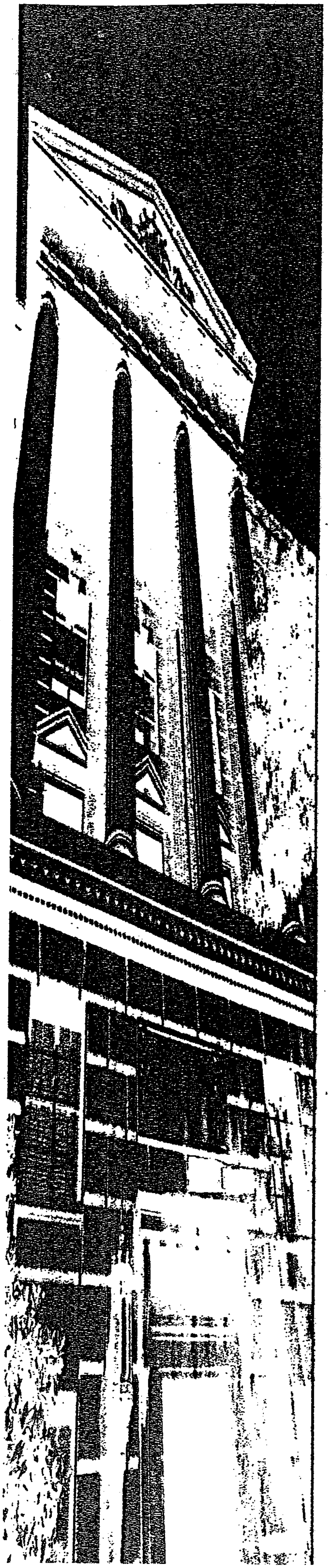

U.S. DEPARTMENT OF COMMERCE
Office of Inspector General

PUBLIC RELEASE

NATIONAL INSTITUTE OF STANDARDS AND TECHNOLOGY

Northeastern Pennsylvania Industrial Resource Center, Inc.
NIST MEP Award No. 70NANB9H0070

Audit Report No. DEN-14046-1-0001 / September 2001

Office of Audits, Denver Regional Office

TABLE OF CONTENTS

APPENDICES

EXECUTIVE SUMMARY

In August 1999, NIST awarded Cooperative Agreement No. 70NANB9H0070 under its Manufacturing Extension Partnership (MEP) program to Northeastern Pennsylvania Industrial Resource Center, Inc., for the period from July 1, 1999, through June 30, 2000. The total estimated project cost was $2 million, with the federal share not to exceed $500,000. On August 20, 1999, NIST amended the award to add $330,000 ($110,000 federal share) for the center to conduct Y2K activities. Although the estimated costs appear to indicate a 25-percent federal cost share, the award terms and conditions state that the federal share shall not exceed 33.33 percent. In August 2000, NIST granted a one-year, no-cost extension ending June 30, 2001. As of February 2001, the center submitted requests for reimbursement to NIST for the period from July 1, 1999, through June 30, 2000, totaling $572,418.

The center has an inadequate cost accounting system resulting in inaccurate distribution of labor and overhead (see page 3). We recommend that the Chief, NIST Grants and Agreements Management Division, direct the center to develop (1) a labor cost distribution system to accurately distribute salary costs and related fringe benefits to each benefitting cost objective, and (2) a cost allocation plan for the equitable distribution of common administrative costs to each benefitting objective. The center will need to seek approval of the cost allocation plan from the Office of Inspector General, Indirect Cost Processing Office.

The center's costs reported to NIST on its claims for reimbursement do not agree with its financial records, and are incomplete and inaccurate (see page 5). We recommend that the Chief, NIST Grants and Agreement Management Division, direct the center to completely and accurately report all program outlays and program income earned on the financial reports provided to NIST.

Finally, we question $290,249 of the $2,146,774 costs incurred by the center, and further note $328,887 in unreported excess program income earned by the center. We recommend that NIST seek recovery of $63,256 for NIST overdisbursements (see page 7).

