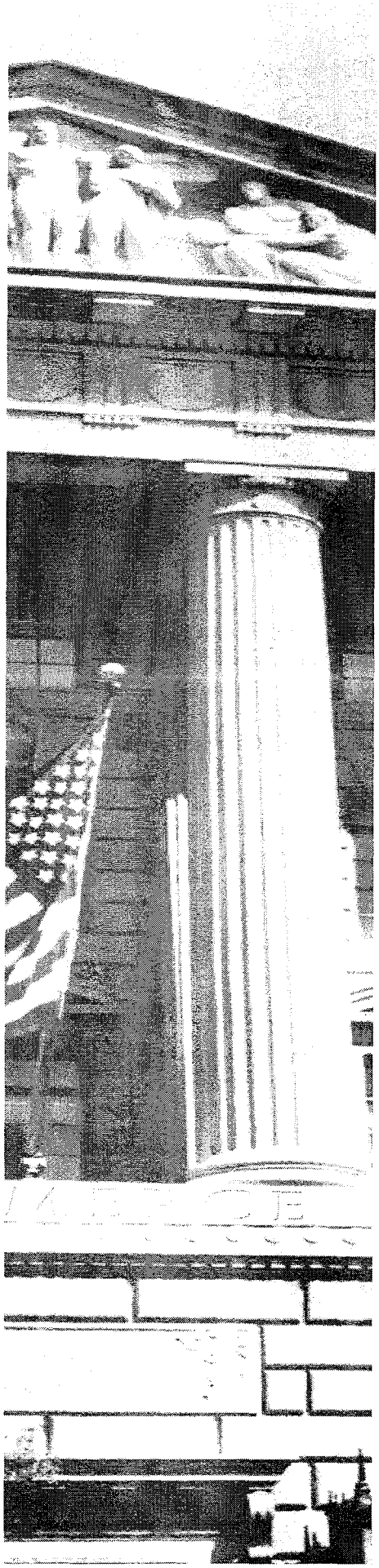

U.S. DEPARTMENT OF COMMERCE
Office of Inspector General

National Institute of Standards and Technology

State of Ohio Department of Development MEP Award 70NANB5H1188

Audit Report No. DEN-18604
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Denver Regional Office of Audits

CONTENTS

INTRODUCTION

In September 2005, the National Institute of Standards and Technology (NIST) awarded Manufacturing Extension Partnership (MEP) Cooperative Agreement No. 70NANB5H1188 to the Ohio Department of Development (ODOD) to continue operating an existing MEP center. The September 2005 award funded the period July 1, 2005, through June 30, 2006. The award was later amended to extend the period an additional 12 months through June 30, 2007. Total estimated project costs for the 24-month award period were $27,272,502, with the federal government's share not to exceed $9,090,834, or 33 percent of allowable project costs.

In May 2007, we initiated an audit of the cooperative agreement to determine whether the recipient complied with award terms and conditions and NIST operating guidelines for MEP centers. The audit covered the 21-month period July 1, 2005, through March 31, 2007, during which time the recipient claimed project costs of $20,269,989 and received federal reimbursements totaling $6,517,538.We examined the costs the recipient claimed to have incurred as well as the cost claims of two grant subrecipients, Manufacturing Advocacy and Growth Network (MAGNET) and TechSolve, Inc.

When we examined the recipient's financial records, we found the total recorded expenditures were actually $[redacted], or $[redacted] more than the project costs reported to NIST. We were able to reconcile the recipient's financial records against the errors in its cost claims to NIST, and we based the audit on the $[redacted] project cost figure because this is the amount the recipient would have claimed had it not included the errors in its financial reports to NIST.

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

We issued a draft report of our findings and recommendations to ODOD on November 30, 2009, and ODOD responded on December 30, 2009. Based on information provided in the response, we adjusted our findings and recommendations as discussed in the respective sections of this report.

FINDINGS AND RECOMMENDATIONS

Our audit questioned $6,781,041 in claimed costs. Of this amount, $6,773,534 was claimed by the two MEP subrecipients, MAGNET ($4,095,476) and TechSolve ($2,678,058). The remaining $7,507 in question was claimed directly by the recipient for employees whose salary and benefit charges were also included in the recipient's indirect costs.

We also found that the subrecipients did not report program income generated under their subawards to the recipient, and consequently the recipient did not report this information to NIST. We determined the two subrecipients generated combined program income of $1,424,266 in excess of amounts needed to fund their nonfederal matching share costs for the year ended June 30, 2006.[1] Neither the recipient nor the subrecipients requested written permission from NIST to retain excess program income to fund future nonfederal project costs, which is required by cooperative agreement terms and conditions as well as federal regulations.

As a result of the questioned costs and excess program income, ODOD received $2,057,121 more than it should have in federal funds. (See page 14 for a summary of this financial audit.)

We also found that the financial reporting system of subrecipient MAGNET did not provide accurate, current, and complete disclosure of the financial results of the MEP subaward. MAGNET also did not maintain adequate property management standards.

I. Questioned Subrecipient Costs

ODOD's recorded MEP project costs for the period July 1, 2005, through March 31, 2007, included $21,333,564 reported by its two subrecipients, MAGNET ($[redacted]) and TechSolve ($[redacted]).

A. MAGNET Questioned Costs

The $4,095,476 in questioned costs claimed by MAGNET consists of $[redacted] in contractual costs, $[redacted] in personnel costs, and $[redacted] in indirect costs.

1. Questioned Contractual Costs

MAGNET reported $[redacted] in contractual costs to ODOD for the period July 1, 2005, through March 31, 2007. MAGNET provided us with documentation for the contractual costs reported to the recipient, as well as documentation for an additional $[redacted] in contractual costs incurred during the period July 1, 2005, through June 30, 2006, that it had not reported to ODOD. We considered these previously unclaimed costs in our determination of accepted contractual costs, which adjusted MAGNET's total contractual costs to $[redacted]. We accepted

[1] Because NIST's requirements for utilizing program income to fund MEP centers' nonfederal matching share costs apply to 12-month operating years, calculation of excess program income must be performed on a full 12-month period; therefore, we did not examine program income generated and applied during the final 9 months of our 21-month audit period.

$[redacted] of MAGNET's contractual costs for the period July 1, 2005, through March 31, 2007.

In analyzing MAGNET's contractual costs, we learned that it was accumulating and reporting all of its costs not reimbursed by ODOD as contractual costs. MAGNET followed this practice regardless of the line item under which the specific costs were recorded in its internal financial records. We reviewed these expenses in their respective cost categories for each award year.

We questioned $518,419 of MAGNET's contractual costs incurred during the period July 1, 2005, through June 30, 2006, in the categories of personnel ($82,108), direct subs ($285,540), and subcontractors[2] ($150,771). MAGNET could not provide supporting documentation to prove these costs were allocable to the MEP subaward. Instead, the costs were accumulated in MAGNET's non-MEP project accounts and supposedly transferred into MEP project accounts, although MAGNET's general ledger does not reflect these transfers. We asked MAGNET officials for additional information regarding individual transactions that were moved from other projects to the MEP accounts, but we were told that MAGNET transferred these cost share amounts by summary, not by detail. MAGNET's only documentation related to the transfers is a spreadsheet showing blocks of transferred costs. MAGNET's spreadsheet contains no detail on specific transactions and does not explain why MAGNET concluded the costs were allocable to its MEP subaward rather than other accounts to which they were charged.

Guidance in OMB Circular A-122[3] requires allowable costs to be adequately documented. Without such documentation, we questioned $518,419 of MAGNET's undocumented transfers to its MEP subaward.

We also questioned $8,563 of travel costs included in MAGNET's contractual costs from July 1, 2005, through June 30, 2006. MAGNET claimed two trips to China, but it did not have prior approval from NIST, which is required by OMB Circular A-122.[4] We also noted that MAGNET staff traveled on foreign air carriers during these trips, which would have required additional approval of the NIST grants officer, pursuant to Department of Commerce *Financial Assistance Standard Terms and Conditions*, Section M.02.d.

MAGNET's contractual cost claim from July 1, 2005, through June 30, 2006, included a total of $[redacted] in personnel overhead ($[redacted]) and general and administrative (G&A) costs ($[redacted]). These costs should have been claimed as indirect costs.

