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Office of Inspector General*



*National Institute of Standards
and Technology*

*The University of Texas at
Arlington
MEP Award 70NANB5H1005*

*Final Report No. DEN-18573
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Denver Regional Office of Audits



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INTRODUCTION

In March 2005, the National Institute of Standards and Technology (NIST) awarded Manufacturing Extension Partnership (MEP) Cooperative Agreement No. 70NANB5H1005 to the University of Texas at Arlington (UTA) to continue operating the Texas Manufacturing Assistance Center. The mission of the MEP center is to increase the global competitiveness of Texas manufacturers by providing assistance in the appropriate use of technologies and techniques. The award funds seven centers throughout the state—one operated by the prime recipient, UTA, and six operated by other institutions under subawards from UTA: University of Houston, University of Texas – El Paso, Southwest Research Institute, Texas Engineering Extension Service, Texas Tech University, and University of Texas – Pan American. The March 2005 award approved funding for the period of December 1, 2004, through June 30, 2005, but was later amended to extend through August 31, 2007. Total estimated project costs for the 33-month award period were \$42,035,636, with the federal government's share not to exceed \$14,010,422, or 33.33 percent of allowable project costs.

In March 2007, we initiated an audit of the award to determine whether UTA had complied with award terms and conditions and NIST operating guidelines for MEP centers. The audit covered September 1, 2005, through March 31, 2007, during which time UTA claimed total project costs of \$21,126,265 and received federal reimbursements totaling \$6,595,798.

In addition to UTA's claims for incurred costs, we examined cost claims submitted to UTA from two subrecipients: Texas Engineering Extension Service and Southwest Research Institute.

FINDINGS AND RECOMMENDATIONS

Our audit questioned \$1,619,280 in costs, including \$1,533,055 in subrecipient contractual costs and \$86,225 in UTA costs.

Apart from the questioned costs, we identified issues regarding two subrecipients that we would like to bring to NIST's attention.

1. Subrecipient Texas Engineering Extension Service used funds budgeted for indirect costs to cover direct project costs without approval from NIST or UTA and incorrectly reported program income generated by its subrecipients.
2. Subrecipient Southwest Research Institute improperly reported indirect costs as in-kind contributions.

I. Subrecipient Questioned Costs

OIG questions \$1,533,055 of claimed contractual costs, including (1) \$1,271,827 from subrecipient Texas Engineering Extension Service (TEEX) and two of its subrecipients that we determined were not allowable MEP project costs; (2) \$ [REDACTED] from TEEX that were based on estimates and therefore did not have adequate supporting documentation; and (3) \$6,439 related to excessive indirect costs claimed.

A. \$1,271,827 in unallowable subrecipient costs

In 2006, TEEX made two subawards: one to Biotech Manufacturing Center, a nonprofit organization that provides a full-scale manufacturing environment for medical device developers, and another to Emergency Services Training Institute, a division of TEEX that trains firefighters and emergency responders. Both organizations recover a portion of the cost of providing services through customer fees.

Subaward agreements required these two organizations to (1) report to TEEX all costs and associated revenue for services provided to manufacturing customers located in the state of Texas, and (2) advise their Texas-based customers of additional services available from the MEP center, as needed.

TEEX reported the subrecipients' accumulated costs to UTA as MEP project costs. UTA in turn included these costs in its claims to NIST. As permitted by its agreement with UTA, TEEX was reimbursed for [REDACTED] percent of its subrecipients' costs.

—Biotech Manufacturing Center reported total costs of \$ [REDACTED] during the 13-month period that coincided with our audit period, and TEEX received

reimbursement from UTA for \$ [REDACTED].

—The Emergency Services Training Institute reported total costs of \$ [REDACTED] during the 7 months that coincided with our audit period, and TEEEX received reimbursement of \$ [REDACTED].

In both cases TEEEX retained [REDACTED] of the UTA reimbursement and forwarded the remaining [REDACTED] to the subrecipients—\$ [REDACTED] ([REDACTED] of \$ [REDACTED]) to Biotech; \$ [REDACTED] ([REDACTED] of \$ [REDACTED]) to the training institute.

We question whether the subrecipients' reported costs are allowable MEP costs because they were associated with services the two were already providing and would have continued to provide had there been no association with the MEP. With the exception of some marketing of potential MEP services, the local manufacturing community received no additional services by virtue of the connection with the MEP. In short, we found little to no value added by the subrecipients' association with the MEP. And while both subrecipients told us they had been actively marketing MEP services to their Texas-based manufacturing customers, they could recall referring only three customers for additional services.

Therefore, the \$1,271,827 in claimed costs is for services provided to manufacturers whose only connections to the mission of the MEP are (1) they happen to be located in the state of Texas, and (2) they may have been advised of additional services they could receive from the MEP. As a result of these claims, TEEEX received federal funds in the amount of \$190,774 and its subrecipients received federal funds of \$190,774. Though both subrecipient organizations charged their customers for services, neither used their reimbursements to reduce amounts charged. Thus, the Texas-based manufacturers received no cost-benefit from the subrecipients' association with the MEP program, and the \$190,774 in federal funds the subrecipients received appears to be a windfall. Furthermore, TEEEX incurred no costs associated with the claims submitted by its subrecipients, so its \$190,774 reimbursement also appears to be a windfall.

B. \$ [REDACTED] claimed based on estimated costs

TEEEX claimed \$ [REDACTED] under its MEP subaward by allocating costs from 12 different program accounts from June 1, 2006, through August 31, 2006, and claimed \$ [REDACTED] in MEP costs related to a "Basic Economic Development Course."

- \$ [REDACTED] from 12 program accounts. According to TEEEX officials, the organization conducted an internal "brainstorming session" in June 2006 to determine what percentage of time various TEEEX programs spent dealing with manufacturers in the state of Texas. They consulted with program managers to determine which services benefited manufacturers within the

state and allocated expenses incurred by those divisions based on estimates. The allocations were based on *types* of services performed, rather than on work performed for the benefit of specific MEP customers.

TEEX concluded that 12 program accounts were candidates for allocation, and claimed as MEP project costs the respective percentages of total costs in each account during the 3-month period in question. Seven of the 12 accounts were allocated at [REDACTED] percent to MEP cost claims, 4 accounts were allocated at [REDACTED] percent, and 1 account was allocated at [REDACTED] percent.

We asked for documentation supporting how these percentages were derived. Officials told us they had not retained any written records and that all TEEEX personnel involved in developing the percentages had left the organization.

We reviewed UTA's MEP operating plan for the period September 1, 2005, through August 31, 2006, to determine whether the university and NIST were aware that TEEEX would be allocating estimated costs incurred by programs outside its dedicated MEP program. We found no such indication but did find that TEEEX's operating plan budget for this award year showed 13 full-time staff performing MEP services. The operating plan for the subsequent award period provided for only 3 full-time staff. During this subsequent period TEEEX lost a significant number of staff dedicated to the MEP, and it appears that during the final 3 months of the subaward period (ending August 31, 2006), TEEEX allocated \$ [REDACTED] from other programs to its MEP subaward to, in part, make up for costs it was unable to claim as staff left the MEP program.

- \$ [REDACTED] related to Basic Economic Development Course. TEEEX officials described this course as training in how private and public industrial and economic development organizations operate. We asked the basis for claiming this training as an MEP expense, given that the content appears to be outside the MEP's scope of providing assistance to Texas manufacturers. TEEEX officials explained that the \$ [REDACTED] claimed equals [REDACTED] percent of costs incurred in providing the training. They arrived at this percentage by estimating that if individuals attending the class do become associated with an industrial or economic development organization, they will spend [REDACTED] percent of their time providing services to manufacturers in the state.

TEEX's estimated charges in both instances violate 15 CFR 14.21, which establishes minimum financial management standards for Department of Commerce financial assistance awards. This regulation, incorporated into TEEEX's subaward, requires the recipient of financial assistance to maintain a system that provides accurate, current, and complete disclosure of the financial results of each federally sponsored award. (See 15 CFR 14.21(b)(1)). Cost claims submitted to NIST

must reflect actual costs incurred in performing services under the MEP award, not—as in these instances—estimates based on assumed percentages of costs that may have some connection to Texas manufacturers, but were incurred outside the MEP program.

C. \$6,439 excessive indirect costs claimed

We questioned \$6,439 claimed by subrecipient University of Texas – El Paso, which UTA recorded as contractual costs, because this amount exceeded the approved budget's line item for indirect costs for the period September 1, 2005, through August 31, 2006. Department of Commerce Financial Assistance Standard Terms and Conditions, Section A(5)(f), states,

“Regardless of any approved indirect cost rate applicable to the award, the maximum dollar amount of allocable indirect costs for which (the Department) will reimburse the recipient shall be the lesser of (1) the line item amount for the Federal share of indirect costs contained in the approved budget of the award; or (2) the Federal share of the total allocable indirect costs of the award based on the indirect cost rate approved by a cognizant or oversight Federal agency and current at the time the cost was incurred, provided the rate is approved on or before the award end date.”

Section J.02 of the Department's Standard Terms and Conditions requires subrecipients to comply with all terms and conditions of the award.

D. Other subrecipient issues

We found that TEEEX used \$238,338 budgeted for indirect costs to cover direct costs claimed from September 1, 2005, through August 31, 2006, without prior approval from NIST or UTA. Department of Commerce Financial Assistance Standard Terms and Conditions, Section A(4)(c), states, “The recipient is not authorized at any time to transfer amounts budgeted for direct costs to the indirect costs line item or vice versa, without the prior approval of the Grants Officer.” We did not include these costs in the questioned amounts because to do so would duplicate a portion of the questioned \$1,271,827 related to TEEEX's two subrecipients. If NIST determines any portion of the costs claimed for the two subrecipients is allowable, it should carefully analyze the amounts it accepts to prevent a violation of Section A(4)(c).