The center provided a written response, dated September 21, 2001, to our August 23, 2001 draft audit report. The center's response is summarized in this report, and included as Appendix B.

INTRODUCTION

In August 1999, the National Institute of Standards and Technology awarded Cooperative Agreement No. 70NANB9H0070 under its Manufacturing Extension Partnership (MEP) program to Northeastern Pennsylvania Industrial Resource Center, Inc., to support the Northeastern Pennsylvania Manufacturing Extension Partnership for the period July 1, 1999, through June 30, 2000. The total estimated project cost was $2 million, with the federal share not to exceed $500,000. On August 20, 1999, NIST amended the award to add $330,000 ($110,000 federal share) for the center to conduct Y2K activities. Although the estimated costs appear to indicate a 25-percent federal cost share, the award terms and conditions state that the federal share shall not exceed 33.33 percent. We will accept the higher sharing ratio, as stated in the terms and conditions, up to the maximum approved federal funding of $610,000. In August 2000, NIST granted a one-year, no-cost extension ending June 30, 2001.

PURPOSE AND SCOPE OF AUDIT

The objectives of our audit were to (1) determine whether the center's accounting and financial management system complies with federal regulations and NIST/MEP requirements, and (2) perform a final financial and compliance audit of the award. The audit covered the award period from July 1, 1999, through June 30, 2000.

Our audit included interviews of center officials, and review of the center's accounting and financial records, available supporting documentation, and financial reports submitted to NIST. We also examined workpapers and an audit report prepared by the center's independent public accountant. Our fieldwork was conducted in February 2001 at the center in Wilkes-Barre, Pennsylvania.

We did not perform a review of the general and application controls of the center's computer systems. We did, however, conduct other substantive tests and procedures to ensure that the computer-processed data was reliable.

We reviewed compliance with laws and regulations as they applied to costs incurred, using as criteria OMB Circular Numbers A-122, *Cost Principles for Non-Profit Organizations* and A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* and 15 CFR Part 14, *Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, Other Non-Profit, and Commercial Organizations,* which superceded OMB Circular A-110. We also assessed compliance with the Department of Commerce Financial Assistance Standard Terms and Conditions, MEP General Terms and Conditions, and NIST's Special Award Conditions. Instances of noncompliance with the above stated laws and regulations are noted in this audit report.

The audit was conducted in accordance with the *Government Auditing Standards* issued by the Comptroller General of the United States, and was performed under the authority of the Inspector General Act of 1978, as amended, and Department Organization Order 10-13, dated May 22, 1980, as amended.

FINDINGS AND RECOMMENDATIONS

INADEQUATE ACCOUNTING SYSTEM

Our audit disclosed that the center has an inadequate cost accounting system resulting in inaccurate distribution of labor and overhead costs. The deficiencies in the accounting system comprise $280,688 of the total $290,249 of questioned costs, consisting of (i) $226,252 in payroll costs and $29,737 of related overhead costs, and (ii) $24,699 of indirect costs charged without an approved indirect cost rate.

Inadequate Labor Distribution System

The center did not maintain an accurate labor distribution system as required by 15 CFR, Part 14, Section 14.21(b), which states,

> "Recipient's financial management systems shall provide for the following:
> (1) Accurate, current and complete disclosure of the financial results of each federally-sponsored project or program ..."

Time sheets supporting salary costs charged against the NIST MEP project often described the charges as "unallocated" labor. Despite these descriptions on time sheets and the center having other non-MEP programs, the center records 100 percent of its payroll costs as NIST MEP project expenses, as if the MEP were its only program. We question $226,252 of the center's salary ($161,645) and associated fringe benefits costs ($64,607), because timesheets supporting these claims classify the labor as "unallocated" (see Appendix A-1, page 11). We also questioned $29,737 in overhead-type costs allocable to the $161,645 of questioned payroll costs.