OMB Circular A-122[5] defines direct costs as, "those [costs] that can be identified specifically with a particular final cost objective ..." The overhead and G&A costs included in MAGNET's contractual costs are not directly connected to the MEP subaward. Instead, they were combined with other similar costs and allocated to the MEP subaward and other MAGNET projects by applying the organization's indirect cost rates. OMB Circular A-122[6] states, "[A] cost may not

[2] "Direct subs" and "subcontractors" are categories of costs included in MAGNET's accounting records.
[3] Attachment A, Section A.2.g.
[4] Attachment B, Section 51(e).
[5] Attachment A, Section B.1.
[6] Ibid.

be assigned to an award as a direct cost if any other cost incurred for the same purpose, in like circumstance, has been allocated to an award as an indirect cost." Therefore, we questioned $[redacted] of indirect personnel overhead and G&A costs claimed in the direct cost line item for contractual costs.

Our draft audit report had questioned $123,721 in marketing expenses claimed by MAGNET as contractual costs from July 1, 2005, through June 30, 2006. After reviewing information provided in ODOD's response to the draft audit report, these costs are not being questioned in the final report.

To summarize, MAGNET claimed $[redacted] in contractual costs for the period July 1, 2005, through June 30, 2006. These claims were $377,079 less than the $[redacted] in contractual costs incurred. We accepted $[redacted] of MAGNET's contractual costs for the year ended June 30, 2006, which results in $1,323,634 of the claimed costs being questioned. (See table 1.)

Table 1. MAGNET Contractual Costs, July 2005 through June 2006

Contractual Cost Categories	Costs Incurred	Questioned Costs	Accepted Costs
Personnel	$[redacted]	$ 82,108	$[redacted]
Supplies/Direct Materials	[redacted]	0	[redacted]
Direct Subs	[redacted]	285,540	[redacted]
Equipment	[redacted]	0	[redacted]
Subcontractors	[redacted]	150,771	[redacted]
Travel	[redacted]	8,563	[redacted]
Direct Costs	$[redacted]	**$ 526,982**	$[redacted]
Personnel Overhead	[redacted]	[redacted]	[redacted]
G&A	[redacted]	[redacted]	[redacted]
Indirect Costs	$[redacted]	$[redacted]	[redacted]
Total Based on Financial Records	$[redacted]	$[redacted]	$[redacted]
Less: Incurred Costs Not Claimed to NIST	[redacted]	[redacted]	[redacted]
Total Based on Costs Claimed to State	$[redacted]	**$1,323,634**	$[redacted]

Source: MAGNET documents

We also examined MAGNET's contractual cost claims for the period July 1, 2006, through March 31, 2007, and found MAGNET also transferred subcontractor costs from non-MEP accounts without detail. (MAGNET's general ledger also does not reflect these transfers.) We questioned $[redacted] of subcontractor costs for which MAGNET did not provide evidence that the costs were allocable to the MEP subaward. MAGNET's only documentation related to the

transfers is a spreadsheet showing blocks of transferred costs, which does not meet the OMB Circular A-122[7] requirement that allowable costs be adequately documented.

While reviewing supporting documentation for a sample of travel expenditures, we found receipts for a total of $[redacted] in alcoholic beverages on a travel expense report. OMB Circular A-122[8] states that costs of alcoholic beverages are unallowable. Therefore, we questioned $[redacted] of MAGNET's contractual cost claim in the travel category.

MAGNET's contractual cost claim for the period July 1, 2006, through March 31, 2007, included a total of $[redacted] in personnel overhead ($[redacted]) and G&A costs ($[redacted]). These costs should have been claimed as indirect costs. OMB Circular A-122[9] defines direct costs as, "those [costs] that can be identified specifically with a particular final cost objective..." The overhead and G&A costs included in MAGNET's contractual costs are not directly identifiable with the MEP subaward, but rather were combined with other similar costs and allocated to the MEP subaward and other MAGNET projects by applying the organization's indirect cost rates. OMB Circular A-122[10] states, "[A] cost may not be assigned to an award as a direct cost if any other cost incurred for the same purpose, in like circumstance, has been allocated to an award as an indirect cost." We questioned $[redacted] in indirect personnel overhead and G&A costs claimed in the direct cost line item for contractual costs.

Table 2 summarizes our calculation of the $717,943 in questioned contractual costs claimed by MAGNET during the period July 1, 2006, through March 31, 2007.

Table 2. MAGNET Contractual Costs, July 2006 through March 2007

Contractual Cost Categories	Costs Incurred	Questioned Costs	Accepted Costs
Personnel	$[redacted]	0	$[redacted]
Supplies/Direct Materials	[redacted]	0	[redacted]
Direct Subs	[redacted]	0	[redacted]
Equipment	[redacted]	0	[redacted]
Subcontractors	[redacted]	$[redacted]	[redacted]
Travel	[redacted]	[redacted]	[redacted]
Direct Costs	$[redacted]	$[redacted]	$[redacted]
Personnel Overhead	[redacted]	[redacted]	[redacted]
G&A	[redacted]	[redacted]	[redacted]
Indirect Costs	$[redacted]	$[redacted]	[redacted]
Total	$[redacted]	**$717,943**	$[redacted]

Source: MAGNET documents

[7] Attachment A, Section A.2.g.
[8] Attachment B, Section 3.
[9] Attachment A, Section B.1.
[10] Ibid.

2. *Questioned Personnel Costs*

MAGNET's practice is to include indirect overhead costs allocated to direct salaries as part of its direct personnel cost claims. MAGNET's direct personnel cost claims of $[redacted] for the period July 1, 2005, through March 31, 2007, include $[redacted] of indirect overhead costs. As previously noted, OMB Circular A-122[11] states that direct costs are identifiable with a specific cost objective, while indirect costs are assigned to cost objectives based on an allocation process. The overhead costs included in MAGNET's direct personnel claims were allocated to the MEP subaward and MAGNET's other projects by applying the organization's indirect cost rates. These overhead costs should have been claimed as indirect costs; thus, we questioned $[redacted] of MAGNET's direct personnel costs.

3. *Questioned Indirect Costs*

MAGNET's approved budget listed $[redacted] of indirect costs for the 2-year period of July 1, 2005, through June 30, 2007. As of March 31, 2007, MAGNET had claimed indirect costs of $[redacted], exceeding the approved budget by $19,450. Department of Commerce *Financial Assistance Standard Terms and Conditions*, Section A.05(f), limits allowable indirect costs to the lesser of the line item amount for indirect costs in the approved budget, or the total allocable indirect costs based on an approved indirect cost rate. Therefore, we questioned $19,450 of MAGNET's indirect cost claims that exceed the approved budget.

In our analysis of allowable subaward costs, we considered the overhead and G&A costs that were included in MAGNET's direct contractual and personnel cost claims, as indirect costs. We accepted MAGNET's indirect costs up to the amount in the indirect cost line item in the approved budget. Since MAGNET's indirect costs claimed through March 31, 2007, exceeded allowable indirect costs for the period through June 30, 2007, transferring the indirect costs that were claimed within direct-cost line items to the indirect cost line item did not increase total accepted subaward costs for MAGNET.

B. TechSolve Questioned Costs

TechSolve claimed a total of $3,114,232 in questioned costs, consisting of $[redacted] of indirect costs that were claimed as direct personnel charges and $[redacted] in travel costs. Similar to our findings at MAGNET, TechSolve's direct personnel cost claims also included $[redacted] of overhead costs that should have been claimed in the indirect cost line item. We considered these costs as indirect costs in our analysis of allowable subaward costs. Department of Commerce *Financial Assistance Standard Terms and Conditions*, Section A.05(f), limits allowable indirect costs to the lesser of the line item amount for indirect costs in the approved budget or the total allocable indirect costs based on an approved indirect cost rate. TechSolve's approved budget for indirect costs for the period July 1, 2005, through June 30, 2007, was $[redacted]. As of March 31, 2007, TechSolve had claimed indirect costs of $[redacted] We accepted TechSolve's indirect costs up to the dollar amount of the indirect cost line item in the approved budget, which is $436,174 more than TechSolve's claimed indirect costs.

[11] Attachment A, Sections B.1 and C.1.