We also found that TEEEX reported incorrect program income for its subrecipients, using an estimate that represented ■ percent of total costs incurred. A June 2007 monitoring report issued by UTA also mentioned this incorrect reporting. The subrecipients have since submitted actual program income to both UTA and TEEEX. UTA officials stated that the university will revise its financial reports to NIST to reflect actual income received.

Subrecipient Southwest Research Institute erroneously claimed its allocation of facility capital cost-of-money charges from September 2005 through March 2007, totaling \$63,412, as an in-kind contribution. The MEP operating plan states that Southwest Research Institute will provide in-kind support to the program by contributing its cost of facilities capital. Although we found no material issues regarding the calculation of these costs, they should not be claimed as in-kind contributions, but instead should be a component of the institute's indirect costs. Facility capital cost of money was applied to the institute's projects based on a rate approved by the Defense Contract Audit Agency on behalf of the federal government. These costs should be included in the indirect cost category for both budgetary and reporting purposes. UTA should direct Southwest Research Institute to include past and future facility capital cost of money allocations in its indirect cost line item, rather than reporting them as in-kind contributions.

E. University response

UTA's complete response is included, without exhibits, as appendix D. A brief summary of the primary points made in UTA's response and our comments follow.

Relationship with Emergency Services Training Institute. UTA stated that TEEEX only has one subrecipient, Biotech Manufacturing Center, and that its relationship with the Emergency Services Training Institute exists under a memorandum agreement between two internal TEEEX divisions.

\$1,271,827 in unallowable subrecipient costs. UTA disagreed that this amount should be questioned, contending (1) the costs are allowable and reasonable, (2) the costs were incurred in support of the intent of the MEP program, (3) Biotech and Emergency Services Training Institute provide invaluable extension services to the MEP, and (4) UTA and NIST have a mutual understanding regarding the allowability of establishing partnerships and leveraging the existing resources of subrecipients.

UTA cited the America COMPETES Act, P.L. 110-69, Sec. 3003(a), which states "...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. 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." UTA stated that the approved operating plan and cooperative agreement provide evidence that Texas Manufacturing Assistance Center (TMAC) has determined the services of Biotech Manufacturing Center and Emergency Services Training Institute are programmatically reasonable and allocable to the MEP program.

In summary, UTA stated, “allowability of costs is described in accordance to applicable federal regulations,... the reasonableness of these questioned costs are established in the communication between NIST and UTA and are further validated in TMAC’s evaluation and communication with NIST. The costs are also properly managed and monitored by the Prime Agency.” Additionally, UTA stated that “The TMAC Partnership and leveraging of existing resources are encouraged by the MEP and sustainability or expansion of these services to reach small to medium manufacturers is an important objective of the MEP. [Biotech Manufacturing Center and Emergency Services Training Institute] have shown evidence of the expansion of MEP services and they will continue to be evaluated in terms of their effectiveness.”

\$ [REDACTED] in estimated costs claimed from allocations of 12 different TEEEX accounts. UTA stated that the TMAC operating plan for the period September 1, 2005, through August 31, 2006, included 12 agency funded projects supplied by TEEEX that were intended to enhance the TMAC offerings for manufacturers. UTA explains that these 12 projects were started in January 2006 but associated costs were not allocated to the TMAC project until June 2006, after TEEEX determined the direct benefit to manufacturers. UTA states that because the allocation of costs based on proportional benefit is allowable under OMB Circular A-21, Sec. C(4)(d), the \$ [REDACTED] should be allowed. UTA also noted that 7 of the 12 project accounts were allocated to the TMAC project at [REDACTED] percent, which is not an issue of proportional benefit and should not have been questioned for that reason.

\$ [REDACTED] questioned in connection with the Basic Economic Development Course. UTA contended this amount should be allowed because this course was determined to have a direct impact on Texas manufacturers. Manufacturing and its importance to economic development is referenced several times throughout the course material and TMAC is listed in the manual as a resource for course participants.

\$6,439 in excessive indirect costs claimed by subrecipient University of Texas – El Paso that exceeded the approved budget. UTA contended this amount should be allowed because the NIST approved budget was for the prime awardee, UTA, which did not exceed budgeted funds for indirect costs, and that UTA does not need NIST approval for budget changes at the subrecipient level.

\$ [REDACTED] in questioned in-kind costs. UTA provided additional support for this amount—copies of TMAC noncash contribution forms for in-kind costs claimed related to three economic development centers. These forms included the percent of time ([REDACTED] percent), salary rate, a brief description of the tasks performed, and an after-the-fact signed certification by the contributor.

F. OIG comments

Relationship with Emergency Services Training Institute. Despite UTA's clarification that the Emergency Services Training Institute is not a subrecipient, but a partner under a memorandum agreement between two internal TEEEX divisions, UTA and TEEEX referred to the institute as a subrecipient in the interagency memorandum agreements, award correspondence, and conversations with the OIG. We continue to refer to both the institute and the Biotech Center as subrecipients for clarification purposes.

\$1,271,827 in unallowable subrecipient costs. UTA failed to provide any new information that changes our opinion and position regarding questioned subrecipient costs of \$1,271,827 claimed for Biotech Manufacturing Center and Emergency Services Training Institute. UTA argued that the subrecipient relationship with Biotech Manufacturing Center and Emergency Services Training Institute is an invaluable extension of services provided by TMAC to small and medium sized manufacturers in the state of Texas. Again, we question whether the costs reported by the two subrecipients are allowable MEP costs because these costs were associated with services the two subrecipients were already providing and would have continued to provide had there been no relationship with the MEP. We found little to no value added to the MEP partnership by the subrecipients' association.

\$ [REDACTED] in estimated costs. We continue to question the \$ [REDACTED] allocated from 12 TEEEX accounts and \$ [REDACTED] associated with a Basic Economic Development Course. Although OMB Circular A-21 does allow for the allocation of costs based on proportional benefit, Sec. C(4)(a) of the circular states that "a cost is allocable to a sponsored agreement if ... it benefits both the sponsored agreement and other work of the institution, in proportions that can be approximated through use of reasonable methods." The "brainstorming session" during which TEEEX assigned percentages of costs from 12 program accounts is not considered a reasonable method. The percentages were not based on estimates of the proportions of time each of the 12 programs spent assisting MEP customers, but rather on whether the customers of the 12 non-MEP programs happened to be manufacturers located in the state of Texas. UTA's response did not include a description of the type of services provided by the 12 programs, nor did UTA explain the nature of any relationships between the 12 programs' customers and the MEP center.

\$ [REDACTED] for Basic Economic Development Course. UTA contended this course should be accepted as allowable because it was determined to have a direct impact on Texas manufacturers. TEEEX officials stated that the \$ [REDACTED] was based on the estimate that if individuals attending the class do become associated with an industrial or economic development organization, they will spend [REDACTED] percent of their time providing services to manufacturers in the state of Texas. However, UTA provided no documentation to support this statement.

\$6,439 in excessive indirect costs. NIST's operating plan guidelines for MEP centers, dated March 2005, require all MEP subrecipient agreements to include the applicable administrative requirements and all general and special award conditions imposed on the recipient. Additionally, the administrative principles contained in 15 CFR, Part 14, are incorporated by reference into UTA's cooperative agreement with NIST. These requirements flow down to subrecipients, pursuant to 15 CFR, Sec. 14.5. We disagree with UTA's assertion that budget changes at the subrecipient level do not need to be approved by NIST. Amendment No. 4 of the cooperative agreement incorporates the scope and budget outlined in the TMAC operating plan for the period of September 1, 2005, through August 31, 2006, which includes a separate budget for UTA and all six of the main subrecipient organizations. UTA and each of the six subrecipients are required to adhere to the budget identified in this operating plan and all corresponding award criteria, including the requirement that claimed indirect costs be limited to the amount contained in the approved budget of the award. Therefore, we continue to question \$6,439 claimed by subrecipient University of Texas – El Paso for the amount exceeded in the approved budget's line item for indirect costs.

\$ [REDACTED] of in-kind costs. The TMAC Non-Cash Contribution Forms submitted in response to the draft audit report contains all of the necessary information identified by the MEP General Terms and Conditions. These costs are no longer questioned.

Other issues. UTA stated that the issues concerning estimated program income and improperly recorded indirect costs have been corrected. However, since there was no documentation provided in its response to support this statement, the grants officer should verify that program income and indirect costs have been revised and reported correctly by UTA during the audit resolution process.

II. UTA Questioned Costs

UTA claimed questioned costs of \$86,225: (1) \$ [REDACTED] related to lobbying activities, (2) \$ [REDACTED] for hotel expenses that were erroneously claimed twice, and (3) \$ [REDACTED] in indirect costs related to the questioned lobbying and hotel expenses.

A. \$ [REDACTED] in questioned lobbying costs

The University of Texas at Arlington claimed \$ [REDACTED] in costs related to 2 years' annual dues paid to the American Small Manufacturers Coalition. The coalition's web site describes it as an advocate for legislative and programmatic resources that allow small manufacturing clients to better compete in the global marketplace. The coalition and its members achieve this mission by increasing awareness of the importance of American small manufacturers, the challenges they face, and the federal legislation and programs affecting them. Among other activities undertaken

by the coalition are yearly "Hill Day" events in Washington, D.C., where its staff, members, and clients advocate for congressional support for the MEP program during the federal appropriations process. Based on information the coalition reported to the Secretary of the United States Senate, the organization incurred \$ [REDACTED] in expenses relating to lobbying activities for the period July 1, 2005, through June 30, 2007.

Section J.33 of OMB Circular A-21 provides that the costs of a covered institution's membership in a business, technical, or professional organization are allowable. Section J.28(a) provides that, notwithstanding any other provision of the circular, costs associated with certain types of lobbying activities (including attempts to influence the introduction of federal or state legislation, the enactment or modification of pending federal or state legislation through communication with any member or employee of Congress, or any government official or employee in connection with a decision to sign or veto enrolled legislation) are unknnot allowed.

