separate program with a budget that is comprised solely of state funds and therefore is excluded from the A-133 audit. The [redacted] is located in a building off-campus, but in the general vicinity of the college. Through their partnership, both organizations provide workforce training to manufacturers in Northern Los Angeles County with minimal duplication of effort. [redacted] has four full-time and four part-time employees who provide program administration and outreach efforts to recruit companies for its training program. [redacted] hires independent contractors to conduct trainings either at [redacted]'s facilities or at the manufacturing company's site. CMTC provides no funding to [redacted] for these services.

[redacted] uses the Community College accounting software but the accounting function is maintained by the [redacted]. The accounting function includes the review and hiring of employees and vendors, approving payroll and vendor invoices, and generating invoices to the State. The Community College's fiscal services department issues payments to employees and contractors. [redacted] maintains copies of all of its financial records on site prior to submitting them to the Community College for processing and payment.

[redacted] does not have a time-keeping system that tracks specific daily hours for full time employees assigned to specific projects. Instead the [redacted] utilizes a "negative" payroll system. In a negative payroll system, hours are reported for time *not* worked. This system is an accounting method acceptable under California law and commonly used among community colleges in the state.[67] The employees of [redacted] receive a full salaried paycheck unless the employee takes time off without sufficient leave accruals. Hours *not* worked, rather than hours worked, are submitted by the employee to the Program Director. The Program Director then verifies that the time-off data is correct before reporting it to the [redacted] for processing. The Payroll department at the [redacted] processes the pay check. This is an exception-based payroll method.

[redacted] prepares the in-kind contribution report from its accounting records each quarter.[68] [redacted]s expenditures are related to the manufacturing employment training panel and therefore costs are 100% allowable under the grant. For the audit period in question,

[67] *See* Exhibit 17 at 3, *Compton Community College District Administrative Regulations* (describing the "negative time reporting" documentation method).
[68] *See* Exhibit 18, [redacted] Quarterly Expenditure Reports.

[redacted] submitted two expenditure reports to CMTC.[69] The reports include the period of performance, contact information, and expenditures by line item, including salaries and benefits, supplies, subcontracts, travel, printing, postage, speaker fees, conference meals, equipment/lease, and facilities. The expenditures come from records of expenses that are tabulated by administrative personnel and the report is signed by the director of [redacted]. The report also includes the period of performance, contact information, scope of work, and breaks down the line item of salaries and benefits by name or employee ID, employee title, salary, percent of effort dedicated to in-kind activities, and benefits rate.

b. [redacted]

As a tax-exempt organization, [redacted] is subject to an annual financial audit and subject to reporting annually on IRS Form 990. [redacted]'s accounting systems, under the oversight of the organization's Board of Directors, meet tax-exempt non-profit standards and State requirements. [redacted]'s mission is to respond to the State's focus on growing its biotech industry by providing support to manufacturers through professional and workforce training and group purchasing offers. During the audited period, [redacted]'s in-house accounting department maintained the organization's financial information under the direction of the Chief Financial Officer, [redacted].[70] The Controller is responsible for payroll, accounts payable, accounts receivable, and general accounting.

[redacted] does not have a time-keeping system that tracks and individual's daily hours by specific projects as it is not required under California law or necessary for the their program operations. [redacted] instead provides a list of employees and their salaries to CMTC when it submits the expenditure reports. [redacted]'s management systems are designed for its own needs and CMTC has not required [redacted] to alter these systems since [redacted] receives no funds from CMTC related to its contributions to the MEP program. Nevertheless, the documentation available is fully compliant with 15 C.F.R. § 14.23

[redacted]'s accounting staff produces a report from its internal accounting system to complete the Quarterly Report of Expenditures that it submits to CMTC.[71] The expenditure report includes the period of performance, contact information, and expenditures by line item, including salaries and benefits, supplies, sub-contracts, travel, marketing printing, postage, speaker fees, conference meals, equipment/lease, and facilities.[72] The report is then reviewed and signed by the CFO. This expenditure report also includes the period of performance, contact information, scope of work, and breaks down the line item of salaries and benefits by name or employee ID, employee title, salary, percent of effort dedicated to in-kind activities, and benefits rate.