1. Questioned Personnel Costs

TechSolve's direct personnel cost claims of $[redacted] for the period July 1, 2005, through March 31, 2007, include $[redacted] of indirect overhead costs. These costs should have been claimed as indirect costs because they are not directly connected to the MEP subaward. Instead, they were combined with other similar costs and allocated to the MEP subaward and other TechSolve projects by applying the organization's indirect cost rates. We questioned the $[redacted] of indirect overhead costs claimed as direct personnel costs.

2. Questioned Travel Costs

We questioned $[redacted] for unallowable alcoholic beverages claimed by TechSolve in the travel category. OMB Circular A-122[12] states that costs of alcoholic beverages are unallowable.

3. Adjustments to Final Report

After adjusting for the acceptance of indirect costs claimed as direct personnel up to the indirect cost line item, questioned costs for TechSolve are $2,678,058.

Our draft audit report had questioned $883,898 of in-kind contributions claimed by TechSolve. After reviewing information provided in ODOD's response to the draft audit report, these costs are not questioned in the final audit report.

C. Recipient's Response

ODOD submitted its response to our draft audit report on December 30, 2009. See appendix B for ODOD's response, which separately addressed 13 instances of questioned costs and excess programs.

The majority of costs questioned in the draft audit report involved MAGNET's and TechSolve's practices of reporting much of their respective indirect costs within direct-cost line items. ODOD's response included proposed budget revisions for both MAGNET and TechSolve. The proposed budgets redistribute costs previously reported in the direct personnel and contractual line items as indirect costs. Based on the proposed budget revisions, ODOD requests the grants officer accept a total of $[redacted] in costs questioned in the draft audit report, computed as follows:

- $[redacted] claimed as MAGNET contractual costs,
- $[redacted] claimed as MAGNET personnel costs,
- $19,450 claimed as MAGNET indirect costs, and
- $[redacted] claimed as TechSolve personnel costs.

[12] Attachment B, Section 3.

ODOD's response requests the grants officer accept the $[redacted] (fiscal year 2006) and $[redacted] (fiscal year 2007) in MAGNET contractual costs that were questioned in draft audit report as not allocable to the MEP award. The response states that these costs were accumulated in MAGNET's Product Development Group, a division of MAGNET jointly funded by MEP and a state grant program. The response maintains that the MEP and the state grant program have similar purposes and the services of the Product Development Group are consistent with the goals of both funding programs.

MAGNET allocated Product Development Group between the MEP award and the state grant "for cost share reporting purposes."[13] However, the allocations were tracked on a separate spreadsheet and were not reflected in MAGNET's general ledger. Although the response states ODOD's belief that this was "a legitimate technique for tracking expenditures,"[14] MAGNET will provide greater transparency in the future by identifying Product Development Group costs that directly support MEP clients.

ODOD requested the grants officer accept $[redacted] of MAGNET marketing expenses questioned in our draft audit report. ODOD's response included a summary of MAGNET's MEP-related marketing activities and states that these activities were included in the MEP operating plan approved by NIST.

ODOD's response also requests the grants officer retroactively approve $[redacted] in travel costs, which we questioned in our draft audit report because the costs were related to overseas travel that had not been approved in advance by the grants officer, as required by MEP award terms and conditions. The response does not dispute that the overseas travel was not approved, but also states ODOD's belief that the grants officer would have approved the travel in advance, had MAGNET requested prior approval.

The response did not dispute the draft audit report's finding of $[redacted] in questioned MAGNET travel costs related to purchases of alcoholic beverages.

ODOD's response requested the grants officer accept the total $[redacted] claimed by TechSolve for in-kind contribution of software licenses it received from a third party. ODOD cited a letter provided to TechSolve by the donor stating the fair market value of the licenses was more than $[redacted] on the date of donation. The $[redacted] claim represented the portion of TechSolve's 5-year amortization of the license value that fell within the audit period.

The response did not dispute our draft report's finding of $[redacted]n questioned TechSolve travel costs related to purchases of alcoholic beverages.

ODOD did not dispute the draft report's finding that the $[redacted] of direct salary and benefit costs were incorrectly allocated to the MEP award.

[13] ODOD draft report response, p. 2.
[14] ODOD draft report response, p. 2.

D. OIG Comments

We reviewed the proposed budget revisions for MAGNET and TechSolve, as submitted with ODOD's response to the draft audit report. Although the methodology for removing indirect costs from budgeted direct-cost line items appears reasonable, we were unable to reconcile the proposed costs using MAGNET's and TechSolve's indirect cost rates. For MAGNET, proposed indirect costs were significantly less than what would be allowable based on the organization's rates. (See table 3.) Conversely, proposed indirect costs for TechSolve were slightly higher than allowable based on TechSolve's approved rates. (See table 4.)

Table 3. MAGNET Proposed Indirect Costs, July 2006 through March 2007

	ODOD Proposed	OIG Computed	Difference
July 2005 - June 2006	$ [redacted]	$ [redacted]	($1,262,935)
July 2006 - June 2007	[redacted]	[redacted]	(950,448)
Total	$ [redacted]	$ [redacted]	($2,213,383)

Source: ODOD draft report response and OIG calculation

Table 4. TechSolve Proposed Indirect Costs, July 2006 through March 2007

	ODOD Proposed	OIG Computed	Difference
July 2005 - June 2006	$ [redacted]	$ [redacted]	$108,938
July 2006 - June 2007	[redacted]	[redacted]	9,216
Total	$ [redacted]	$ [redacted]	$118,154

Source: ODOD draft report response and OIG calculation

Costs related to our findings that MAGNET's and TechSolve's claims included indirect costs in direct-cost line items, causing actual indirect costs to exceed approved budgets, remain questioned in the final audit report. As stated above, neither subrecipient's proposed indirect costs agreed with amounts calculated based on each organization's indirect cost rates. Furthermore, ODOD's response did not include evidence that MAGNET's and TechSolve's proposed budget modifications had been approved. The amounts will remain questioned until budget modifications that appropriately redistribute indirect costs are approved, as required by Title 15 of the Code of Federal Regulations (CFR), Section 14.25(c)(5).

While ODOD's response provided copies of MAGNET financial records related to the questioned Product Development Group allocations, we were unable to determine the allowability of the transactions. The records detail only the specific costs MAGNET claims to be allocable to the MEP award, without descriptive detail supporting their allowability or distinguishing them from costs not allocated to MEP. Furthermore, the MAGNET cost records did not reconcile with amounts claimed. For MAGNET fiscal year 2006, the claimed amount of transfers was $[redacted], while the cost details provided in ODOD's response totaled $[redacted]. For fiscal year 2007, the documents provided with the response account for $[redacted] of alleged allocations to the MEP award, while the amount claimed through March 31, 2007, was $[redacted]

Based on (1) the continuing lack of detail relating specific costs to specific MEP tasks, (2) lack of evidence to distinguish claimed MEP costs from other costs within the Product Development Group, and (3) inconsistencies between amounts claimed and documentation provided in the response to the draft audit report, we continue to question the claimed $[redacted] allocation of MAGNET Product Development Group costs to the MEP award.

We continue to question $[redacted] of MAGNET travel costs related to overseas travel for which the recipient did not receive prior grants officer approval. Although ODOD's response stated its belief that the grants officer would have approved the travel if requested, the trip remains unapproved and in violation of the applicable regulation.

ODOD did not dispute $[redacted] of questioned travel expenses for purchases of alcoholic beverages by MAGNET ($[redacted]) and TechSolve ($[redacted]). The recipient also did not dispute $[redacted] in questioned ODOD salaries and benefits that were incorrectly allocated to the award. These costs remain questioned in the final audit report.

We now accept $[redacted] in MAGNET marketing costs and $[redacted] of TechSolve in-kind contributions.

II. Excess Program Income

We found that the two subrecipients did not report program income generated under the subawards. As a result, ODOD did not report some of its program income to NIST.

Program income, as defined in 15 CFR, Section 14.2(aa), is revenue generated by work performed under a financial assistance award. Tuition or other fees paid by manufacturers who attend training classes and fees paid for services provided by MEP staff or contractors are two common sources of program income in MEP centers. NIST generally allows MEP centers to use program income to fund the nonfederal share of project costs.

We analyzed MAGNET's and TechSolve's accounting records for the period July 1, 2005, through June 30, 2006, and found the two subrecipients had generated a combined program income of $1,424,266 in excess of what was required to pay the nonfederal share of project costs.[15] MAGNET generated $[redacted] of the excess and $[redacted] was attributed to TechSolve.