Although Section J. 33 would ordinarily allow us to accept the costs of dues paid to a business, professional, or technical organization, the American Small Manufacturers Coalition clearly engages in the type of lobbying activities that are prohibited by Section J.28(a). Because we cannot tell from the coalition's invoices to UTA which portion of the dues supports prohibited lobbying activities and which portion funds activities that might be allowable under the circular, we are questioning the entire \$ [REDACTED] claimed for membership dues as unallowable lobbying costs.

B. \$ [REDACTED] in unallowable other direct costs

UTA's direct cost claims include \$ [REDACTED] for hotel room charges incurred while hosting an MEP-related conference. University officials explained, and supporting documentation confirmed, that UTA intended to place these charges in an account for unallowable MEP costs to ensure that they were not claimed twice—first by the university, then by subrecipients attending the conference. However, these costs were charged to an account that tracks allowable MEP costs and were ultimately included in the total program outlays reported to NIST. University officials told us they are taking the appropriate corrective action in light of this oversight.

C. \$ [REDACTED] in questioned indirect costs

The University of Texas at Arlington's claims included \$ [REDACTED] in questioned indirect costs associated with the \$ [REDACTED] in questioned lobbying costs. We calculated the questioned indirect costs using the university's indirect cost rate of [REDACTED] percent, applied to costs processed through the university's accounting system.

D. University response

UTA's complete response is included as appendix D. A brief summary of the primary points in the response and our comments follow:

Unallowable lobbying costs. UTA stated that the dues paid to the American Small Manufacturing Coalition did not support any lobbying activities and should not be questioned. The university included a letter it received from the coalition stating that "FY06 membership dues were applied only to ASMC's general and administrative expenses. These expenses include an MEP Salary Survey, MEP state funding survey, instructional handbook to build and maintain stakeholder relationships, and regular legislative updates, which include updates on MEP and manufacturing related legislation and reviews of manufacturing policy papers." This letter further states, "TMAC was invoiced for \$ [REDACTED] in FY07 for administrative and general services only, and continues to be billed only for non-lobbying activities."

Unallowable other direct costs. UTA stated that it has removed the \$ [REDACTED] that was inadvertently included in the total program outlays reported to NIST and provided a copy of a Statement of Account for September 2007 as evidence of the correction.

Questioned indirect costs. UTA believes that there should be no questioned indirect costs. These indirect costs relate to questioned direct costs for coalition dues that UTA believes should be accepted as allowable and direct costs questioned for hotel room charges, in which related indirect costs were incorrectly questioned in the draft audit report, that UTA has now documented that no associated indirect costs were claimed.

E. OIG comments

We continue to question the \$ [REDACTED] claimed for dues paid to the American Small Manufacturers Coalition. Although UTA provided a letter from the coalition's executive director and invoices indicating the dues were used to pay nonlobbying-related costs, the documentation is not sufficient to validate the claims. At a minimum, UTA should provide financial records from the coalition that demonstrate the dues were accounted for separately from the coalition's other dues revenue and that they were restricted to nonlobbying uses.

The Statement of Account provided by UTA does confirm that \$ [REDACTED] was placed into an account previously identified as one used by UTA to process unallowable MEP-related expenses. However, we still question these costs because the \$ [REDACTED] is included in the total program outlays reported as of March 31, 2007. If the grants officer can verify UTA's adjusted subsequent cost claims submitted to NIST

removing these questioned costs, then this adjustment should be accounted for in the audit resolution process.

We verified from documentation provided with UTA's response that the university did not claim indirect costs related to the \$ [REDACTED] of unallowable hotel charges; therefore, we reduced indirect costs questioned in the final report by \$ [REDACTED]. Since the \$ [REDACTED] claimed for American Small Manufacturers Coalition dues remain questioned, we continue to question the associated indirect costs of \$ [REDACTED].

III. Recommendations

We recommend that the grants officer disallow questioned costs of \$1,619,280 and recover \$94,120 of excess federal funds.

SUMMARY RESULTS OF FINANCIAL AUDIT
(September 1, 2005, through March 31, 2007)

Federal Funds Disbursed		\$6,595,798
Costs Incurred	\$21,126,265	
Less Questioned Costs	<u>1,619,280</u>	
Costs Accepted	19,506,985	
Federal Cost Sharing Ratio	x <u>33.33%</u>	
Federal Funds Earned		<u>6,501,678</u>
Refund Due the Government		<u>\$ 94,120</u>



Dr. Brett M. Baker
Assistant Inspector General for Audit

APPENDIX A: OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of our audit was to determine whether the University of Texas at Arlington claimed costs to NIST, including costs incurred by subrecipients, that were reasonable, allocable, and allowable in accordance with applicable federal cost principles, cooperative agreement terms and conditions, and NIST policy, including MEP Operating Plan Guidelines. To meet our objective, we interviewed recipient and NIST Grants Office officials, reviewed NIST award documents, examined financial records of the University of Texas at Arlington, and analyzed the budgeted versus actual cost claims for the university and all of its subrecipients. We also interviewed officials and examined the financial records of two subrecipients: Texas Engineering Extension Service and Southwest Research Institute.

Our audit objective did not include assessing the recipient's performance under the award, so any subsequent performance audits could result in additional questioned costs. We did not rely solely on computer-processed data but instead augmented this data with substantive tests of transactions to develop our findings and recommendations.

Our scope included costs claimed by the UTA MEP from September 1, 2005, through March 31, 2007, and an assessment of the recipient's internal controls applicable to the award to evaluate the effectiveness of the control and accountability systems. We reviewed UTA's single audit reports for the years ended August 31, 2005 and 2006. The Texas State Auditor's Office conducted the audits in accordance with Office of Management and Budget Circular A-133. These reports found no material weaknesses. We did not rely upon the state auditor's internal control reviews but instead determined that we could better meet our audit objectives by testing transactions.

We reviewed compliance with laws and regulations as they applied to costs incurred, using as criteria OMB Circulars A-21, *Cost Principles for Educational Institutions*, and A-122, *Cost Principles for Nonprofit Organizations*, and 15 CFR, Part 14, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, Other Non-Profit, and Commercial Organizations*. We also assessed compliance with the Department of Commerce *Financial Assistance Standard Terms and Conditions*, *MEP General Terms and Conditions*, and the cooperative agreement *Special Award Conditions*. We note instances of noncompliance with stated laws and regulations in this report.

We performed our fieldwork during May and June 2007, at UTA's offices in Arlington, Texas, and at subrecipient offices in College Station and San Antonio, Texas. We conducted this audit 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 does provide a reasonable basis for our findings and conclusions.

APPENDIX B

UNIVERSITY OF TEXAS AT ARLINGTON
NIST COOPERATIVE AGREEMENT NO. 70NANB5H1005
SUMMARY OF SOURCE AND APPLICATION OF FUNDS
SEPTEMBER 1, 2005 THROUGH MARCH 31, 2007

	<u>Approved Budget (a)</u>	<u>Receipts & Expenses (b)</u>
<u>SOURCE OF FUNDS:</u>		
Federal	\$10,872,742	\$ 6,595,798
Nonfederal	<u>21,748,938</u>	<u>14,530,466</u>
Total	<u>\$32,621,680</u>	<u>\$21,126,265</u>

APPLICATION OF FUNDS:

Personnel	\$ [REDACTED]	\$ [REDACTED]
Fringe Benefits	[REDACTED]	[REDACTED]
Travel	[REDACTED]	[REDACTED]
Equipment	[REDACTED]	[REDACTED]
Supplies	[REDACTED]	[REDACTED]
Contractual	[REDACTED]	[REDACTED]
Other	[REDACTED]	[REDACTED]
Indirect Costs	[REDACTED]	[REDACTED]
Total	<u>\$32,621,680</u>	<u>\$21,126,265</u>

Notes:

- (a) The approved budgeted costs are for the period of September 1, 2005, through August 31, 2007.
- (b) The receipts and expenses are for the period of September 1, 2005, through March 31, 2007.

APPENDIX C

UNIVERSITY OF TEXAS AT ARLINGTON
NIST COOPERATIVE AGREEMENT NO. 70NANB5H1005
SUMMARY OF FINANCIAL/COMPLIANCE AUDIT
SEPTEMBER 1, 2005 THROUGH MARCH 31, 2007

Description	Approved Budget (a)	Costs Claimed (b)	Results of Audit		
			Costs Questioned	Costs Unsupported	Costs Accepted
Personnel	\$ [REDACTED]	\$ [REDACTED]	0	0	\$ [REDACTED]
Fringe Benefits	[REDACTED]	[REDACTED]	0	0	[REDACTED]
Travel	[REDACTED]	[REDACTED]	0	0	[REDACTED]
Equipment	[REDACTED]	[REDACTED]	0	0	[REDACTED]
Supplies	[REDACTED]	[REDACTED]	\$ [REDACTED] (c)	0	[REDACTED]
Contractual	[REDACTED]	[REDACTED]	1,533,055 (d)	0	[REDACTED]
Other	[REDACTED]	[REDACTED]	[REDACTED] (e)	0	[REDACTED]
Indirect Costs	[REDACTED]	[REDACTED]	[REDACTED] (f)	0	[REDACTED]
Total	<u>\$32,621,680</u>	<u>\$21,126,265</u>	<u>\$1,619,280</u>	<u>0</u>	<u>\$19,506,985</u>
Federal Funds Disbursed			\$6,595,798		
Costs Incurred		\$21,126,265			
Less Questioned Costs		<u>1,619,280</u>			
Costs Accepted		19,506,985			
Federal Cost Sharing Ratio x		33.33%			
Federal Funds Earned			<u>6,501,678</u>		
Refund Due the Government			<u>\$ 94,120</u>		

Notes:

- (a) Approved budget is for September 1, 2005, through August 31, 2007.
- (b) The costs claimed are for September 1, 2005, through March 31, 2007.
- (c) Questioned supplies costs represent annual membership dues paid to the American Small Manufacturers Coalition that may be related to lobbying activities.
- (d) Questioned contractual costs include (1) \$1,271,827 claimed by subrecipient TEEX for costs reported by two of its subrecipients that were not related to MEP activities, (2) \$ [REDACTED] in estimated costs claimed by subrecipient TEEX, and (3) \$6,439 of excessive indirect costs claimed by subrecipient University of Texas El Paso.
- (e) Questioned other direct costs reported by the University of Texas at Arlington are for conference-related charges that were also claimed by MEP subrecipients.
- (f) Questioned indirect costs of \$ [REDACTED] are related to the \$ [REDACTED] in questioned supplies (lobbying) costs.