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[69] Note: CMTC later determined that there appears to be duplicative information in the two annual expenditure reports submitted by [redacted]. *See supra* Section IV.C., Costs Prior to Award Period. As such, CMTC understands the need to adjust the relevant reporting periods and intends to do so as soon as possible.
[70] Note: [redacted] is no longer serves as [redacted]'s CFO.
[71] *See* Exhibit 18, [redacted] Expenditure Reports.
[72] *See* Exhibit 19, [redacted] Quarterly Expenditure Reports.

c. [redacted]

As a 501(c)(3) tax exempt organization, [redacted] complies with the accounting standards applicable to nonprofit organization and is subject to an annual audit. [redacted] operates an office in downtown Los Angeles and assists manufacturers in obtaining federal, state and regional tax credits as well as city permits. [redacted] also supports manufacturers by encouraging companies to remain in California and assisting with relocation and site selection.

[redacted] has an in-house accounting department that keeps track of the organization's financial information. The accounting standards meet State requirements and are subject to the oversight of the organization's board of directors. The Chief Financial Officer, [redacted], also serves as the corporate treasurer. The accounting department has various personnel responsible for payroll, accounts payable, accounts receivable, and general accounting.

[redacted] uses a manual time-keeping system that records hours worked for the day. [redacted] does not track specific work activities as there is no business need to do so for salaried personnel. The purpose of the time sheet is to identify hours worked for payroll purposes and to record time-off information for the employees of the organization. [redacted] uses the ADP Payroll System to process their payroll. Manual timesheets are completed by the employees every two weeks and submitted to their supervisor. The supervisor reviews the hours worked or time-off reported and manually signs the timesheets before submitting them to the payroll department for processing. This information is provided in the Report of Expenditures for In-kind Match to CMTC.[73]

The report includes the period of performance, contact information, and expenditures by line item, including salaries and benefits, supplies, sub-contracts, travel, printing, postage, speaker fees, conference meals, equipment/lease, and facilities. The expenditures are taken from their accounting system and the report is signed by the Vice-President of Business Assistance and Development, [redacted], confirming the costs are allocable to the MEP program and are actual expenditures. In lieu of requesting employees to allocate time specifically to manufacturing, [redacted], estimates the percent of effort spent on providing services to manufacturers based on her personal knowledge of her staff's activities.

d. [redacted]

[redacted] is a private, for-profit subsidiary of [redacted]. During the audited period, [redacted] and CMTC conducted a series of workshops directed at improving the energy efficiency of California manufacturers. The workshops were titled "Energy Savings Strategies," and were comprised of five modules including *Lean Manufacturing*, *Value Energy Stream Mapping* (VeSM™), *Benchmarking & Best Practices, Energy Efficiency Strategies for Competitive Advantage and Tying It All Together*. In addition, [redacted] and CMTC provided a unique energy savings program specifically tailored for manufacturers in southern California.

[73] *See* Exhibit 20. [redacted] Quarterly Expenditure Reports.

[redacted] completed a Report of Expenditures for In-kind Match only reporting personnel expenses. The personnel costs claimed only involved providing services to manufacturers. The report included the period of performance, contact information, and expenditures by line item, including salaries and benefits. The personnel expenditures were signed by [redacted], the Manager of Business and Economic Development at [redacted] with direct knowledge of the activities of the personnel. The report also includes the period of performance, contact information, employee ID, employee title, salary, percent of effort dedicated to in-kind activities, and benefits rate.[74] Personnel expenses were allocated by staff members that specifically provided services to manufacturers in a reported period.

e. [redacted]

[redacted] is a stand-alone non-profit economic development agency based in the City of San Diego. It is a 501(c)(6) tax-exempt organization and as such, it complies with regulations and accounting standards applicable to non-profits, including an annual audit. [redacted] operates an office in downtown San Diego and has employees that offer free Business Assistance services, such as international trade assistance, site selection, workforce resources, incentive packages, permits, licenses, zoning or local industry analyses for companies expanding or relocating in the City of San Diego.