[15] Because NIST's requirements for utilizing program income to fund MEP centers' nonfederal matching share costs

Our calculations of excess program income are based on each center's requirements for nonfederal cash outlays after accounting for state grant funds and questioned project costs. If any of the costs questioned in this report are subsequently accepted by NIST, the calculated amount of excess program income must be adjusted. (See tables 5 and 6 for our calculations of program income by both subrecipients.)

Table 5. MAGNET Program Income Analysis, July 1, 2005, through June 30, 2006

Costs Incurred	$[redacted]	100.00%
Costs Questioned	2,701,786	[redacted]
Costs Accepted	[redacted]	
Nonfederal Cost Share Ratio in Approved Budget[a]	x 67.47%	
Nonfederal Share of Accepted Costs	$[redacted]	
State Grant Funds Provided	1,000,000	
Cash Requirement for Program Income	$[redacted]	
Program Income Associated with Accepted Costs[b]	[redacted]	
Excess Program Income	$[redacted]	

Source: OIG analysis

[a] The proposed nonfederal share in MAGNET's approved budget, $[redacted], is 67.47 percent of total budgeted costs of $[redacted].

[b] MAGNET's financial records indicate it earned $[redacted] in program income during the year ended June 30, 2006. We reduced total program income by a factor of [redacted] percent to exclude from our calculation the program income associated with costs questioned in this report.

apply to 12-month operating years, we did not examine program income generated and applied during the final 9 months of our 21-month audit period.

Table 6. TechSolve Program Income Analysis, July 1, 2005, through June 30, 2006

Costs Incurred	$[redacted]	100.00%
Costs Questioned	2,111,682	[redacted]
Costs Accepted	[redacted]	
Nonfederal Cost Share Ratio in Approved Budget[a]	x 67.47%	
Nonfederal Share of Accepted Costs	$[redacted]	
State Grant Funds Provided	1,000,000	
Cash Requirement for Program Income	$[redacted]	
Program Income Associated with Accepted Costs[b]		
Excess Program Income	$[redacted]	

Source: OIG analysis

[a] The proposed nonfederal share in TechSolve's approved budget, $[redacted], is 67.47 percent of total budgeted costs of $[redacted].
[b] TechSolve's financial records indicate it earned $[redacted] in program income during the year ended June 30, 2006. We reduced total program income by a factor of [redacted] percent to exclude from our calculation the program income associated with costs questioned in this report.

Our draft audit report stated that MAGNET's excess program income was $[redacted] and TechSolve's was $[redacted] Upon accepting the costs questioned in the draft report, we adjusted the calculations to the amounts shown above.

ODOD's MEP operating plan budget projected that MAGNET and TechSolve would generate program fees of $[redacted], but it indicated that all program income would be expended during the operating year. We reviewed the operating plan for the year ended June 30, 2006, to determine whether the center advised NIST that it would be generating program income in excess of its nonfederal matching share requirements.

In May 2006, NIST issued a universal amendment to all MEP cooperative agreements that were effective as of July 1, 2005, incorporating revised *MEP General Terms and Conditions* (April 2006), into all active awards. Section 15.F, "Excess Program Income," states:

> Program income in excess of what is required in an operating year to meet the non-federal share portion of the award may be carried over to the subsequent funding period, *with the prior written approval of the grants officer* [emphasis added], for the same purpose of the non-federal share of the annual operating budget.

We examined the terms and conditions of the cooperative agreement and the subaward agreements with MAGNET and TechSolve and found no prior approval by the grants officer. When recipients are allowed to use program income to fund the nonfederal share of program expenditures, 15 CFR, Section 14.24(c), requires amounts in excess of any limits stipulated to be deducted from total allowable project costs in computing the amount of federal funds for which

the recipient qualifies. We reduced total accepted project costs for each subrecipient by its respective excess program income in computing the amount of federal funds it should have received during the year ended June 30, 2006.

A. Recipient's Response

ODOD did not agree with OIG's calculation of MAGNET's program income. According to ODOD's response, the total program income stated in the draft report ($[redacted]) includes $[redacted] of revenue generated by MAGNET's Product Development Group that was related to the group's non-MEP portion of expenses. When this amount is deducted from program income stated in the draft audit report, adjusted MEP program income would be $[redacted]. Because the $[redacted] reduction in program income exceeds the $[redacted] excess program income in our draft audit report, ODOD asserts that MAGNET did not generate excess program income.

ODOD's response explains that the methodology employed by TechSolve to calculate its program income indicated it had no excess. According to ODOD, NIST did not provide guidance on how MEP centers were supposed to calculate excess program income. TechSolve, in good faith, developed a process that eliminated revenue and expenses from non-MEP activities from total, firm-wide operations. Based on this methodology, TechSolve determined total MEP expenses exceeded MEP revenue by about $[redacted] in fiscal year 2006; thus, by TechSolve's calculations there was no excess program income. In the absence of NIST guidance for calculating excess program income, ODOD requests the grants officer accept TechSolve's determination that it had no excess program income for fiscal year 2006. TechSolve will revise its process for computing program income if given specific guidance from NIST.

B. OIG Comments

ODOD responded to our draft audit report findings related to each subrecipient's excess program income, but did not comment on its failure to report any program income to NIST, irrespective of determinations of excess program income.

MAGNET provided a spreadsheet to the auditors during fieldwork stating that its total MEP program income for fiscal year 2006 was $[redacted]. ODOD's response, while claiming that this amount includes $[redacted] of non-MEP revenue, did not provide details of which revenue elements to exclude, nor did it explain why its calculation of program income differs from information we obtained directly from MAGNET during our fieldwork. It is also important to note that our calculation of program income excludes a pro rata share of revenue related to MAGNET's MEP cost claims that were questioned in our draft audit report. As summarized in table 5, we determined $[redacted] of MAGNET's reported program income was related to the portion of MEP cost claims accepted. Because we continue to question the transfer of Product Development Group costs included in MAGNET's cost claims, our adjustment accounts for the group's revenue before determining excess program income.

The final report reduces MAGNET's excess program income from the $[redacted] included in the draft report to $[redacted]. The reduction is the result of our acceptance of MAGNET marketing costs that had been questioned in the draft audit report.

In response to ODOD's and TechSolve's statement that NIST did not provide guidance on calculation of excess program income, we point to 15 CFR, Section 14.2(aa), which defines program income as "gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award." TechSolve's methodology is not in agreement with the regulation in that it appears to define program income based on a netting of total expenses against total revenue, rather than gross revenue generated as a result of program expenditures. ODOD did not challenge our determination that TechSolve's total MEP program income, before adjusting for questioned costs, was $[redacted] for fiscal year 2006. We maintain our methodology for calculating excess program income is in accordance with the applicable regulations and MEP award terms and conditions.

The final audit report reduces TechSolve's excess program income from the $[redacted] included in the draft audit report to $[redacted]. The reduction is the result of acceptance of TechSolve's in-kind contribution claims that had been predominately questioned in the draft audit report.

As demonstrated by the adjustments to our calculations upon our accepting costs that had been questioned in the draft report, any reinstatement of questioned costs by the grants officer will also result in a need to recalculate excess program income.

III. Internal Control Issues

Our draft report included an adverse finding and associated recommendation related to MAGNET's internal accounting controls. Approval of the proposed restructuring of MAGNET's budget to redistribute indirect costs from within direct-cost line items will alleviate our concerns about the accuracy of MAGNET's financial reporting. Furthermore, ODOD's response to our draft report included evidence of a defense contract audit agency's review of MAGNET's accounting system. The audit agency reported no deficiencies. Therefore, we removed the finding and recommendation related to MAGNET's internal controls from the final audit report.

IV. Recommendation

We recommend the chief of NIST Grants and Agreement Management Division disallow $6,781,041 in questioned costs; deduct $1,424,266 in excess program income from total accepted project costs from ODOD's subrecipients; and recover $2,057,121 of excess federal funds.

SUMMARY RESULTS OF FINANCIAL AUDIT

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

Federal Funds Disbursed		$6,517,538
Costs Incurred	$21,587,896	
Less Questioned Costs	6,781,041	
Costs Accepted	14,806,855	
Less Excess Program Income	1,424,266	
Basis for Federal Share	13,382,589	
Federal Cost Sharing Ratio	x 33.33%	
Federal Funds Earned		4,460,417
Refund Due the Government		$2,057,121 [a]

[a] The refund due includes excess disbursements of federal funds in the amounts of $1,141,150 to MAGNET and $848,402 to TechSolve.