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September 19, 2008

Judith J. Gordon
Assistant Inspector General for Audit and Evaluation
United States Department of Commerce
Office of Inspector General
1401 Constitution Avenue, NW
Room 7876
Washington, DC 20230

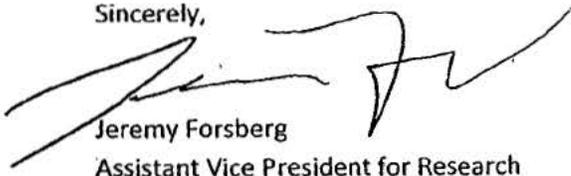
re: Draft Audit Report No. DEN-18573-8-0001

Dear Ms. Gordon,

Please find attached The University of Texas' response to the draft audit report of the U.S. Department of Commerce financial assistance Award No. 70NANB5H1005 sponsored by the National Institute of Standards and Technology.

If you have any questions about our response or if we can provide you with additional information please contact me at (817)272-██████ or email j.forsberg@uta.edu.

Sincerely,



Jeremy Forsberg
Assistant Vice President for Research

cc: John S. Bunting, Regional Inspector General for Audits, US DoC

cc (w/o encl): Joyce Brigham, Grants Officer, NISI
Kenneth W. Schroeder, Director, Internal Audit, UT Arlington
Stephen Willet, NIST Audit Liaison
J. Michael Simpson, Director, System Operations, NIST/MEP
William Kinser, NIST Grants and Agreement Management
Division

INTRODUCTION

The University of Texas at Arlington (UTA) is pleased to submit the following response to the OIG Draft Audit report on behalf of the Texas Manufacturing Assistance Center (TMAC).

The following response coincides with the format in the OIG Draft Audit report No. DEN-18573-8-0001. The section and subsection headings match those found in the Draft Audit report in order to easily reference exhibits and/or the evidence, explanation and response to the questioned costs identified by the OIG.

SUBRECIPIENT QUESTIONED COSTS

1. **\$1,271,827 in claims from the Texas Engineering Extension Service (TEEX) and two of its subrecipients the OIG determined were not allowable MEP project costs:**

TEEX has only one subrecipient, the Biotech Manufacturing Center of Texas (BMC).

The Emergency Services Training Institute (ESTI) in and of itself is not a Subrecipient to the UTA Cooperative Agreement. ESTI is an institute within TEEX. TMAC Statewide, a TMAC regional center, is also an organization within TEEX. TEEX holds the Subrecipient Agreement to manage the TMAC Statewide Region. To better manage and review the participation of ESTI in TMAC, TMAC Statewide and ESTI have a Memorandum of Agreement as a TEEX internal Agreement. To illustrate the TMAC network of Subrecipients please refer to the TMAC Subrecipient Schematic as Exhibit 1.

The responses for these questioned costs are partitioned as follows and build upon each other in their respective order:

- A) Allowability of costs and relevant federal regulations for their determination
- B) The programmatic intent/reasonableness of costs communicated from the Federal government
- C) The rationale for including ESTI and BMC in TMAC
- D) The evaluation, effectiveness and results of the TMAC Partnership
- E) The Monitoring, Accountability and Oversight of Subrecipients
- F) Other Programmatic Responses
- G) Summary Response

A) Allowability of Cost and Federal Regulations:

The applicable federal policy to determine allowability of cost under this Cooperative Agreement is Title 2, Volume 1 Part 220 Cost Principles for Educational Institutions, (hereinafter 2CFR220) see http://edocket.access.gpo.gov/cfr_2008/janqtr/2cfr220.5.htm. When applying these principles, there is an important exchange of documentation and

communication between the federal sponsoring agency (NIST) and the performing agencies (TMAC Partners) to implement the intent of the federal program (MEP) and incur the appropriate costs to execute it. For example, under Section A of 2CFR220; "Purpose and scope", Section 2. "Policy guides" , states the following (emphasis added):

"The successful application of these cost accounting principles requires development of mutual understanding between representatives of universities and of the Federal Government as to their scope, implementation, and interpretation. It is recognized that ... arrangements for Federal agency and institutional participation in the financing of a research, training, or other project are properly subject to negotiation between the agency and the institution concerned, in accordance with such government wide criteria or legal requirements as may be applicable."

The mutual understanding between TMAC and NIST is communicated through the Proposal, Approved Operating Plans, Panel Reviews, NIST Strategic Plan, Federal Government Guidance, NIST MEP Source for Centers, Policies, Notices etc., all of which are further expanded on in subsection B) of this section.

The OIG report questioned whether the costs reported by BMC and ESTI are allowable MEP costs because "they were associated with services the [BMC and ESTI] were already providing and would have continued to provide had there been no association with the MEP." Because a partner offers services that they were already providing and would continue to provide does not mean the costs are unallowable. NIST MEP encourages the leveraging of resources through partnerships. If the partners were required to develop different services in order to participate in the MEP, then there would be no leveraging. While the OIG Report questions the costs, there is no reference to a violation of 2CFR220.

To determine the specific "allowability" of costs TMAC referred to 2CFR220 Part C "Basic considerations", items 2 and 3 (emphasis added):

"2. Factors affecting allowability of costs. The tests of allowability of costs under these principles are: (a) they must be reasonable; (b) they must be allocable to sponsored agreements under the principles and methods provided herein; (c) they must be given consistent treatment through application of those generally accepted accounting principles appropriate to the circumstances and (d) they must conform to any limitations or exclusions set forth in these principles or in the sponsored agreement as to types or amounts of cost items."

We have met all of the factors mentioned above for determining allowability. However, in the exit interview; the OIG did mention "reasonableness" as it related to the inclusion of these partners in TMAC, which is expanded on in the information below.

2CFR220 Continued: "3. Reasonable costs. A cost may be considered reasonable if the nature of the goods or services acquired or applied, and the amount involved therefore, reflects the action that a prudent person would have taken under the circumstances prevailing at the time the decision to incur the cost was made."

The decision to include the BMC and ESTI costs do reflect an action that a prudent person would have taken under the circumstances at the time. The General Terms and Conditions for the Hollings Manufacturing Extension

Partnership Statement of Work states: "The tasks to be performed by the Recipient under this award are detailed in the original proposal as amended by the required plans. During the period, if any modifications are required to the statement of work or plans, these modifications must be submitted in writing and are not effective until approved by the NIST Grants Officer in writing. These modifications will be incorporated as an amendment to the cooperative agreement." In Grant Year 12 BMC and ESTI were in the NIST approved Operating Plan. In Grant Year 11, BMC was referenced in TMAC-Statewide's statement of work and incorporated into amendment number 3 to their Subrecipient Agreement after extensive consultation with NIST MEP. Furthermore, MEP did conduct appropriate program reviews during which these programs were discussed. Therefore, TMAC believes there was ample communications with NIST MEP, and the Program Officer/Account Manager were aware of actions planned and undertaken. Based on these circumstances, including the BMC and ESTI costs reflect what a prudent person would do and therefore should be considered reasonable.

2CFR220 Continued: "Major considerations involved in the determination of the reasonableness of a cost are: (a) whether or not the cost is of a type generally recognized as necessary for the operation of the institution or the performance of the sponsored agreement; (b) the restraints or requirements imposed by such factors as arm's length bargaining, Federal and State laws and regulations, and sponsored agreement terms and conditions; (c) whether or not the individuals concerned acted with due prudence in the circumstances, considering their responsibilities to the institution, its employees, its students, the Federal Government, and the public at large; ..."

These subrecipient costs are recognized as necessary for the performance of the NIST Cooperative Agreement as evidenced in subsection B of this section. These costs are reasonable as they were incurred with due prudence and diligence for the circumstances and communication received from NIST, and were further validated in program reviews.

It is important to recognize the Cost Principles applicable to this program do not necessarily take into account the outcome or resulting value that may eventually occur when establishing allowability of costs. The results of a grant or federal assistance project may not be easily known and often are difficult to predict. The pursuit of relationships/collaborations and the intent to fulfill programmatic requirements or the conduct of program activities are executed by meeting the initial requirements described above to determine allowability. The effectiveness of these efforts and resulting outcomes are a matter of programmatic determination. Evaluation, monitoring and accountability of performing agencies and the mechanisms by which to analyze them help determine due diligence in order to alter the course of a program should federal funds need to be diverted to other program goals. Indifferent to the actual outcome, the costs are allowable when initiating the relationship in accordance with the applicable cost principles.

B) Programmatic Intent of the MEP communicated by the Federal Government:

There are numerous examples of the programmatic intent of the MEP communicated by the federal government and the federal sponsoring agency to the public and participating institutions that are used to establish the "mutual understanding" between TMAC and NIST as to the application of the cost accounting principles' "scope, implementation and interpretation" and, therefore, determine the allowability and reasonableness of costs as described in subsection A above.

Some of the examples NIST, Department of Commerce, and Congress have provided to the public to communicate the intent and therefore allowability (programmatic reasonableness) of costs are as follows (emphasis added):

The NIST MEP Statute: TITLE 15 - COMMERCE AND TRADE
CHAPTER 7 - NATIONAL INSTITUTE OF STANDARDS AND TECHNOLOGY
Sec. 278k. Regional Centers for the Transfer of Manufacturing Technology
States "...the Objective of the Centers is to enhance productivity and technological performance in United States manufacturing through...

2. the participation of individuals from industry, universities, State governments, other Federal agencies, and, when appropriate, the Institute in cooperative technology transfer activities;
3. efforts to make new manufacturing technology and processes usable by United States- based small- and medium-sized companies;
4. the active dissemination of scientific, engineering, technical, and management information about manufacturing to industrial firms, including small- and medium-sized manufacturing companies; and ..."