Indirect Costs Charged Without a Cost Allocation Plan

The center charged the NIST award $24,699, described on its accounting records as indirect costs, which were (1) not provided for in the award budget and (2) not supported by an approved cost allocation plan.

We questioned the indirect costs the center charged since they are not contained in the award budget, as required by Section .05a of the Department of Commerce Financial Assistance Standard Terms and Conditions, which provides that indirect costs will not be allowable charges unless specifically included in the award budget. The award terms and conditions also require that the center obtain approval of a cost allocation plan before charging indirect costs. The center's accounting system does not have a consistent methodology for charging indirect costs to projects benefitting from these costs.

The center's accounting system is significantly flawed, beyond just the indirect costs questioned, since the system does not provide for the allocation of indirect costs on a consistent basis to each cost objective. The inadequate indirect cost allocation caused incorrect distribution of labor costs to projects, because the center does not have adequate records to support directly chargeable costs (see previous finding).

Recommendation

We recommend that the Chief, NIST Grants and Agreements Management Division, direct the center to develop (1) a labor cost distribution system to accurately distribute salary costs and related fringe benefits to each benefitting cost objective, and (2) a cost allocation plan for the equitable distribution of common administrative costs to each benefitting objective. The center will need to seek approval of the cost allocation plan from the Office of Inspector General, Indirect Cost Processing Office.

Center's Response

The center disagreed with the draft report finding that its accounting system resulted in the inaccurate distribution of labor and overhead costs and the finding that indirect costs were improperly charged. The center claimed that documents including grant applications, calculations based upon audited financial statements and analyses of employee time sheets, both manually and by direct database queries, support that the center has only one program to which all allowable expenditures can be charged. The center claimed that staff salaries and related overhead are appropriately charged to that program and that the center has no indirect costs. The center also claimed that it used "Unallocated Time" for employee time-reporting purposes and "Indirect Costs" for internal tracking purposes.

OIG Comments

We disagree with the center's comments since they do not contain sufficient additional evidence for us to accept the adequacy of the accounting system or support costs reported as inadequately supported. The explanation regarding "unallocated time" is inconsistent since some administrative personnel, such as the Executive Director and the Controller, charge their time directly to the award, while other administrative personnel represent their time to be "unallocated". To accept unallocated time, we require certification from employees with unallocated time that their administrative time was in support of the NIST program and not some other non-program function, such as fund raising, lobbying or other functions that would not be allocable to the NIST program.

Furthermore, we question the center's claim that its only program is NIST MEP, especially since the center operates an EDA RLF, and also claims to have residual income from prior years from non-NIST activities. The explanation that "indirect costs" and "unallocated time" are for internal use does not correct the problem of the accounting records regarding the allocability of administrative-type costs to the NIST award or any other center function.

INACCURATE FINANCIAL REPORTING

The center's costs reported to NIST on its claims for reimbursement do not agree with its financial records, and are incomplete and inaccurate. The program outlay and program income data reported by the center on Requests for Reimbursement do not agree with amounts in the center's accounting records, which were verified by an independent auditor.

The center did not report to NIST *any* program income earned on its existing award or funds earned and carried over from a previous NIST award. We determined that the center did not report a $129,229 carryover of program income earned under the previous award, or $412,163 in program income generated under the current award, resulting in $328,887 excess program income (see Appendix A-3). In addition, the center's actual costs incurred, as detailed in the independent auditor's workpapers, totaled $2,146,774. However, the center reported only $1,717,254 in program outlays on its financial reports to NIST.

Recommendation

We recommend that the Chief, NIST Grants and Agreement Management Division, direct the center to completely and accurately report all program outlays and program income earned on the financial reports provided to NIST.

Center's Response

The center agreed that amounts reported to NIST did not agree to the financial records. According to the center, this is attributed to the fact that NIST reports were prepared prior to the completion of the center's annual financial audit and did not include year-end accruals and adjustments. The center stated that internal controls have been put into effect to prevent this from occurring in the future.