APPENDIX A: OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of our audit was to determine whether ODOD reported costs to NIST, including costs incurred by subrecipients, that were reasonable, allocable, and allowable in accordance with applicable federal cost principles, cooperative agreement terms and conditions, and NIST policy, including *MEP Operating Plan Guidelines*.

The audit scope included a review of costs claimed by ODOD during the award period July 1, 2005, through March 31, 2007. We performed our fieldwork during May, June, and August 2007 at ODOD in Columbus, Ohio, and MAGNET in Cleveland. We analyzed TechSolve's subaward without a site visit.

To meet our objective, we

- interviewed ODOD officials,
- reviewed NIST award documents,
- examined ODOD's financial records, and
- interviewed officials and examined financial records of subrecipients MAGNET and TechSolve.

We also reviewed the following laws, regulations, and award requirements, and found instances of noncompliance, as discussed in this report:

- Office of Management and Budget Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*
- Office of Management and Budget Circular A-122, *Cost Principles for Nonprofit Organizations*
- Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*
- 15 CFR, Part 14, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, Other Non-Profit, and Commercial Organizations*
- 15 CFR, Part 24, *Uniform Administrative Requirements for Grants and Agreements to State and Local Governments*
- Department of Commerce *Financial Assistance Standard Terms and Conditions*, *MEP General Terms and Conditions*
- cooperative agreement *Special Award Conditions*

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

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

We obtained an understanding of the management controls of ODOD and its subrecipients by interviewing ODOD and subrecipient officials; examining policies, procedures, and each entity's most recent single audit report; and reviewing written assertions of ODOD and subrecipient officials. Our report contains specific recommendations to address a control deficiency identified at subrecipient MAGNET.

The audit was conducted under the authority of the Inspector General Act of 1978, as amended, and Department Organization Order 10-13, dated August 31, 2006, and in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX B: AGENCY RESPONSE TO DRAFT REPORT

Ohio | Department of Development

Ted Strickland, Governor
Lee Fisher, Lt. Governor

Lisa Patt-McDaniel, Director

December 30, 2009

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

Dear Ms. Barton:

In response to draft audit report number DEN-18604 concerning the Manufacturing Extension Partnership (MEP) cooperative agreement 70NANB5H1188, the Ohio Department of Development (ODOD) respectfully submits this report on behalf of the State of Ohio and its subrecipients, MAGNET and TechSolve. We challenge several of the findings of questioned costs.

We have responded in detail to each instance of questioned costs and excess program income in the draft audit report. We provide the rationale and proposed resolutions for $10,127,031 dollars of the questioned costs. We accept the draft audit findings related to the remaining questioned costs of $7,539.

We look forward to receipt of the final audit report. If you should have questions regarding the financial aspect of our response, please contact:

Jon Rayer, Fiscal Officer
Ohio Department of Development
77 South High Street, 25th Floor
Columbus, OH 43216
614-466-[redacted]
[redacted]@development.ohio.gov

77 South High Street
P.O. Box 1001
Columbus, Ohio 43216-1001 U.S.A.

614 | 466 2480
800 | 848 1300
www.development.ohio.gov

Questions regarding the technical aspects of Ohio MEP Program should be addressed to:

Beth Colbert, Program Administrator
Ohio Department of Development
77 South High Street, 25th Floor
Columbus, OH 43216
614-644-[redacted]
[redacted]@development.ohio.gov

Sincerely,

John Griffin
Director
Technology & Innovation Division
Ohio Department of Development

Enclosure

Cc (w/o encl): Laura Cesario, Chief, NIST Grants and Agreements Management Division
CC (w/ encl): Candace Jones, Chief Legal Counsel, Ohio Department of Development
Gary Conley, President, TechSolve
Dan Berry, President, MAGNET
Jon Rayer, Fiscal Officer, ODOD
Beth Colbert, Program Manager, ODOD

Ohio | **Department of Development**

Ted Strickland, Governor **Lisa Patt-McDaniel**, Director
Lee Fisher, Lt. Governor

Ohio Department of Development Response to Draft Audit Report # DEN-18604 United States Department of Commerce, Office of Inspector General

On November 30, 2009, the Ohio Department of Development (ODOD) received draft audit report number DEN-18604 from the United States Department of Commerce, Office of Inspector General. The report details preliminary findings from a May 2007 audit of National Institute of Standards and Technology (NIST) Manufacturing Extension Partnership (MEP) Cooperative Agreement No. 70NANB5H1188 for the period July 1, 2005 through March 31, 2007. During the time period covered by the audit, ODOD served as the recipient of funding awarded by NIST MEP. As part of the agreed upon operational plan, ODOD awarded the bulk of the funding to two subrecipient organizations, the Manufacturing Advocacy and Growth Network (MAGNET) and TechSolve, Inc. MAGNET provided NIST MEP-sponsored services and programs primarily throughout northern Ohio, and TechSolve, Inc. provided NIST MEP-sponsored services and programs primarily throughout southern Ohio.

The draft audit report includes 13 instances of questioned costs and excess program income related to ODOD and its subrecipients. This document serves as ODOD's response to the preliminary findings in DEN-18604.

The following narrative and supporting Attachments provide detailed responses to the questioned costs and excess program income identified in the draft audit report, and presents evidence to support ODOD's position that some questioned costs should be considered allowable. Specifically, ODOD disputes $10,127,031 in questioned costs and excess program income, and respectfully requests that the ODOD proposed resolutions be accepted.

1. Transfer of Contractual Costs - MAGNET

The draft audit report's preliminary findings indicated that $[redacted] ($[redacted] in FY06 and $[redacted] in FY07[1]) of MAGNET's contractual costs was found not to be directly

[1] Items identified in the narrative as applicable to FY06 refer to the period July 1, 2005 through June 30, 2006, and those identified in the narrative as applicable to FY07 refer to the period July 1, 2006 through March 31, 2007.

allocable to the MEP subaward. The audit report states that MAGNET moved these costs from a non-MEP account into the MEP account.

The non-MEP account referred to in the draft audit directly corresponds with MAGNET's Product Development Group, a division of MAGNET that is jointly funded by the NIST-MEP subaward and by an Ohio Edison Program grant. All of the activities conducted by the MAGNET Product Development Group are promoted by NIST as a critical MEP offering and by the Ohio Edison Program as a critical element of technology-based economic development. The MAGNET Product Development Group provides services to small- and medium-sized manufacturers in a manner consistent with both the intended purpose of the MEP subaward and the intended purpose of ODOD's Edison program grant funding. Therefore, because the Product Development Group is jointly funded by both the federal and state programs for the same purpose, MAGNET accumulated costs for the Product Development Group and subsequently allocated those costs for cost share reporting purposes between Edison and MEP activities.

While MAGNET maintained a separate spreadsheet that detailed the pool of expenses for the Product Development Group, MAGNET originally allocated undifferentiated costs from the Product Development Group expenses to satisfy the MEP subaward cost-share requirement; MAGNET did not make individual transfers within its general ledger to correspond to the expenses allocated from the Product Development Group. While MAGNET's approach was a legitimate technique for tracking expenditures, MAGNET has addressed the audit issue and provided greater transparency by identifying specific costs incurred by the Product Development Group that directly supported MEP clients. The identified costs are included as **Attachment A**. This action corrects the issue identified in the draft audit, as specific costs are now allocated directly to the MEP subaward.

Proposed Resolution: We respectfully request that **Attachment A** be accepted as the resolution regarding the $[redacted] in questioned contractual costs as specific costs are now clearly allocated directly to the MEP subaward.

2. Marketing Expenses – MAGNET

The draft audit report's preliminary findings indicated that $[redacted] in costs for marketing materials is unallowable due to allocation across multiple activities and lack of prior approval.

During the time period in question, MAGNET undertook the following marketing activities to support the MEP program in northern Ohio:

- Content, graphics and daily updating for MAGNET's two websites:
  - www.magnetwork.org and www.magnetpdd.org
- Content, graphics and maintenance of MAGNET's e-marketing program, including the following newsletters:
  - MAGNET Insider (a monthly events calendar)

- Manufacturing Roundup (bimonthly news on advanced manufacturing topics)
- MAGNET Public Policy News (quarterly news on local, regional, state and federal legislation/policy)
- As needed email blasts to promote MAGNET events, programs and initiatives.