The CFDA# 11.611, www.cfda.gov (MEP) description states the "Objective" as:

"To 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."

And 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 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 the purpose of demonstrations, technology deployment, 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."

The NIST - MEP website: www.mep.nist.gov/partners/index.htm : it further clarifies the intent of the program as follows:

"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.

Creatively 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.“

The America Competes Act, Public Law 110-69, Sec 3003 (a) CLARIFICATION OF ELIGIBLE CONTRIBUTIONS IN CONNECTION WITH REGIONAL CENTERS RESPONSIBLE FOR IMPLEMENTING THE OBJECTIVES OF THE PROGRAM, (C) states:

“... 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. 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.”

The Center Director, in concert with the NIST MEP Program Office as evidenced in the approved Operating Plan and Cooperative Agreement, has determined BMC and ESTI as programmatically reasonable and allocable to the MEP program and is included as a portion to the Center's contribution.

The CFR Part 290 – Regional Centers for the Transfer of Manufacturing Technology, Subchapter K – Advanced Technology Program Procedures states (emphasis added):

“§ 290.3 Program Description.

(d) Center organization and operation.

Each Center will be organized to transfer advanced manufacturing technology to small and medium sized manufacturers located in its service region. Regional Centers will be established and operated via cooperative agreements between NIST and the award-receiving organizations. Individual awards shall be decided on the basis of merit review, geographical diversity, and the availability of funding.

The 1992 MEP NIST report “A National Strategy for Manufacturing Excellence” (a report requested by the NIST VCAT in 1991, and presented to the NIST VCAT in 1992. The report was strongly endorsed in the 1993 Annual Report of the VCAT) 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. Furthermore, we believe that the effective partnerships with existing national, state, and local resources, as well as private sector organizations, allows for the most efficient and effective delivery of services to manufacturers. Clearly, in applying the cost principals to determine allowability of costs, NIST has communicated the intent of the MEP to leverage existing resources and services and the costs reasonably associated with executing the MEP. BMC and ESTI are examples of leveraged resources to serve manufactures in the TMAC network. These partnerships accomplish what NIST MEP desires. They leverage investments in infrastructure and product development. They are partnerships with existing state and private sector organizations, existing state agencies, and BMC a not for profit.

C) The rationale for including ESTI and BMC in TMAC:

For the specific questioned costs associated with BMC and ESTI, it is important to recognize the invaluable extension services they uniquely provide to the TMAC partnership that are in-line with the MEP program intent described above.

BMC Background: The Biotech Manufacturing Center (BMC) was formed as a non-profit entity in 2004 with partial funding from the local economic development center in Athens, Texas to utilize abandoned medical facilities. These facilities were available because a large medical manufacturer left town. This action meant that valuable medical jobs were lost in the community and the state.

As with any fledgling non-profit entity, BMC struggled to remain financially solvent while building up its capabilities and identifying start-up medical customers to utilize its services in product design, prototyping, and pilot production. In fact, the local economic development center on several occasions considered ceasing support and funding feeling the financial burden was too much for the local community to absorb. In early 2006 TMAC recognized the value that BMC offered not only to the small manufacturing community in Athens, but also to companies all over Texas. TMAC approached BMC and the local community to develop a viable partnership. By leveraging TMAC and the local community, BMC was able to focus on additional business development activities to attract new customers and tenants to the facility. This partnership allowed TMAC to align with NIST's Next Generation Strategic Plan (v.1. 12/23/05) by adding innovation services including product development capability. In-turn, BMC gained access to full suite of TMAC services. This value exchange brought new offerings including not only the cutting-edge information on technology adoption, environment and energy, but also manufacturing ISO certification, and assistance in FDA approval in the only FDA registered support facility in the state of Texas.

A TMAC Success Story: An example of this model and a significant success story is the first tenant and graduate of the BMC, Pharma-Pen, a company that had patented an innovative auto-injection device. Not only did Pharma-Pen utilize the facilities at BMC, but owner Rick Gillespie utilized a market assessment performed by TMAC-Statewide that helped identify market opportunities and assisted in his business plan that attracted seed funding for his company. Mr. Gillespie provided a BMC-Pharma-Pen Summary attached as Exhibit 2 that states in part:

"TMAC helped put together an assessment that was a major part of my first business plan I put together," Gillespie said. "That plan was used essentially to attract my first round of seed investors that really got this initiative off the ground."

As a result of the many services provided by BMC and TMAC-Statewide to Pharma-Pen during this design and prototyping phase, Gillespie and his investors partnered with an established pharmaceutical company, West Pharmaceutical, to market and produce the auto injector device. During West Pharmaceutical's tour of the BMC facilities to evaluate Pharma-Pen, they were so impressed with the facility and the support of the center that they not only agreed to keep operations and manufacturing of the auto injector in Athens, but they also decided to relocate other out of state jobs to Athens, and plan to add additional jobs in Athens in the next several years. Overall, the short term economic impact was estimated conservatively at just under \$1.0 million. That figure will continue to grow as the facility operates in Athens and attracts additional high paying medical manufacturing jobs as planned in rural east Texas.

Coming directly from Rick Gillespie at Pharma-Pen, this success story would not have happened in Texas without the support of the BMC and the MEP. Exhibit 2 continued:

"BMC provided me the facilities, infrastructure, and support that as a start-up company I didn't have. They have a one-of-a-kind medical device manufacturing facility that's FDA approved," Gillespie said. "They certainly accelerated the development process, and we wouldn't be doing this in Athens or Texas if this facility wasn't available."

As a result of BMC and the support of the MEP, the small, rural city of Athens regained high dollar, high quality medical manufacturing jobs by utilizing an abandoned medical manufacturing facility. The state of Texas now has a unique facility in the region that can attract medical device start-up companies and grows the medical manufacturing base by increasing the probability of commercial success by offering MEP services and leveraging the MEP network. Exhibit 2 continued:

"This acquisition provides approximately 15 jobs here in Athens and West is expected to have up to 30 employees within a year or two, depending on the assistance given by the BMC, TMAC, and the city of Athens," said Gary San Miguel, executive director of BMC."

The success of BMC in the TMAC partnership: After joining TMAC as a subrecipient in January 2006 in Grant Year 11, BMC's total reported program income was \$ [REDACTED]. In Grant Year 12 their reported program income had grown to \$ [REDACTED]. This revenue growth is only one example of how the program has expanded as a result of this partnership. Moreover, Texas now has an FDA registered medical device incubation facility to attract medical device innovators and start-up companies. BMC and the importance of the TMAC partnership is reflected in a letter (see Exhibit 3) submitted from Executive Director Gary San Miguel in October, 2007 when he wrote:

"Our relationship with TMAC is a critical link in our growing success. Funding from TMAC has proven instrumental in the growth and expansion of services offered by BMC to support small and start-up companies in the design, development, prototyping, and pilot productions runs of new medical device innovations in the commercialization process. The impact can be seen in several critical financial and operational milestones.

In terms of total companies served, BMC's client list has increased significantly since partnering with TMAC. Since our partnership with TMAC in January 2006, 18 additional new clients have been served and our projects supporting small manufacturers have increased [REDACTED] %.

Support services and associated revenues of BMC have almost tripled since the inception of the TMAC/BMC partnership."

In conclusion, Mr. San Miguel reiterated the importance of the TMAC partnership to the financial viability and success of the BMC, and in turn the success of its start-up manufacturing tenants. (Exhibit 3 continued):

"Without TMAC, our success would be sharply curtailed... We have completed several major projects with economic impact of 5.2 million dollars... In conclusion, we are a non-profit entity struggling to survive as any other new company. Due to our uniqueness of incubating new companies, TMAC not only offers financial support that allows us to acquire key technical personnel, TMAC also offers services such as sales, marketing, ISO implementation, lean manufacturing to name a few that prove instrumental in new companies development. The goal of the BMC, with the valuable partnership of TMAC, is to assist manufacturing companies. That is what we do."

Summary: In reference to the audit report's claim that BMC and ESTI could only recall referring three customers for additional services, we wish to clarify the following points: First, TMAC-Statewide and BMC marketed and referred TMAC to many potential customers through multiple interactions and the use of marketing materials. However, their utilization is difficult gauge and record through the use of referral reporting. TMAC provided additional MEP services to three BMC customers. The three BMC customers and the MEP services provided during the audit period are as follows:

1) TMAC performed a market assessment for Pharma-Pen in support of their business plan.

2) TMAC generated a market opportunity study for [REDACTED], a BMC client looking to validate market opportunities for its self-adjusting door lock that was being designed and prototyped at BMC. TMAC provided market intelligence and insight into the construction and locksmith industry, including specific distributors and manufacturers of locks that were potentially interested in partnering with the client

3) TMAC performed a feasibility study for another BMC customer (requested their name not be disclosed publically) that was prototyping a misting device. TMAC generated industry feedback on the device and identified potential commercial opportunities and strategies used in the client's strategic and business plan.

TMAC-Statewide and BMC actively marketed the services of each organization jointly. TEEX marketed the services of BMC at several state universities that produce medical device innovations including Texas A&M University, Texas Tech University, UT-Arlington, and UT-San Antonio, and BMC was active in educating its tenants about additional TMAC/MEP services and actively marketed its partnership with TMAC at various conferences, meetings, and on its website.

ESTI Background: With respect to the Emergency Services Training Institute (ESTI) at TEEX, ESTI has been provided training and technical assistance to Texas industries since the Summer of 2006 under its current agreement with TMAC-Statewide. ESTI's services are designed to prepare emergency response personnel to safely, efficiently, and effectively perform rescues in the event of an emergency. The training and technical assistance that is offered enables manufacturing personnel to apply newly acquired skills and knowledge in a real-world hazardous environment. There is no doubt the customers that participated in the TMAC program and received training benefited greatly in their abilities to protect themselves, co-workers, the environment, their communities and their livelihoods. The impact is particularly strong when you consider the value that small to medium-sized manufacturers receive from such training.