However, the center strongly disagrees with the conclusion that the center had excess program income during the project which should be allocated to NIST, claiming that NIST did not designate the use of program income, and some income reported was overstated in the OIG draft report.

The center cites 15CFR Section 14.24, claiming that NIST did not require program income to be treated in any specific manner, and the CFR requires, in that case, program income must be used to expand the program, and not used to reduce program costs.

The center also claims that the amount considered program income in the draft report includes amounts that were received from manufacturers during periods for which the center had only state DCED funding; earned before the NIST award, and that the state allowed it to retain those payments and apply them to center operating costs in future years. It also claims that program income should be reduced for amounts subsequently written off as uncollectible.

OIG Comments

OIG concurs with the center's efforts to correct our finding regarding inaccurate financial reporting to NIST. However, we do not agree with the center's claim that it did not receive instructions from NIST concerning the treatment of program income. On February 15, 2001, NIST instructed the center that program income is to be used to finance the center's matching share, and made this requirement part of an award amendment. If the center earns more income than needed to provide the local match, unless it has grant authority to expand the scope of work of the grant with the excess income, it needs to reduce its claims of NIST funds by the NIST share of that excess income.

The center's claim that the draft report overstated program income is unsupported by documentation regarding the income source or other reductions to income. Therefore, we reaffirm our findings and recommendation.

RESULTS OF FINANCIAL AUDIT

The results of our financial audit covering the period July 1, 1999, through June 30, 2000, as detailed in Appendix A, are summarized as follows:

Budgeted costs	$2,330,000	
Costs incurred	$2,146,774	
Less: Costs questioned	(290,249)	(a)
Costs accepted	$1,856,525	
Less: Excess program income	(328,887)	(b)
Adjusted accepted costs	$1,527,638	
Award percentage	x 33.33%	
NIST share of accepted costs	$ 509,162	
Less: NIST disbursements	(572,418)	
Balance due NIST	$ 63,256	

Notes:

(a) Costs questioned consist of unsupported salary costs, applicable fringe benefits and overhead-type costs; indirect costs charged without an approved rate; automotive equipment charged as a direct costs without NIST's prior approval; and, unallowable interest expense (see Appendix A, page 9).

(b) Represents MEP program income earned from current and prior program years which exceeds accepted costs (see Appendix A-3, page 13).

Recommendation

We recommend that the Chief, NIST Grants and Agreements Management Division, recover $63,256 of excess federal disbursements.

Center's Response

The center disagreed with most of the findings contained in the draft report and stated that $37,582 in NIST funds was owed to the center.

OIG Comments

The center's response did not contain sufficient documentary evidence for us to alter our findings and recommendations; therefore, we reaffirm our position.

William R. Suhre September 28, 2001
Regional Inspector General for Audits

Appendix A
Page 1 of 2

NORTHEASTERN PENNSYLVANIA INDUSTRIAL RESOURCE CENTER, INC.
NIST Cooperative Agreement No. 70NANB9H0070

Summary of Audit Results
July 1, 1999 through June 30, 2000

Budgeted costs	$2,330,000 (a)
Costs incurred	$2,146,774
Less: Costs questioned	(290,249) (b)
Costs accepted	$1,856,525
Less: Excess program income	(328,887) (c)
Adjusted accepted Costs	$1,527,638
Award percentage	x 33.33%
NIST share of accepted costs	$ 509,162
Less: NIST disbursements	(572,418)
Balance due NIST	$ 63,256

Notes:

(a) Represents MEP project costs, as reported by the center's independent auditor.

(b) Consists of (i) $226,252 in payroll costs, including $161,645 in salaries and $64,607 in applicable fringe benefits not supported by adequate time distribution records (see Appendix A-1 for detail), (ii) $29,737 of overhead costs applicable to the questioned payroll costs, (iii) $24,699 of indirect costs which were not included in the grant budget (see Appendix A-2) and were charged without an approved indirect cost rate, (iv) $8,585 in lease costs for an auto used by the center's director which is not included in the award budget (see Appendix A-2), incurred without prior NIST approval, as required by OMB Circular A-122, Attachment B, Paragraph 7.g., and (v) $976 in interest expense, not included in the award budget (see Appendix A-2), which is unallowable pursuant to OMB Circular A-122, Attachment B, Paragraph 23.a.