- Content and graphics for MAGNET print materials, such as sales collateral, brochures, flyers, and the print version of the Manufacturing Roundup.
- Content, promotion and registration for MAGNET events, workshops, seminars.
- Creation, placement and budgeting for print, radio, TV and internet advertising.
- An ongoing media relations campaign that includes contacts at print, radio, TV and internet outlets throughout Northern Ohio.
- Creation of client "success stories" that are required by NIST/MEP.

All of these marketing activities promote and support the MEP mission and are part of the MEP operating plan. Furthermore, MAGNET accumulates direct marketing costs in total under the MEP program using its project cost system. In its project cost system, any project number that begins with the letter G is associated with the MEP program. The marketing department uses project number G40103, and all of the MEP-related marketing costs were accumulated under this project number. Recognizing that the marketing department does some support for MAGNET's Business Incubator, ten percent of the marketing costs are allocated to that program. The percentage of costs attributable to the Business Incubator marketing is reviewed semi-annually and is modified as required. This approach results in a reasonable allocation of the marketing costs out of the MEP program based on the business activities of MAGNET.

With respect to the preliminary audit finding that MAGNET lacked prior approval for marketing activities, marketing activities were approved as a program expense in the approved operating plan. Specifically, MAGNET's original budget narrative, as approved, identifies personnel to perform marketing activities.

Proposed Resolution: We respectfully request that marketing activities are considered to have received prior approval and that $[redacted] of marketing costs be determined to be allowable under the MEP program.

3. Travel Expenses – MAGNET

The draft audit report's preliminary findings identify $[redacted] in questioned travel costs related to two trips to China for which MAGNET did not have prior approval from NIST.

We do not dispute this finding; there was no prior approval for the trip. It is important to note, however, that this was the first time MAGNET had an employee travel overseas for MEP-related business, the trip was with a group of potential MEP clients and subject matter experts on Chinese trade (exporting and importing), and foreign air carriers were

used only as needed to accomplish the mission of the trip. MAGNET's goal for the trip was to assist northern Ohio's manufacturing base enter the Chinese market.

Proposed Resolution: Had MAGNET requested prior approval, we believe NIST would have recognized the China effort as supportive of MEP activities and that the request for travel would have been granted. Therefore, while we do not dispute that prior approval was not sought appropriately, we respectfully request that the circumstances be taken into account and that approval now be granted retroactively which would allow the $[redacted] in questioned travel costs to be considered allowable costs.

4. Indirect Costs Reported as Contractual Costs – MAGNET

The draft audit report's preliminary findings indicated that $[redacted] ($[redacted] in FY06 and $[redacted] in FY07) of personnel overhead and general and administrative (G&A) costs were reported on the direct contractual line item for MEP cost-share. The draft audit report further states that the indirect costs were combined with other similar costs and allocated to the MEP subaward.

MAGNET developed its budget under the assumption that all cost-share related expenses, regardless of type, were to be reported as a contractual expense. As a result, MAGNET incorrectly reported personnel overhead and G&A as direct costs (contractual expense) instead of reporting them as indirect costs. We do not dispute the characterization of personal overhead and G&A as indirect expenses.

The audit report further states that the indirect costs were combined with other similar costs and allocated to the MEP subaward. This is an incorrect statement. The indirect costs in question were not combined with direct costs in the general ledger; instead, they were combined on the billing statement only. Therefore, while we agree that the indirect costs should have been reported separately, the audit finding needs to be clarified as these questioned costs were never combined with direct costs in the general ledger.

Proposed Resolution: We propose that MAGNET be allowed to re-report its cost-share expenses for the audit period to identify them in the correct cost line items, and that the budget for the period be amended to correspond to the revised reporting. **Attachment B** contains the proposed revised budgets for FY06 and FY07 for MAGNET that would account for the accurately defined direct and indirect costs. We respectfully request acceptance of this revised budget, which would allow the $[redacted] of personnel overhead and general and administrative (G&A) costs to be considered allowable costs.

5. Alcoholic Beverage Expenses –MAGNET

The draft audit report's preliminary findings identify $[redacted] in questioned costs related to alcoholic beverage expenses.

MAGNET has procedures in place to segregate any alcoholic beverages out in expense reports so they can be eliminated from cost match reporting or from regulatory indirect

rate calculations. This procedure is, for the most part, highly effective. These particular expenses were missed in the elimination process of compiling cost figures.

Proposed Resolution: We do not dispute these findings.

6. Personnel Costs – MAGNET

The draft audit report's preliminary findings indicated that $[redacted] of personnel overhead and general and administrative (G&A) costs were reported in the direct personnel line item of the MEP subaward. The draft audit report further states that the indirect costs were combined with other similar costs and allocated to the MEP subaward.

This issue is similar to the finding discussed under Item #4 above. MAGNET assumed that all personnel costs, direct and indirect, should be reported in the personnel line item. The audit report correctly identifies personnel overhead and G&A expenses as indirect costs, and MAGNET mistakenly reported these costs as direct costs. As with the costs discussed under Item #4 above, the expenses were accumulated costs, and as such are allowable expenses. The personnel overhead is applied to direct labor charges, and the G&A is applied to total direct costs.

MAGNET's budget for the audit period, as approved by NIST as part of the Ohio MEP Operational Plan, reflects that this issue is a reporting matter only and was not a result of overspending by MAGNET for indirect costs. The total budget for personnel is an amount sufficient to cover both the direct personnel salary costs and the personnel overhead and related G&A charges incorrectly reported on the personnel line item.

The draft audit report states that the indirect costs were combined with other similar costs and allocated to the MEP subaward. This is an incorrect statement. The indirect costs in question were not combined with direct costs in the general ledger; instead, they were combined on the billing statement only. Therefore, while we agree that the indirect costs should have been reported separately, the audit finding needs to be clarified as these costs were never combined with direct costs in the general ledger.

Proposed Resolution: It is proposed that MAGNET be allowed to re-report its expenses for the audit period to identify personnel overhead and G&A in the correct cost line items, and that the budget for the period be amended to correspond to the revised reporting. **Attachment B** contains the proposed revised budgets for FY06 and FY07 for MAGNET that would account for the accurately defined direct and indirect costs. We respectfully request acceptance of this revised budget, which would allow the $[redacted] of personnel overhead and general and administrative (G&A) costs to be considered allowable costs.

7. Indirect Costs That Exceeded Approved Budget – MAGNET

The draft audit report's preliminary findings identified $19,450 in indirect costs in excess of MAGNET's approved budget for the cumulative audit period.

Proposed Resolution: **Attachment B** contains the proposed revised budgets for FY06 and FY07 for MAGNET that would account for the accurately defined indirect costs. We respectfully request acceptance of this revised budget, which would allow the $19,450 in indirect costs in excess of MAGNET's approved budget for the cumulative audit period to be considered allowable costs.

8. Personnel Costs -- TechSolve

The draft audit report's preliminary findings indicated that [redacted] of indirect overhead costs was reported in the direct personnel line item costs to the MEP subaward.

The audit report correctly identifies these expenses as indirect costs, and TechSolve mistakenly reported these costs as direct costs. This issue is similar to Item #6 above. TechSolve has three cost components that are applied to its direct costs: fringe benefits, overhead, and G&A. The fringe benefit rate and overhead rate are applied to any direct labor charged to a project. The G&A rate is applied to the total overall direct expense amount and calculated overhead and fringe benefit amounts.

TechSolve reported only G&A on the indirect line, not overhead, because the description on that line of the reporting form was labeled "G&A." TechSolve reported overhead as part of the personnel line item of the report, because the personnel overhead and fringe benefits cost was based on the direct labor of the project. TechSolve disclosed as part of its budget detail for those two fiscal years that the personnel line item included the operating department's "overhead costs" using the approved rate from the DOC. The following description is taken from the May 27, 2005 State of Ohio MEP Operating Plan (emphasis added):

> "Techsolve, along with its indirect rate (G&A), also submits an operating department "Overhead Rate" to the Indirect Cost Rate Unit of the Department of Commerce. ***The Overhead Rate is included as a part of the Personnel Line Item that contains,*** [redacted] The Personnel line therefore includes the total direct cost of providing each unit of labor for the services provided. Using this methodology as approved by the Inspector Generals office, only those costs associated with each client, grant or government contract are charged for the costs associated with providing that service and nothing more." (pg. 38)

TechSolve has revised its budget, contained in **Attachment C,** to correctly identify direct and indirect costs that were applied to the MEP subaward. This corrects the issue identified in the audit report.