One of the most important goals is to increase the availability of safety and emergency response training that can save lives of manufacturing employees. It is critical that emergency responders in the state of Texas receive training that enables them to respond safely and effectively to crisis situations, thus reducing the impact felt to company both in lives and in company assets. By limiting losses, these Texas companies can experience more on-time production and continue to operate without loss of jobs or capacity, stabilizing the Texas manufacturing community. Participating companies obtained training that is directly related to performance objectives which improve their ability to retain current operations and market share in the United States and reduces the risk of the company moving its manufacturing operations to cheaper overseas locations.

A prime example of a customer served in the TMAC program that had a major event in their facility would be [REDACTED]. [REDACTED] had a recent large fire in their facility that raged for hours. The response of [REDACTED]'s Emergency team was exceptional. They exhibited great poise under this stressful situation and saved their company millions of dollars. Without training that [REDACTED] received at ESTI, none of these results could have been possible. There is no insurance policy like a well trained response team. [REDACTED] took the approach to go the extra mile for their team and not just to provide bare minimum training to meet the OSHA mandated level, and it paid off in protecting the lives of their employees and saving millions in assets and protecting the company's ability to operate and stay in business.

As a side note, some of the trainers that instruct for ESTI were part of the search and rescue team that was deployed during Hurricane Ike. Dealing with hurricanes is only one example of a crisis situation.

ESTI works in an environment of cost avoidance, but avoiding costs and minimizing damage in an emergency situation is a positive economic benefit because it can keep the company in business and maintains the manufacturing base. The significant resources ESTI provides to this partnership include technical expertise, equipment, an established training capability, and an existing customer base that augments that of TMAC.

The capabilities that the TMAC/ESTI partnership can offer are especially important to the small to medium sized manufacturing companies. These companies have less room for error and a fire or other emergency event can impact their ability to stay in business, thus compromising the Texas manufacturing job market. These companies must ask themselves; "would the services that TMAC/ESTI provides improve the companies' position in the market place and provide a competitive advantage"? This is a fact of doing business as these companies are mandated by OSHA regulations to train their personnel in emergency response, but more importantly companies that do this well tend to stay in business.

Through the TMAC/ESTI partnership, we look to attract new and unique customers who will benefit from the services that we provide. More importantly, we look for small to medium-sized companies that can realize the greatest impact from emergency response training. ESTI was also able to provide training to a group of small and medium-sized companies that would not likely have been serviced without TMAC assistance. These new companies were exposed to training which will no doubt increase their ability to respond to emergencies and prevent loss of life, reduce damage to equipment, reduce extended downtime and increase their competitiveness in the Texas economy. These companies include [REDACTED] and [REDACTED].

The MEP program is founded on the principle of leveraging existing technical assistance capacity that builds infrastructure to assist small and medium manufacturers. The fact that ESTI had pre existing capabilities of serving manufacturers is exactly the kind of leveraging the MEP program is referring to above. The additional federal dollars allows

ESTI to expand their ability to serve manufacturers with a focus on small and medium sized manufacturers.

In reference to the claim by the OIG that TEEEX could only recall referring three potential customers for additional TMAC services, the ESTI program manager of the private sector group, Gordon Lohmeyer personally and directly met with each and every TMAC customer and counseled the client on TMAC, handed out a customized joint ESTI-TMAC brochure that spelled out the services of both (see Exhibit 4), and then briefly reviewed the TMAC surveying process.

In addition, Mr. Lohmeyer and his team distributed hundreds of ESTI-TMAC brochures at exhibits and various fire and emergency services trade shows and conferences. The following conferences occurred during the audit period where TMAC services were marketed and displayed:

Texas-based conferences which we attended and actively marketed TMAC:

- 1) October 24 - 29, 2006 - EPA Region 6 Hot Zone Conference (Houston, Tx)
- 2) February 13 - 16, 2007 - Industrial Fire Safety and Security (Galveston, Tx)
- 3) March 27 - 28, 2007 - Industrial Fire World (Beaumont, Tx)

AFTER AUDIT PERIOD

- 4) May 1 - 3, 2007 - National Petroleum Refiners Association (Woodlands, Tx)
- 5) June 4 - 7, 2007 Texas Chemistry Council (Moody Gardens - Galveston, Tx)
- 6) July 22, 2007 TEEEX/ESTI Annual Municipal Show and Expo (CollegeStation, Tx)
- 7) October 16 - 21, 2007 EPA Region 6 Hot Zone Conference (Houston, Tx)
- 8) February 4 - 8, 2008 Industrial Fire Safety and Security (Galveston, Tx)
- 9) February 10-12, 2008 South West Fire and Rescue (Moody Gardens - Galveston, Tx)

To summarize, not only do the BMC and ESTI add value to the MEP program; they also add capability and capacity that is critical for manufacturers that is very hard to access elsewhere. With regard to BMC, a new product can take up to 10 years to launch, the impact of the BMC's efforts will not be fully realized for several years. The discontinuance of MEP support of BMC and ESTI will cause TMAC to lose capabilities and reduce services grounded in business strategy development, market expansion, new product development, integration into supply chains and engaging the creativity and technical problem solving skills of the workforce that NIST places emphasis in fulfilling for the intent of the MEP. Without BMC the state and nation will lose additional capacity to develop products. By leveraging MEP service providers, TMAC increases in recognition, marketing outreach, and builds internal capacity to the entire program. BMC and ESTI offer unique services that all TMAC Centers can direct customers to as services not offered in their respective regions. Lastly, TEEEX (TMAC Statewide), BMC and ESTI are resources serving an underrepresented rural area in TMAC that requires the necessary financial incentives to provide MEP related services that otherwise are unsustainable by the market place.

D) The establishment, evaluation, effectiveness and results of the TMAC Partnership:

To further solidify the mutual understanding of the MEP guidance provided to TMAC and the allowability to establish partnerships and the leveraging of existing resources in accordance to applicable federal costing policies, TMAC has communicated the inclusion and rationale for BMC and ESTI to NIST. It is an ongoing communication and post review process to ensure the reasonableness and allowability of costs incurred and that proper partnerships are maintained. Examples of the evaluation, validation, and programmatic results communicated with NIST are as follows:

TMAC Integrated Business Plan Grant Year 12:

Innovation Goal: "Provide Engineering and design prototyping services for companies needing to test, market, and prove out their new product ideas through our sub-recipient agreement with the Biotech Manufacturing Center (BMC) in Athens, TX" (Page 40, Critical Success Factor 8).

Sustainability Goal: "Provide training and technical assistance improving the safety and security of the Texas-based petrochemical, power generation, pharmaceutical, transportation, and manufacturing industries through a partnership with ESTI." (Page 44, Critical Success Factor 9).

The CFR Part 290 – Regional Centers for the Transfer of Manufacturing Technology, Subchapter K – Advanced Technology Program Procedures states (emphasis added):

§ 290.8 Reviews of centers.

(a) *Overview.* Each Center will be reviewed at least annually, and at the end of its third year of operation according to the procedures and criteria set out below. There will be regular management interaction with NIST and the other Centers for the purpose of evaluation and program shaping. Centers are encouraged to try new approaches, must evaluate their effectiveness, and abandon or adjust those which do not have the desired impact. (b) *Annual reviews of centers.* Centers will be reviewed annually as part of the funding renewal process using the criteria set out in § 290.8(d). The funding level at which a Center is renewed is contingent upon a positive program evaluation and will depend upon the availability of federal funds and on the Center's ability to obtain suitable match, as well as on the budgetary requirements of its proposed program."

(c) *Third year review of centers.* Each host receiving a Center Operating Award under these procedures shall be evaluated during its third year of operation by a Merit Review Panel appointed by the Secretary of Commerce. Each such Merit Review Panel shall be composed of private experts, none of whom shall be connected with the involved Center, and Federal officials. (establishment of "reasonableness") An official of NIST shall chair the panel. ... (d) *Criteria for annual and third year reviews.* Centers will be evaluated under the following criteria in each of the annual reviews, as well as the third year review: (1) The program objectives specified in § 290.3(b) of these procedures; (2) Funds-matching performance; (3) The extent to which the target firms have successfully implemented recently developed or currently developed advanced manufacturing technology and techniques transferred by the Center; (4) The extent to which successes are properly documented and there has been further leveraging or use of a particular advanced manufacturing technology or process; (5) The degree to which there is successful operation of a network, or technology delivery mechanism, involving the sharing or dissemination of information related to manufacturing technologies among industry, universities, nonprofit economic development organizations and state governments. ..."

The 2005 Panel Review was conducted to evaluate the performance and effectiveness of TMAC to NIST. The 2005 Panel Review states:

"The Panel observed positive trends in the Center's performance metrics, specifically in the area of cost per impacted client. The Panel noted that this was a significant accomplishment while building a network of partnerships and allowing the Center to become more visible and active at the State leadership levels. This strong alignment of institutional partners might offer great potential for alternative means for State funding in the future. The Panel congratulates the Center on these achievements and encourages such further efforts in the future."

The Panel recognized the importance of leveraging a wide network of TMAC partners.

The 2007 Panel Review again commended TMAC for work with our partnerships. The report states:

"The Panel is impressed with TMAC's network of partnerships. The Panel commends TMAC for bringing together a far reaching and complex network of universities and community colleges, the Manufacturing Caucus, and Federal agencies such as the Environmental Protection Agency and Department of Labor. The Panel is impressed that the Center has been able to develop and utilize the network at multiple levels to accomplish desired strategic outcomes."

TMAC works to leverage our products offerings and technology through partnerships.

BMC and ESTI's Inclusion in TMAC: BMC and ESTI were included via an amendment to the TMAC-Statewide's Subrecipient Agreement in Grant Year 11 and included in the annual continuation proposal submitted to and approved by NIST in Grant Year 12. The Panel Review communication between NIST and TMAC helps to evaluate the effectiveness of TMAC (including ESTI and BMC) and the use of federal funds.