The [redacted] has an in-house accounting department that keeps track of the organization's financial information and which is designed to meet State requirements and the Board of Directors oversight of the organization. During the audit period, the Chief Financial Officer, [redacted],[75] was in charge of payroll, accounts payable, accounts receivable and general accounting. [redacted] uses the Sage MIP Accounting system which is the same accounting system used by CMTC.

[redacted] has a unique time-keeping practice. They complete hourly timesheets four times a year and only for employees who are paid through certain County and State funding sources. The timesheets do not report hours charged to specific projects. Some salaried or exempt employees are not required to complete timesheets. [redacted] uses Paychex Payroll System to process their payroll. Paychex Payroll is a third party payroll service provider similar to Automatic Data Processing (ADP).

[redacted] completes a Report of Expenditures for In-kind Match each quarter.[76] The report includes the period of performance, contact information, and expenditures by line item, including salaries and benefits, supplies, sub-contracts, travel, printing, postage, other speaker fees, conference meals, equipment/lease, and facilities. The expenditures are generated by their accounting system and the report is signed by the Accounting/Operations Manager. The expenditure report also includes the period of performance, contact information, scope of work, and breaks down the line item of salaries and benefits by name or employee ID, employee title, salary, percent of effort dedicated to in-kind activities, and benefits rate. The CFO at the time manually estimated the effort and expenses spent on providing services to manufacturers.

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[74] *See* Exhibit 21, [redacted] Quarterly Expenditure Reports.
[75] Note: [redacted] no longer serves as the Chief Financial Officer for [redacted].
[76] *See* Exhibit 22, [redacted] Quarterly Expenditure Reports.

2. CMTC Review of Third Party In-Kind Contributors Expenditure Reports

After each third party in-kind contributor submits its Report of Expenditures, CMTC reviews the report against the budget and determines whether 1) the manufacturing companies served are identified and that the effort assigned to the work is reasonable and consistent with past practices; 2) the partner has included authorized signatures; 3) the report period does not overlap any reports the partner previously submitted and that the period is covered by the signed Memorandum of Understanding [77]; and 4) the expenditure report is filled out and includes the percentage of effort. CMTC also ensures that the total salaries and benefits reported agree with the Report of Expenditures. CMTC compares the total in-kind match reported against the in-kind budget amount approved by NIST to ensure that CMTC does not use more than the approved amount for cost sharing purposes. Once the report period and amount are verified against the approved budget, the CFO and Controller review and sign off on the report, approving the use of the submitted expenditures for cost sharing purposes against the NIST grant. CMTC's Financial Analyst recorded the expenditures in the General Ledger as in-kind match, and included the amount in the quarterly financial reports submitted to NIST on SF-269, line (e).

3. Improvements to Record-Keeping

Since the OIG audit, CMTC has made several improvements to the manner in which it evaluates cost share contributions from third party contributors. Representatives from CMTC now conduct an on-site review at least once a year to ensure that adequate controls are in place to verify that the reporting meets the allowability requirements. CMTC first determines whether the costs are documented and verified based on general ledgers, underlying documentation, invoices, and checks from the partner. CMTC then reviews copies of the detailed general ledger for all of the reported in-kind match expenditures. CMTC evaluates whether the costs are included as a cost sharing commitment related to any other Federal project or program. CMTC also checks the audit report and interviews financial personnel to ensure that the costs are not reported for another federal program.