Proposed Resolution: It is proposed that TechSolve be allowed to re-report its cost-share expenses for the audit period to correctly identify direct and indirect costs that were applied to the MEP subaward, and that the budget for the period be amended to correspond to the revised reporting. **Attachment C** contains the proposed revised budgets for FY06 and FY07 for TechSolve that would account for the accurately defined direct and indirect costs. We respectfully request acceptance of this revised budget, which would allow the $[redacted] of indirect overhead costs to be considered allowable costs.

9. Other Direct Costs - TechSolve

The draft audit report's preliminary findings identified $943,898 of TechSolve's costs as questioned "other direct costs."

The [redacted] with a fair market value of [redacted] as evidenced by a letter dated December 19, 2002 from the vendor, [redacted] to TechSolve, included as **Attachment D**. The value of the software to TechSolve is the cost TechSolve would have paid [redacted] in a typical license transaction. Instead of paying the vendor for the software license, however, the vendor was willing to provide the software to TechSolve in [redacted] This arrangement in which [redacted] was structured as a special and [redacted] continuing for a 5-year period. Therefore, the value of a standard membership is not a reasonable measure for the [redacted] membership. TechSolve appropriately reported the software according to its fair market value.

Proposed Resolution: We respectfully request acceptance of the fair market value ascertained by the vendor, [redacted] as sufficient evidence that the $943,898 of TechSolve's other direct costs be considered allowable costs.

10. Alcoholic Beverage Expenses – TechSolve

The draft audit report's preliminary findings identify $[redacted] in questioned costs related to alcoholic beverage expenses.

TechSolve has procedures in place to segregate any alcoholic beverages out in expense reports so they can be eliminated from cost match reporting or from regulatory indirect rate calculations. This procedure is, for the most part, highly effective. These particular expenses were missed in the elimination process of compiling cost figures.

Proposed Resolution: We do not dispute these findings.

11. Excess Program Income - MAGNET

The draft audit report's preliminary findings identify that MAGNET accumulated $[redacted] in program income that exceeded the amount required to pay the nonfederal share of project costs.

The audit examined MAGNET's financial statements and concluded that all industrial revenue and event revenue was attributed to the MEP program. We respectfully disagree. The audit allocates all revenue from the Product Development Group to MEP. Associated revenue in the amount of $[redacted] should not be applied to the MEP program, as the corresponding costs were for State of Ohio funded (Edison Program) industrial projects for which there was industrial revenue.

The finding concerning excess program income relates to the issue discussed in Item #1 in this document. Item #1 discusses the allocation of Product Development Group costs between MEP and the Edison Program. Similarly, revenue from Product Development Group activities was allocated between MEP and the Ohio Edison Program in a manner corresponding to the allocation of costs. Allocating Product Development Group revenue between MEP and the Edison Program reduces the amount of program income for MEP in FY06 to $[redacted] from the $[redacted] stated in the draft audit report. Therefore MAGNET had no excess program income in FY06.

Proposed Resolution: We respectfully request acceptance of the proposed allocation of program revenue. Allocating revenue in a manner consistent with the allocation of costs between the federal and state funding sources reduces the amount of program income for MEP in FY06 to $[redacted], from the $[redacted], a net decrease of $756,880. As a result, MAGNET had no excess program income in FY06.

12. Excess Program Income - TechSolve

The draft audit report's preliminary findings identify that TechSolve accumulated $[redacted] in program income that exceeded the amount required to pay the nonfederal share of project costs.

TechSolve used a methodology for calculating program income that resulted in a determination that it had no excess program income. Therefore, TechSolve did not report any excess program income or request permission for carrying over any excess program income to the subsequent funding period to use for the same purpose of the non-federal share of the operating budget.

NIST has provided no specific methodology for grantees to calculate excess program income. TechSolve, in good faith, calculated program income by using [redacted]

[redacted] This calculation methodology is detailed in **Attachment E**. Using this reasonable methodology, the calculation resulted in TechSolve having no excess program income to report. Since there was no calculated program income to report, there was no requirement for TechSolve to report excess program income or a need to request permission for carrying over excess program income.

Proposed Resolution: We respectfully request, in absence of a required methodology for determining program income, that TechSolve's determination of its program income be accepted, resulting in no excess program income. Acceptance of this request would remedy the issue identified in the audit report. TechSolve will also revise its methodology for calculating program income going forward if given a specific process from NIST.

13. Salary Allocation – ODOD

The draft audit report's preliminary findings identify $[redacted] in incorrectly allocated salary and benefit charges to the MEP subaward.

We agree that during the time period of the audit, ODOD applied salary and benefit charges to the MEP subaward for employees who are included in the indirect costs for the Department.

Proposed Resolution: We do not dispute these findings.

14. Internal Control Issues – MAGNET

The draft audit report's preliminary findings state that MAGNET's financial reporting system is inadequate for complete accounting of MEP activities. It also states that MAGNET does not maintain sufficient property management records.

We disagree with the findings of the draft audit report. In October 2009, DCAA conducted an audit of MAGNET's accounting system and found MAGNET's accounting system to be adequate. **Attachment F** contains the summary of the DCAA audit.

Proposed Resolution: We believe the results of the DCAA audit should satisfy the concerns in the draft audit report.

Attachment B – MAGNET's Proposed Budget Revision

TECHNOLOGY DIVISION
FY2007 OHIO MANUFACTURING EXTENSION PARTNERSHIP PROGRAM (MEP)

Total Project					
Cost Categories	Federal Funds	State Funds	Cost Share		Total
			Cash	In Kind	
Personnel	$	$	$ -	$ -	$
Fringe	$ -	$ -	$ -	$ -	$ -
Equipment	$ -	$ -	$	$ -	$
Supplies	$ -	$ -	$	$ -	$
Contractual	$ -	$ -	$	$ -	$
Sub Awards	$ -	$ -	$ -	$ -	$ -
Travel	$ -	$ -	$	$ -	$
Other	$ -	$ -	$ -	$ -	$ -
Total Direct Cost	$	$	$	$ -	$
G & A	$	$			$
Grand Total	$	$	$	$ -	$

G & A RATE =15%

Proposed Revision					
Cost Categories	Federal Funds	State Funds	Cost Share		Total
			Cash	In Kind	
Personnel	$	$	$	$ -	$
Fringe	$	$	$	$ -	$
Equipment	$ -	$ -	$	$ -	$
Supplies	$ -	$ -	$	$ -	$
Contractual	$	$	$	$ -	$
Sub Awards	$ -	$ -	$ -	$ -	$ -
Travel	$ -	$ -	$	$ -	$
Other	$ -	$ -	$ -	$ -	$ -
Total Direct Cost	$	$	$	$ -	$
Labor Overhead	$	$	$		$
G&A	$	$	$		$
Total Indirect	$	$	$		$
Grand Total	$	$	$	$ -	$

G & A RATE =15%

MAGNET MEP Budget FY07 Revised.xls

TECHNOLOGY DIVISION
FY2006 OHIO MANUFACTURING EXTENSION PARTNRSHIP PROGRAM (MEP)

Total Project					
Cost Categories	Federal Funds	State Funds	Cost Share		Total
			Cash	In Kind	
Personnel	$ [redacted]	$ [redacted]	$ -	$ -	$ [redacted]
Fringe	$ -	$ -	$ -	$ -	$ -
Equipment	$ -	$ -	$ -	$ -	$ -
Supplies	$ -	$ [redacted]	$ -	$ -	$ [redacted]
Contractual	$ -	$ [redacted]	$ [redacted]	$ -	$ [redacted]
Sub Awards	$ -	$ -	$ -	$ -	$ -
Travel	$ -	$ -	$ -	$ -	$ -
Other	$ -	$ -	$ -	$ -	$ -
Total Direct Cost	$ [redacted]	$ [redacted]	$ [redacted]	$ -	$ [redacted]
G & A	$ [redacted]	$ [redacted]	[redacted]		$ [redacted]
Grand Total	$ [redacted]	$ [redacted]	$ [redacted]	$ -	$ [redacted]