BMC and ESTI Initiated Projects:

- TMAC-Statewide initiated a total of 61 projects in Grant Year 12 which included 21 ESTI projects and 14 BMC projects.
- TMAC-Statewide initiated a total of 56 projects in Grant Year 13 which included 21 ESTI projects and 28 BMC projects.

These figures show the significant contributions of BMC and ESTI and in particular the growth and expansion of services for BMC towards meeting the goals of the MEP.

All of these Projects will be in the NIST Survey pipeline for TMAC. Upon completion, TMAC customers will have the opportunity to quantify the impact of TMAC services. We will continue to monitor results of these TMAC Partners as they progress.

BMC is on track for its customers to demonstrate the impact of MEP-supported services. Initial projects were begun in 2006. Because BMC's product development projects are typically long and complex, the first of these projects were completed in 2007. NIST's current survey cycle calls for gauging project impact one year after completion, so the initial BMC customers would be

surveyed no earlier than 2008. In fact, seven BMC customers are scheduled for inclusion in the upcoming 2008Q3 survey, to be conducted in October-November. These customers received an average of 1600 hours of service from BMC. UTA will monitor the survey results to assess the impact of BMC on the companies it has served.

ESTI's MEP-related services may be difficult to quantify in terms of value because its services are aimed at assisting manufactures minimizing loses due to safety, emergencies, or disaster recovery/prevention. The value of these services may only be evident after a disaster. With multiple avenues of outreach and marketing, it is often difficult to connect a project opportunity with the marketing effort that generated it.

Plan for ESTI: In accordance to CFR § 290.8, regions are encouraged to try new approaches. TMAC evaluates their effectiveness and makes adjustments accordingly to achieve the desired impact. TMAC-Statewide continues to expand ESTI services related to MEP goals to improve impact. As part of programmatic performance and the process of continuous improvement, ESTI plans to reach out to additional TMAC customers and assist them in meeting their regulatory required training objectives. This will help ensure that TMAC participating companies have advantages to remain competitive and deal with or reduce risks brought on by natural or other disasters in today's environment.

The plan to increase services and quality of training offerings that these customers can expect to receive includes:

1. Increased potential to market our abilities and services available to small and medium-sized customers. The increased awareness and participation in services that are available will improve their position in the market place and handle cost avoidance issues.
2. Increased class offerings to participating manufacturers that focus on specialized needs for their particular facility. By offering "customized" training, these companies can better prepare themselves for emergency events which could negatively impact their ability to produce commodities for their customers.
3. Expansion of curriculum to offer "special hazards" training that many Texas based companies could benefit from. This will include such courses as Flammable Liquid Storage, LPG Emergency Management, and Advanced Hazmat Container Specialist.
4. Expansion, refurbishing and enhancement of the training props at Brayton Fire Field. This will allow the emergency responders from the state to have absolutely the best, most realistic training environment possible.
5. Purchase of training equipment which would allow us to better serve our customers by providing the newest, most up to date tools available.

In summary, the full potential value of BMC and ESTI may take time to be realized in quantifiable terms; however their establishment is allowable, their leveraging value has been realized and continues to be reviewed. Most importantly TMAC partners, BMC and ESTI, are examples of leveraged resources the MEP strongly encourages to meet the goals of the MEP.

E) The Monitoring, Accountability and Oversight of Subrecipients:

The monitoring of subrecipients is necessary in order to effectively implement the MEP program through TMAC. As the Prime Agreement holder, UTA exercises ongoing oversight and training for its Subrecipients related to compliance with MEP and Federal requirements. Elements of the process include the Subrecipient Agreement itself, monthly follow up on Requests for Reimbursement, monthly operations committee meetings, annual financial managers meetings, grants management training opportunities and a detailed Monitoring Plan.

The Monitoring Plan was developed and implemented by UTA staff in the Offices of Grant and Contract Services, Internal Audit, and Institutional Compliance who is independent of the TMAC program management.

To develop the Monitoring Plan, UTA performed a risk assessment that consisted of the review of regulatory requirements within the MEP Audit Guide, DOC and MEP Terms & Conditions and applicable Federal Regulations and Cost Principles. These items were compared to the associated risks inherent in managing a multiple subrecipient network of entities that constitute the TMAC - MEP partnership. The result of this risk assessment was a comprehensive monitoring check list (Exhibit 5) that included a review of financial, programmatic and administrative items and was utilized in a monitoring site visit at TEEX.

UTA through this monitoring plan and site visit was able to view processes, review documentation, make observations and issue recommendations in order to mitigate risks within TEEX (Exhibit 6) UTA and TEEX Monitoring Report). In-turn, because of the proper agreements TEEX has with their partners, TEEX was able to review and monitor their subrecipient BMC and the ESTI program (as evidenced in benefit correction 5b). It is important to note and recognize this process as it relates to the entire applicability of costs within the MEP context; where allowability of costs are established without knowing the actual resulting outcome and the proper mechanisms (subrecipient agreements) are in place in order to provide the ability for governing bodies, whether it be the Prime Agency (UTA or TEEX for their Subrecipient/Partners), the federal independent oversight body (OIG), or the federal sponsoring agency (NIST) to review the effective use of federal funds.

The implementation of the Monitoring Plan demonstrates due diligence necessary to administer federal funding in accordance to the documentation noted above (subsections A-D). Moreover, this monitoring process was commended by the OIG auditors during the audit and at the audit exit conference.

F) Other Programmatic Responses to the OIG:

From Page 2 of the OIG Draft Audit Report:

"Therefore, UTA's cost claims to NIST include \$1,272,827 for services provided to manufacturers whose only connections to the mission of the MEP are (1) they happen to be located in the state of Texas and (2) they may have been advised of additional services they could receive from MEP."

The services BMC and ESTI provide to manufactures are directly related to the mission of the MEP which is:

"To strengthen the global competitiveness of U.S.-based manufacturing by providing information, decision support, and implementation of innovative approaches focused on leveraging new technologies, techniques, and business best practices."

BMC and ESTI work with manufactures not simply because they happen to be in the state of Texas, but rather BMC and ESTI add unique services to the TMAC portfolio that cannot be found anywhere else in the state or elsewhere in the country.

Cross-promotional activities among TMAC regions and partners expand market opportunities for all. TMAC works hard to build an image across the state, expending resources and time to develop leads that generate revenue. It is not trivial, and by having TEEX, which is well known throughout the state, marketing TMAC products is a definite benefit for TMAC. BMC may not have the same reputation as TEEX, but they do have a lot of visibility in the state. Having them promote TMAC is a definite benefit to the TMAC goal of creating an image. TMAC promotes both BMC and ESTI. In turn, BMC and ESTI promote TMAC.

Page 2 of the OIG Draft Audit Report continued:

"Though both subrecipient organizations charged their customers for services, neither used their reimbursements to reduce the amount charged to customers."

TMAC charges customers for the cost of delivering the services. It is not a TMAC practice to use reimbursements to reduce the costs we charge customers. We do not believe that is desired by NIST MEP either. Nothing in the MEP Terms and Conditions or Operating Plan Guidelines stipulate a required pricing structure for MEP services. In TMAC, reimbursement dollars are used to pay for the cost of providing services in rural areas, to offset the inefficiencies of working with the smaller customers, developing leads and other expenses.

Page 2 of the OIG Draft Audit Report continued:

"Thus , the Texas-based manufacturers received no cost benefit from the subrecipients' association with the MEP program..."

Customers of both BMC and ESTI do benefit from federal support of these programs. The reimbursements allow the organizations to expand their capability and improve their services. Without the reimbursement, BMC and ESTI may not focus in areas related to the goals of the MEP.

Page 2 of the OIG Draft Audit Report continued:

"... and the \$190,774 of federal funds received by the subrecipients appears to be a windfall for the subrecipients."

This program is not a windfall for either BMC or ESTI. TMAC is leveraging their programs and in turn they have to meet additional obligations that they would not otherwise have to do. We have already mentioned the activities of Gordon Lohmeyer in promoting TMAC's image, an example of the additional costs incurred by BMC and ESTI to participate in the program. The funds received by BMC are necessary to sustain their operations. Again, based on the desire to keep the service available to Texas Manufacturers, we feel it is reasonable way to allocate the funds.

Page 2 of the OIG Draft Audit Report continued:

"Furthermore, TEEX incurred no costs associated with the claims submitted by its subrecipients, so the \$190,774 reimbursement also appears as a windfall."

TMAC-Statewide, the TMAC region that operates in East Texas does incur expenses to manage its partnerships with BMC and ESTI. More importantly, those partnerships provide resources that allow TMAC-Statewide to serve its entire rural region. This is a difficult area to serve because there are a relatively few number of companies, and a large area to cover.

Companies clustered in northeast Texas are located 100-200 miles away from Statewide's offices in College Station. To serve those rural areas with MEP services is costly. The projects are typically small in scope and rural clientele have limited financial resources to justify the expense without leveraging additional funds accumulated from other MEP activities. In fact, TMAC Statewide brought on Bill Cornett out of his office in Tyler to assist BMC on an ongoing basis with its metrics reporting as well as onsite monitoring of the subrecipient. TMAC Statewide leveraged Cornett's presence in Northeast Texas to assist in business development and identifying other clients in need of TMAC services. Specifically, Cornett was instrumental in providing NIST MEP services to East Texas small manufacturers affected by Hurricane Rita. This ongoing presence in East Texas is a direct result of the funding received from the BMC activities in support of their administrative task burden.

In allocating resources, TMAC operates to maintain a presence across the state. Each region has different challenges. How the federal dollars are allocated is a decision made by the region based on the situation and approved in the operating plan. The federal dollars received by TEEX are not a windfall. They are funds necessary to provide services across their region. The \$190,774 received by TEEX is spent on the MEP program and maintaining a presence in rural areas.