The third party contributors also utilize better methods of allocating costs towards the MEP program. For example, CMTC conducts an annual analysis to determine the percent of manufacturers served by [redacted] to establish a baseline for allocability of in-kind expenditures to the partnership. This analysis determines the percentage of manufacturers (defined as companies engaged in research and development ("R & D") and/or manufacturing of medical related products) out of all the companies served by the organization. For example, if [redacted] has a total of [redacted] member companies, of which [redacted] are in R&D or manufacturing, then [redacted]% services the organization provided were dedicated to the MEP mission. In this case [redacted]% percent of [redacted]'s costs are determined to be related to manufacturing and are then submitted to CMTC as in-kind cost share. Based on review meetings with officials at [redacted], about [redacted]% of companies [redacted] served were in R&D or manufacturing of medical or life sciences related products. It is important to note that [redacted] only reports certain personnel and outreach expenses as in-kind cost share to CMTC. This accounts for approximately [redacted]% of its total

[77] *But see supra* Section IV.C. "Costs Prior to Award Period" (CMTC subsequently discovered some overlap between periods).

budget. [redacted] provides the analysis backup documentation to CMTC for review and inspection. The analysis results are printed on [redacted]'s company letterhead and are signed by an official at [redacted] who has detailed knowledge of the survey data within the organization.

E. CMTC Followed GAAP With Respect To In-Kind Contributions

The Draft Audit Report questions all the third party contributions because CMTC does not include in-kind contributions as revenue in its audited financial statements. The auditor concludes that CMTC violated the cost principles because it failed to adhere to GAAP, citing Statement of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made* ("FAS No. 116"). Despite the auditor's summation that the interpretation and compliance with FAS No. 116 is clear-cut, there is a great deal of ambiguity and debate over how to apply this Statement.[78] CMTC's audited financial statements are completed pursuant to the advice of its A-133 audit firm. It should be noted that one of CMTC's financial advisors, [redacted], is not only a partner in a major accounting firm, but also sits on the American Institute of Certified Public Accountants (AICPA) nonprofit committee. CMTC follows GAAP pursuant to the competent professional interpretation of its financial advisors. In any event, the treatment of in-kind contributions was acceptable under FAS No. 116 for three reasons: 1) the in-kind contributions are discussed in the notes of the audited financial statements, 2) under the interpretation of the scope of FAS No. 116, the in-kind contributions should not have been recognized as revenue in CMTC's audited financial statements, and 3) even if the in-kind contributions were within the scope of FAS No. 116, they would not be recognized pursuant to paragraph 9 of FAS No. 116.

The fact that the in-kind contributions were not recognized as revenue in the financial statements is inconsequential as to whether the costs were allowable third party in-kind contributions. Even the auditor notes that the in-kind contributions were included in the notes of the financial statements and not completely ignored.[79]

The auditor cites the general rule of FAS No. 116, to recognize the value of in-kind contributions as revenue, but fails to discuss the scope of the statement, which significantly limits the general rule.[80] One such exception to the rule is if the "reporting entity acts as an agent, trustee, or intermediary, rather than as a donor or donee."[81] Under the MEP program, the ultimate donees are the small- and medium-sized manufacturers benefiting from the services, and therefore, CMTC would not need to recognize the value of goods and services in CMTC's financial statements since the services were never provided to CMTC.

The rule concerning contributions of services is as follows:

> Contributions of services shall be recognized if the services received (a) create or enhance nonfinancial assets or (b) require

[78] *See* Exhibit 23. FAS No. 116 (indicating in the notes that many non-profits do not recognize in-kind contributions as revenue and the interpretations of this Statement are inconsistent).
[79] *See* Draft Audit at 5. *See also* Exhibit 24, CMTC Audited Financial Statements.
[80] *See* FAS No. 116 para. 1
[81] *See* FAS No. 116 at 5 para. 4.

> specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. Services requiring specialized skills are provided by accountants, architects, carpenters, doctors, electricians, lawyers, nurses, plumbers, teachers, and other professionals and craftsmen. Contributed services and promises to give services that do not meet the above criteria shall not be recognized. FAS No. 116 para. 9.