(c) Represents income earned by the center over and above eligible program expenditures (see Appendix A-2). 15 CFR, Part 14, Section 14.24(b)-(c) states:

"(b)...program income earned during the project period shall be retained by the recipient and, in accordance with DoC regulations or the terms and conditions of the award, shall be used in one or more of the ways listed in the following:

Appendix A
Page 2 of 2

(1) Added to funds committed to the project by the DoC and recipient and used to further eligible project objectives.
(2) Used to finance the non-federal share of the project.
(3) Deducted from the total project allowable cost in determining the net allowable costs on which the Federal share of costs is based.

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

We interpret "in excess of any limits stipulated," to mean that program income received in excess of eligible project costs should be used to reduce total project costs before determining the federal share of allowable project costs. While the regulation allows program income to fund eligible project costs and the local matching share, it does not allow recipients to earn a profit or obtain NIST funds in excess of the immediate cash needs to fund the non-federal share of eligible costs.

Appendix A-1

NORTHEASTERN PENNSYLVANIA INDUSTRIAL RESOURCE CENTER, INC.
NIST Cooperative Agreement No. 70NANB9H0070

Summary of Payroll Questioned
July 1, 1999 through June 30, 2000

Employees	Unallocated Hours (a)	Questioned Salary & Bonus	Questioned Benefits (b)	Questioned Total
[redacted]	4.0	$ 320	$ 135	$ 455
	1,965.0	23,680	10,017	33,697
	60.5	1,077	456	1,533
	1,961.0	24,046	10,171	34,217
	1,081.5	8,099	615 (c)	8,714
	13.0	446	189	635
	141.5	3,747	1,585	5,332
	330.0	7,756	2,323 (d)	10,079
	1,898.0	28,404	12,015	40,419
	1,915.0	20,253	8,567	28,820
	52.5	1,459	617	2,076
	2,195.0	42,358	17,917	60,275
Total	11,617.0	$161,645	$64,607	$226,252

Notes:

(a) Represents hours designated as "unallocated" on the center employee timesheets.

(b) The benefits include fringe benefits (34.7%) and payroll tax (7.6%) based on the center's analysis.

(c) [redacted] was a part-time employee who received only payroll tax benefits.

(d) Questioned benefits include payroll taxes applicable to unallocated hours for term of employment and fringe benefits applicable to unallocated hours accrued after 90 days employment.

Appendix A-2

NORTHEASTERN PENNSYLVANIA INDUSTRIAL RESOURCE CENTER, INC.
NIST Cooperative Agreement No. 70NANB9H0070

Source and Application of Funds
July 1, 1999 through June 30, 2000

	Approved Budget Amount (a)	Claimed Receipts/Expense	
SOURCE OF FUNDS:			
Federal	$ 610,000	$ 572,418	
Non-Federal	1,720,000	1,612,994	(b)
Total	$2,330,000	$2,185,412	
APPLICATION OF FUNDS:			
Internal staffing	$1,171,000	$1,088,298	
Outside consultant & professional fees	789,000	665,615	
Occupancy costs	71,000	61,953	
Staff training & development	55,022	62,744	
Office & operating expenses	205,500	233,904	
Non-Budgetary line items:			
Auto lease expense	-0-	8,585	(c)
Interest expense	-0-	976	(c)
Indirect costs	-0-	24,699	(c)
Total	$2,291,522	$2,146,774	(d)

Notes:

(a) Schedule reflects approved budget amount for 12-month project period, including the Y2K amendment.
(b) Consists of (i) state funding ($1,071,602), (ii) carryover program income from previous year ($129,229), and (iii) current year program income ($412,163) (see Appendix A-3).
(c) These line items are not in the budget and the costs are unallowable.
(d) Although the center reported total project costs of $1,717,254 to NIST, for the period from July 1, 1999, through June 30, 2000, the independent auditor's workpapers indicated that actual project costs were $2,146,774.