G) Summary Response:

We feel the above summarizes a comprehensive response to alleviate the questioned items raised by the OIG. The Allowability of costs are described in accordance to applicable federal regulations in section A, the reasonableness of these questioned costs are established in the communication between NIST and UTA (section B) and are further validated in TMAC's evaluation and communication with NIST (sections C & D). The costs are also properly managed and monitored by the Prime Agency (section E) and their value added is presented in section C.

The TMAC Partnership and leveraging of existing resources are encouraged by the MEP (section B & C above) and the sustainability or expansion of these services to reach small to medium manufactures is an important objective of the MEP. BMC and ESTI have shown evidence of the expansion of MEP services and they will continue to be evaluated in terms of their effectiveness. If the value added or return on investment is not reaching programmatic goals, there are mechanisms to divert federal resources into other programmatic avenues. Finally, it should be reiterated that value is subjective and is better decided by the Program (NIST and TMAC staff executing the program). The \$1,271,827 in questioned subrecipient costs are allowable expenses and customary in accordance with program objectives.

2. **§ [REDACTED] Claimed For Estimated Costs:**

Excerpt Page 3 from Draft OIG Report:

Estimated charges to internal accounts. TEEEX claimed \$ [REDACTED] under its MEP subaward by allocating costs from 12 different program accounts from June 1, 2006, through August 31, 2006. According to TEEEX officials, the organization conducted an internal "brainstorming session" in June 2006 to determine what percentage of time various TEEEX programs spent dealing with manufacturers in the state of Texas. They consulted with program managers to determine which services benefited manufacturers within the state of Texas, and allocated expenses incurred by those divisions based on estimates. The allocations were based on types of services performed, rather than on work performed for the benefit of specific MEP customers.

TEEEX concluded that 12 program accounts were candidates for allocation and claimed as MEP project costs the respective percentages of total costs in each account during the 3-month period in question. Seven of the 12 accounts were allocated at [REDACTED] percent to MEP cost claims, 4 accounts were allocated at [REDACTED] percent, and 1 account was allocated at [REDACTED] percent.

We asked for documentation supporting how these percentages were derived. Officials told us that no written records had been retained and that all TEEEX personnel involved in developing the percentages had left the organization.

Excerpt Page 3 from Draft OIG Report

We reviewed the UTA's MEP operating plan for the period September 1, 2005, through August 31, 2006, to determine whether the university and NIST were aware that TEEEX would be allocating estimated costs incurred by programs outside its dedicated MEP program. We found no such reference but did find that TEEEX's operating plan budget for this award year showed 13 full-time staff performing MEP services. The operating plan for the subsequent award period provided for only 3 full-time staff. During this period TEEEX experienced a significant departure of MEP dedicated staff and it appears that during the final 3 months of the subaward period ending August 31, 2006, TEEEX allocated \$ [REDACTED] from other TEEEX programs to its MEP subaward to, in part, make up for costs it was unable to claim as staff left its MEP program.

TEEEX Response:

In GY11, TEEEX supplied TMAC-Statewide with 12 Agency Funded Projects that were intended to enhance the TMAC offerings for manufacturers. The plan for this new funding and projects was included in our GY11 Operating Plan and the budget approved by NIST. These efforts explained the increase in FTEs for that period. The projects started in January but were not allocated to TMAC expenses until June after we were able to see what the direct benefit to manufacturers would be. In May, the TMAC team and Project Managers met to determine the proportional benefit of each project as it applied to manufacturers.

The Project Managers determined the percentage of each project's customer base that was a manufacturer in Texas based on the previous five months' activities. These percentages were then applied to the total expenses for each of the projects and reported on our monthly TMAC RFRs beginning in June. The same percentages for each project were used for the remaining two months of the grant year, July and August, based on input and verification from the Project Managers that the prior allocations were accurate.

These activities included, but were not limited to, Technology Commercialization/ Technology Diffusion, Economic Development for smaller communities (of which manufacturing is an important part), Supply Chain issues and training, and Business Continuity, as spelled out in our GY11 Operating Plan. Allocation of cost based on proportional benefit is allowable under 2CFR220 Section C 4d(3). As to the allocation of cost, seven of the twelve program accounts were allocated at one hundred percent. This is not an issue of proportional benefit and should not have been questioned for the reasons as described above.

When we were preparing the budget and plan for GY12, we evaluated the model that we had been using and adjusted that model to better serve the manufacturers of the State of Texas. When we submitted our Strategic plan for GY12-14 the alliances with BMC and ESTI were included in our strategic goals. The partnerships with ESTI and BMC were entered into because they both offer products and services that are unique in the state and in other MEPs across the nation: Emergency training provided by ESTI and product development provided by BMC.

Excerpt Page 4 from Draft OIG Audit Report

▪ Estimated charges for training class. TEEEX claimed \$ [REDACTED] in MEP costs related to a course titled "Basic Economic Development Course," which TEEEX officials described as offering training in how private and public industrial and economic development organizations operate. We asked the basis for claiming this training as an MEP expense given that the content appears to be outside the MEP's scope of providing assistance to Texas manufacturers. TEEEX officials explained that the \$ [REDACTED] claimed equals [REDACTED] percent of costs incurred in providing the training. They arrived at this percentage by estimating that if individuals attending the class do become associated with an industrial or economic development organization, they will spend [REDACTED] percent of their time providing services to manufacturers in the state of Texas.

TEEX's estimated charges in both instances violate 15 CFR, Sec. 14.21, which establishes minimum financial management standards for Department of Commerce financial assistance awards. This regulation, incorporated into TEEEX's subaward, requires that the recipient of financial assistance maintain a system that provides accurate, current, and complete disclosure of the financial results of each federally sponsored award. (See 15 CFR, Sec. 14.21(b)(1).) Cost claims submitted to NIST must reflect actual costs incurred in performing services under the MEP award, not—as in these instances—estimates based on assumed percentages of costs that may have some connection to Texas manufacturers, but were incurred outside the MEP program.

TEEX Response:

The BEDC in question was included due to its direct impact on Texas manufacturers. Manufacturing and its importance to economic development is referenced several times throughout the course manual and TMAC is listed in the manual as a resource for the participants in this course. This course was determined to provide proportional benefits to the eligible class of customers under this grant and costs were divided accordingly, as allowed by 2CFR220.

We agree that we are subject 15 CFR, Sec 14.21 and contend that we are in compliance with that regulation by following 2CFR220 Cost Standards for Educational Institutions, which is also required by the subaward. While 15 CFR Sec 14.21 provides high-level guidance, the detailed guidance 2CFR220 allows for the allocation of cost based on proportional benefit.

3. **§ [REDACTED] Unsupported In-Kind Contributions:**

Excerpt Page 4 from Draft OIG Audit Report

Subrecipient TEEX claimed to have received § [REDACTED] in in-kind contributions for MEP marketing services provided by regional economic development centers. The value of these contributions were based on [REDACTED] percent of one employee's salary paid by three agencies during a 5-month period and recorded as contractual costs by UTA. We questioned this amount because TEEX did not have the following support documentation for the contributions, as required by MEP General Terms and Conditions:

- A list of projects/tasks and dates worked.
- Number of hours.
- Hourly salary rate and allowable fringe benefits paid.
- Certified time and attendance records.

TEEX Response:

The in-kind contributions for the regional economic development centers submitted by TEEX were based on the proportional benefit of one employee at each of the three centers. TEEX reported the expense of three salaried employees based on [REDACTED] % effort for the distribution of MEP information to potential customers of the MEP program. The documentation of the in-kind contribution was captured on a "TMAC Non-Cash Contribution Form" with an after-the-fact certification. This Form includes the percent of time and salary rate, is signed by the contributor after the services were provided, and confirmed by the Regional Director for the benefit having been received and is attached as Exhibit 7.

4. **§6,439 Excessive Indirect Costs Claimed:**

The NIST Approved Budget for the Prime Awardee, UTA, did not exceed the funds budgeted for indirect. Therefore, UTA did not need NIST approval for budget changes at the subrecipient level.

5. **Other Subrecipient Issues:**

- a. **Questioned Indirect Costs:** The reallocation of the budget to move funds from indirect costs to direct costs in the sub-agreement between UTA and TEEX was approved by UTA in Amendment 3 to that agreement (Exhibit 8).
- b. **Excessive Fringe Benefit Costs:** The issue of fringe benefits being mistakenly included twice by BMC in reported expense was identified and disclosed by TEEX (via the mechanism described in section 1 E above) and has been corrected in the August 2007 RFR (Exhibit 9).
- c. **Estimated Program Income:** The issue related to the reporting of program income was identified during the monitoring visit by UTA (described in section 1E above). Program income has been verified from GY11 forward. Program income carryover will reflect the adjusted amounts.
- d. **Improperly recorded Indirect Costs:** TMAC acknowledges this issue and SWRI has already corrected.

UTA QUESTIONED COSTS

1. **§ [REDACTED] in Questioned Lobbying Costs:** UTA was never asked by the OIG to provide an explanation for these questioned costs paid to the American Small Manufacturers Coalition (ASMC). As explained in Exhibit 10, the dues paid by UTA did not support any lobbying activities.

2. **\$ [REDACTED] in Unallowable Other Direct Costs:** These costs were pre-identified by UTA to the OIG as being inadvertently charged to the federal government. Corrections have already been made and are evidenced by the Statement of Account for September 2007; see Exhibit 11.
3. **\$ [REDACTED] in Questioned Indirect Costs:** The Questioned Indirect Costs should be \$ [REDACTED] (\$ [REDACTED],000 times [REDACTED]%). Indirect were never claimed on the \$ [REDACTED] charge. It is UTA's position that the \$ [REDACTED] costs are allowable because the \$ [REDACTED] in ASMC dues is an allowable cost.

SUMMARY:

Of the \$1,633,870 in total questioned costs, UTA concurs only \$ [REDACTED] in UTA Unallowable Other Direct Costs. Moreover, we have already corrected this amount with NIST. We also note that \$ [REDACTED] of the Indirect Costs questioned by the OIG was never claimed by UTA. It is UTA's position that all other questioned costs are in fact allowable and supported by the evidence presented in this document and its exhibits.