Even if an in-kind contribution is within the scope of FAS No. 116, it is still not clear whether the contribution should be recognized as revenue in the financial statement. There is particular ambiguity under paragraph 9 of the statement explaining exceptions in which in-kind contributions of services should not be recognized as revenue. Much of the in-kind contributions from CMTC partners came in the form of services.

The notes of the statement list five examples related to contributions of services, three of the five in which services should not be recognized as revenue.[82] Under this paragraph, because the in-kind contributions do not affect CMTC assets, those contributions would not meet the criteria of the first requirement under paragraph 9. Third party in-kind contributions to CMTC also fail to meet the second prong in that they are not services in which CMTC would pay for had they not been donated. CMTC did not have sufficient funds to support all the activities of its partners. Fortunately, CMTC has historically benefited from contributions of third parties to meet its statutory obligations at no cost.[83]

The auditor's interpretation of FAS No. 116 is inaccurate however, even if the auditor's interpretation were correct, the remedy would be to revise the financial statements to move the information to the revenue portion, not to *disallow* the costs in their entirety.

F. Additional Funds Available For Cost Share Contribution

CMTC's agreements with each of its partners actually resulted in more matching costs than CMTC needed under its cooperative agreement. Pursuant to NIST's direction and to avoid drawing down more funds than necessary, CMTC only reports the cost share necessary to meet its cost share requirement under the award. Moreover, the SF-269 will not allow recipients to report excess match without affecting the amount of funds to be drawn down in a given period. Nevertheless, CMTC maintains records of all cost share reported by each of its partners in their quarterly expenditure reports, even if ultimately that cost share is not reported to NIST. Therefore, in addition to reported matching costs, if there is a disallowance for one group of costs, the excess match can substitute for other disallowed costs.[84] The Excess Match for the Audit Period, including partners that were not examined as part of the audit, is listed below:

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[82] *See id* at para. 201-206 (Examples 11-15 illustrate examples of when contributed services should be recognized)
[83] *See id.* at para. (noting that the non-profit agency should not recognize as income the services of a telemarketing firm's services when it had previously utilized the services of volunteer students).
[84] *See* GAO Redbook Vol. II, Third Ed. p.10-113 (stating that "[a] grantee may generally substitute other allowable costs for costs which have been disallowed, subject to any applicable cost ceiling. If additional funds become available as the result of a cost disallowance, those funds should be used to pay any "excess" allowable costs which could not be paid previously because of the ceiling.").

Excess Match Available to be applied for 7/1/05 to 6/30/06

[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
TOTAL AVAILABLE FOR FY06	$[redacted]

V. QUESTIONED EXCESS PROGRAM INCOME

The Draft Audit Report takes issue with CMTC's NIST-approved carry-forward of $[redacted]. First, the Draft Audit Report states that CMTC did not need the carry forward to meet its non-federal expense requirements. Second, the Draft Audit Report suggests that the carry forward plus projected program income, which could only have been estimated at time of carry over of program income as it had not yet been earned, would result in a program income balance of approximately $12,000,000. We will address each of these issues in turn.

CMTC received NIST approval for a carry forward of $[redacted] in program income during the audited period. Despite the auditors' concerns about the program income balances, CMTC simply followed the guidance given to MEP Centers about maintaining a cash reserve.[85] Authorized NIST program staff correctly provided guidance to CMTC and other MEP Centers that under cost-reimbursement cooperative agreements the MEP Centers may retain unexpended program income ("UPI") and that it is a source of "reserves."[86] Centers were instructed to maintain a reserve to support the Center during periods of inadequate funding or to accommodate cash flow. Having a cash reserve allows MEP centers to weather fluctuations in the economy without any loss of services to the manufacturing community. Further, CMTC's financial position is unique in that it receives no support from the state of California. Thus, CMTC's cash reserve is vital to its continued existence and to meet the extraordinarily large two-thirds non-federal cost share requirement. CMTC complied with the MEP General Terms and Conditions by obtaining approval from NIST to carry over the UPI. Thus, any concern expressed in the Draft Audit Report with program income carry over lies with NIST policies and administration, not with CMTC's actions.