G & A RATE =15%

Proposed Revision					
Cost Categories	Federal Funds	State Funds	Cost Share		Total
			Cash	In Kind	
Personnel	$ [redacted]	$ [redacted]	$ [redacted]	$ -	$ [redacted]
Fringe	$ [redacted]	$ [redacted]	$ [redacted]	$ -	$ [redacted]
Equipment	$ -	$ -	$ [redacted]	$ -	$ [redacted]
Supplies	$ -	$ [redacted]	$ [redacted]	$ -	$ [redacted]
Contractual	$ -	$ [redacted]	$ [redacted]	$ -	$ [redacted]
Sub Awards	$ -	$ -	$ -	$ -	$ -
Travel	$ -	$ -	$ [redacted]	$ -	$ [redacted]
Other	$ -	$ -	$ -	$ -	$ -
Total Direct Cost	$ [redacted]	$ [redacted]	$ [redacted]	$ -	$ [redacted]
Labor Overhead	$ [redacted]	$ [redacted]	$ [redacted]	[redacted]	$ [redacted]
G&A	$ [redacted]	$ [redacted]	$ [redacted]	[redacted]	$ [redacted]
Total Indirect	$ [redacted]	$ [redacted]	$ [redacted]	[redacted]	$ [redacted]
Grand Total	$ [redacted]	$ [redacted]	$ [redacted]	$ -	$ [redacted]

G & A RATE =15%

TOTAL PROJECT CAMP MEP Budget FY06 v3 full funding.xls

Attachment C – TechSolve's Proposed Budget Revision

Operating Fiscal Year: July 1, 2005 to June 30, 2006
Budget Restatement and Reporting To Correct Incorrect Reporting of Overhead

Cost Category	Federal Funds	State Funds	Cost Share Cash	Cost Share In Kind	Total
Personnel	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Fringe					
Equipment					
Supplies					
Contractual					
Professional Services					
Fees Paid to 3rd Party Providers					
Sub Awards					
Travel					
Other					
Total Direct Costs	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Indirect Costs					
Total Expenses					

ORIGINAL BUDGET

The above budget had Overhead Cost Component Budgeted in the Personnel Cost Component (See Budget Narratives)

Cost Category	Federal Funds	State Funds	Cost Share Cash	Cost Share In Kind	Total
Personnel	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Fringe					
Equipment					
Supplies					
Contractual Total					
Professional Services					
Fees Paid to 3rd Party Providers					
Sub Awards					
Travel					
Other					
Total Direct Costs	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Indirect Costs					
Total Expenses					

RESTATED BUDGET

The above restated budget has the Overhead Cost Component reclassified to the Indirect Cost Component along with G&A

Operating Fiscal Year: July 1, 2006 to June 30, 2007
Budget Restatement and Reporting To Correct Incorrect Reporting of Overhead

Cost Category	Federal Funds	State Funds	Cost Share Cash	Cost Share In Kind	Total
Personnel	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Fringe					
Equipment					
Supplies					
Contractual					
Professional Services					
Fees Paid to 3rd Party Providers					
Sub Awards					
Travel					
Other					
Total Direct Costs					
Indirect Costs					
Total Expenses					

ORIGINAL BUDGET

The above budget had Overhead Cost Component Budgeted in the Personnel Cost Component (See Budget Narratives)

Cost Category	Federal Funds	State Funds	Cost Share Cash	Cost Share In Kind	Total
Personnel	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Fringe					
Equipment					
Supplies					
Contractual Total					
Professional Services					
Fees Paid to 3rd Party Providers					
Sub Awards					
Travel					
Other					
Total Direct Costs					
Indirect Costs					
Total Expenses					

RESTATED BUDGET

The above restated budget has the Overhead Cost Component reclassified to the Indirect Cost Component along with G&A

APPENDIX C: SUMMARY OF SOURCE AND APPLICATION OF FUNDS

State of Ohio Department of Development
NIST Cooperative Agreement No. 70NANB5H1188
July 1, 2005, through March 31, 2007

	Approved Budget[1]	Receipts & Expenses
SOURCE OF FUNDS:		
Federal	$ 9,090,834	$ 6,517,538
Nonfederal	18,181,668	15,070,358
Total	$27,272,502	$21,587,896
APPLICATION OF FUNDS:		
Personnel	$[redacted]	$[redacted]
Fringe Benefits		
Contractual		
Other		
Supplies		
Travel		
Equipment		
Indirect Costs		
Total	$27,272,503	$21,587,896

[1] Approved budget represents amounts approved for 2-year period of July 1, 2005, through June 20, 2007.

APPENDIX D: SUMMARY OF FINANCIAL/COMPLIANCE AUDIT

State of Ohio Department of Development
NIST Cooperative Agreement No. 70NANB5H1188
July 1, 2005, through March 31, 2007

			Results of Audit		
Description	Approved Budget[1]	Costs Claimed	Costs Questioned	Costs Unsupported	Costs Accepted
Personnel	$	$	$ 921 [a]	0	$
Fringe Benefits			6,586 [b]	0	
Contractual			6,773,534 [c]	0	
Other			0	0	
Supplies			0	0	
Travel			0	0	
Equipment			0	0	
Indirect Costs			0	0	
Total	$27,272,503	$21,587,896 [d]	$6,781,041	$0	$14,806,855

Federal Funds Disbursed		$6,517,538
Costs Incurred	$21,587,896	
Less Questioned Costs	6,781,041	
Costs Accepted	14,806,855	
Less Excess Program Income	1,424,266 [e]	
Basis for Federal Share	13,382,589	
Federal Cost Sharing Ratio	x 33.33%	
Federal Funds Earned		4,460,417
Refund Due the Government		$2,057,121 [f]

Notes:

(a) Questioned personnel costs include two ODOD employees who were claimed in personnel costs and included in the indirect cost rate calculation, resulting in double claiming of costs.

(b) Questioned benefit costs include costs associated with the questioned personnel costs of two ODOD employees who were also included in the indirect cost rate calculation.

(c) Questioned contractual costs include $4,095,476 claimed by MAGNET and $2,678,058 claimed by TechSolve, both subrecipients under the MEP award.

(d) ODOD reported total costs of $20,269,989 in its financial status report through March 31, 2007. We examined the recipient's financial records and found total recorded expenditures of $21,587,896, or

[1] Approved budget represents amounts approved for 2-year period of July 1, 2005, through June 20, 2007.

$1,317,907 more than total costs reported to NIST. We reconciled the recipient's financial records against errors in its cost claims to NIST. We determined ODOD should have reported to NIST total expenditures of $21,587,896. This figure served as the basis for project costs subject to audit.

(e) MAGNET and TechSolve generated program income of $1,424,266 in excess of what was required to pay the nonfederal share of project costs. MAGNET accounted for $[redacted] of the excess while $[redacted] was attributed to TechSolve. Neither received required prior approval to carry excess program income forward for use in a subsequent award period. We reduced the total accepted costs by the excess program income in computing federal funds earned by the subrecipients.

(f) The refund due includes excess disbursements of federal funds in the amounts of $1,141,150 to MAGNET and $848,402 to TechSolve. Our calculations of refunds due from MAGNET and TechSolve are summarized as follows:

Ohio Department of Development
NIST MEP Cooperative Agreement No. 70NANB5H1188
Summary of Financial Audit
July 1, 2005, through March 31, 2007

	MAGNET	TechSolve
Costs Claimed	$[redacted]	$[redacted]
Costs Questioned	4,095,476	2,678,058
Costs Accepted	$[redacted]	$[redacted]
Excess Program Income		
Basis for Federal Funds	$[redacted]	$[redacted]
Federal Sharing Ratio[a]	-	-
Federal Funds Earned	$ 2,041,783	$ 2,231,871
Federal Funds Received	3,182,933	3,080,273
Refund Due	$ 1,141,150	$ 848,402

[a] MAGNET's and TechSolve's federal sharing ratios differ slightly between award years. The ratios were [redacted] percent for the period July 1, 2005, through June 30, 2006, and [redacted] percent for the period July 1, 2006, through March 31, 2007