The Draft Audit Report asserts that with projected program income for the award period beginning July 1, 2006, CMTC's program income balance will top $12,000,000. However, the actual carry over amount to the 2007 award year was approximately 15% less than the requested carry over, totaling $[redacted].[87] During the 2007 award year, there was a slowdown in business resulting in loss of revenue to the MEP program. As a result, program income was expended to cover the deficit in the subsequent award period and the program income reserve

[85] *See* Exhibit 25, PowerPoint Presentation by Mike Simpson.
[86] *Id.*
[87] *See* Exhibit 16 at 7-12, SF 269 (June 30, 2006).

dropped to $[redacted].[88] The continued economic decline has resulted in slowed business, and the program income has dipped to $[redacted] as of June 30, 2009.[89]

The Draft Audit Report states that there was "significant inconsistency between program income reported to NIST and CMTC's audited financial statements." Draft Audit Report at 6. As noted above, the amount carried over from FY06 was $[redacted] less than the amount approved by NIST. The $[redacted] figure was merely an estimate for the purposes of filling in CMTC's NIST Operating Plan for the 2007 award year because final figures were not yet calculable. The MEP program expenses include capitalized expenses that are reported as program income as a whole to NIST, but amortized under GAAP principles. Thus, the net assets reported by CMTC on its financial statements would not match the amount of UPI reported on the SF-269. The Draft Audit Report fails to recognize this fundamental difference between program income reported on the SF-269 and GAAP information contained in CMTC's financial statements.

Finally, the Draft Audit Report also notes that CMTC's audited financial statements for FY06 do not show any "restricted" assets. On the advice of its [redacted] auditor, CMTC did not label any of its assets as restricted. However, further review and discussion has led CMTC to determine that the program income carried over should be noted on the Financial Statement as "restricted" funds and will direct the A-133 auditor to do so in the future.[90]

VII. CONCLUSION

CMTC is a strong MEP Center with successful in-kind and subrecipient relationships. With the assistance of its partnering organizations, CMTC provides services, including skilled instruction, consulting, and training to small- and medium-sized manufacturers in the state of California.

CMTC consistently followed the direction of NIST and the applicable statutes and regulations in carrying out its MEP program. The auditor's assertion that the subrecipient costs were based on estimates, rather than actual expenditures is incorrect. With the exception of cosmetology salaries and direct costs, which were removed from the costs claimed, all of Cerritos' expenditures were based on actual costs. By agreement between the parties, CMTC accepted responsibility for ensuring that Cerritos' expenditures were reasonable, allocable, and allowable to the MEP program. To verify Cerritos' expenditures, CMTC received quarterly expenditure reports from Cerritos that were then compared to the expenditures in Cerritos' general ledger and sampled purchase orders and invoices. Cerritos readily opened its books to CMTC and provided hundreds of pages of documents to the auditors in support of costs claimed, none of which were cited in the Draft Audit Report. Thus, the auditor's questioning of the entire amount of costs claimed by Cerritos because they were not documented is without merit.

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[88] *See* Exhibit 16 at 15-19, SF 269, (June 30, 2007).
[89] *See* Exhibit 26, SF 269 (June 30, 2009).
[90] *See* Exhibit 2C, Amendment # 3 to Award (2006)(approving requested carryover amount) and Exhibit 27, CMTC Excess Program Income Carryover Request Letter to MEP and Grants (2006).

The auditors' questioning of the validity of CMTC's relationships with five of its third-party in-kind contributors is likewise inaccurate. The auditor contended that the in-kind contributions were not donations but merely the regular activities of the partners, that they failed to meet the documentation and reporting requirements under the General Terms and Conditions, that portions of cost share were incurred prior to the award period, and that the costs were not documented in accordance with GAAP Principles. However, each of the auditors' contentions is incorrect. First, the auditor misunderstands the nature of the MEP program and fails to recognize that the contributions were made not to the CMTC, but to small- and medium-sized manufacturers. Second, the contributions met the requirements for cost share under 15 C.F.R. § 14.23. They should not be subject to retroactive, unilateral terms imposed in the middle of an award period and non-compliant with Part 14 and the cost principles. Third, while CMTC concedes that there were some pre-award costs, no funds are due back because CMTC has additional cost share from its partners that could be substituted for the pre-award costs. Finally, CMTC complied with GAAP as evidenced by its correct reporting of in-kind contributions in its audited financial statements.

Finally, the auditor's criticisms of CMTC's management of its program income are flawed. CMTC properly sought and received NIST approval to carry forward its excess program income. The "reserve" created by the program income carry over ensures CMTC's continued ability to provide vital MEP services in California in a difficult economic climate. The auditors noted an inconsistency in CMTC's program income reporting. The inconsistency resulted because CMTC's financial statement includes non-MEP expenses and non-cash expenses such as vacation accrual, which would not be reported on the SF-269. Finally, CMTC acknowledges that program income must be spent in furtherance of the MEP program. To support our arguments, we have enclosed with this Response necessary supporting documentation for our arguments.

TABLE OF EXHIBITS

1. *America Competes Act*, Pub. L. No. 110-69, Sec. 3003, 121 Stat. 587 (2007)
2. Cooperative Agreement Award No. 70NANB5H1181
    A. Amendment #1
    B. Amendment #2
    C. Amendment #3
    D. Amendment #4
    E. Amendment #5
    F. Amendment #6
    G. Amendment #7
    H. Amendment #8
    I. Amendment #9
3. MEP General Terms and Conditions
    A. June 2005
    B. April 2006
    C. November 2009
4. MEP Operating Plan Guidelines
    A. March 2005
    B. March 2006
    C. February 2007
5. CMTC 2006 Operating Plan
6. CMTC 2007 Operating Plan
7. Cerritos Budgets
8. Cerritos Quarterly Expenditure Reports
    A. 07/05-09/05
    B. 10/05-12/05
    C. 01/06-03/06
    D. 04/06-06/06
    E. 07/06-09/06
    F. 10/06-12/06
    G. 01/07-03/07
9. Cerritos Subrecipient Agreements
10. CMTC Written Policy for In-Kind Contributions
11. [redacted] Memoranda of Understanding
12. [redacted] Memoranda of Understanding
13. [redacted] Memoranda of Understanding
14. [redacted] Memoranda of Understanding
15. [redacted] Memoranda of Understanding
16. CMTC Form SF-269
17. Compton Community College District Administrative Regulations
18. [redacted] Expenditure Submissions
    A. Summary of In-Kind Contributions
    B. Quarterly Expenditure Reports
19. [redacted] Expenditure Submissions
    A. Summary of In-Kind Contributions

B. Quarterly Expenditure Reports

20. [redacted] Expenditure Submissions
    A. Summary of In-Kind Contributions
    B. Quarterly Expenditure Reports
21. [redacted] Expenditure Submissions
    A. Summary of In-Kind Contributions
    B. Quarterly Expenditure Reports
22. [redacted] Expenditure Submissions
    A. Summary of In-Kind Contributions
    B. Quarterly Expenditure Reports
23. Statement of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made* ("FAS No. 116")
24. CMTC Audited Financial Statement
    A. 2005 Audited Financial Statements
    B. 2005 Report on Federal Awards
    C. 2006 Audited Financial Statements
    D. 2006 Report on Federal Awards
    E. 2007 Audited Financial Statements
    F. 2007 Report on Federal Awards
25. PowerPoint Presentation by [redacted], Systems Operation Director
26. CMTC SF 269 (June 30, 2009)
27. CMTC Excess Program Income Carryover Request Letter to MEP and Grants (2006)