Appendix A-3

NORTHEASTERN PENNSYLVANIA INDUSTRIAL RESOURCE CENTER, INC.
NIST Cooperative Agreement No. 70NANB9H0070

Calculation of Excess Program Income
July 1, 1999 through June 30, 2000

NIST funds	$ 572,418	
State grant	1,071,602	
Program income		
Carry-over from previous year	129,229	(a)
Current year	412,163	
Total	$2,185,412	
Less: Allowable costs	(1,856,525)	(b)
Excess program income	$ 328,887	

Notes:

(a) Reported as "Earned manufacturer revenue" in the center's independent auditor report for the year ended June 30, 2000.

(b) Allowable costs represent incurred project costs audited by the center's CPA, minus additional costs questioned in this report (see Appendix A, pages 9 and 10).

Northeastern Pennsylvania Industrial Resource Center, Inc.

Response to Draft Audit Report No. DEN-14046-1-XXXX

Draft Audit Report Date:	August 23, 2001
Response Date:	September 21, 2001
Submitted By:	William J. Desciak, Executive Director Northeastern Pennsylvania Industrial Resource Center, Inc.
Submitted To:	William R. Suhre, Regional Inspector General for Audits U.S Department of Commerce Office of Inspector General Denver Regional Office of Audits
Copy Submitted To:	George White, Chief NIST Grants and Agreements Management Division U.S. Department of Commerce Temporary Research Facility (411)

EXECUTIVE SUMMARY

The Northeastern Pennsylvania Industrial Resource Center, Inc. (NEPIRC) has read Draft Audit Report #DEN-14046-1-XXXX dated August 23, 2001 concerning the U.S. Department of Commerce audit of NEPIRC's financial assistance award #70NANB9H0070. This document constitutes NEPIRC's response to the draft report.

Relative to the adequacy of NEPIRC's existing accounting system, NEPIRC disagrees with the draft report finding that its accounting system resulted in the inaccurate distribution of labor and overhead costs. NEPIRC also disagrees with the finding that indirect costs were improperly charged. NEPIRC's position, which is supported by adequate documentation including items such as grant applications, calculations based upon audited financial statements and analyses of employee timesheets both manually and by direct database queries, is that NEPIRC has only one program to which all allowable expenditures can be charged, that staff salaries and related overhead are appropriately charged to that program and that NEPIRC has no indirect costs. NEPIRC provides extensive clarification on the correct meaning of "Unallocated Time" as it is used for employee time-reporting purposes and "Indirect Costs" as they are used for internal tracking purposes.

Relative to the accuracy of NEPIRC's financial reporting, NEPIRC agrees that amounts reported to NIST did not agree to final year-end financial records. This is attributed to the fact that NIST reports were prepared prior to the completion of NEPIRC's annual financial audit and, therefore, did not include year-end accruals and adjustments. Internal controls have been put into effect to prevent this from occurring in the future. NEPIRC strongly disagrees with the draft report conclusion that NEPIRC had excess program income during the period under audit. NEPIRC cites several aspects of 15 CFR Section 14.24 that clearly indicate that in order for excess program income to exist, NEPIRC would have had to receive authorization from the granting agency to treat program income in accordance with 15 CFR Sections 14.24(b)(1) or 14.24(b)(2), which it did not, and would have had to receive notification of a stipulated limit to such program income, which it did not. NEPIRC also notes that the amount considered program income in the draft report includes amounts that are not program income. NEPIRC also contends that program income in the draft report is not reduced for amounts subsequently written off as uncollectible.

NEPIRC's disagrees with most of the findings within the draft report and believes that the amount due to NEPIRC is $37,582.

RESPONSE TO FINDINGS & RECOMMENDATIONS

ACCOUNTING SYSTEM

Audit Finding

The draft report indicates that NEPIRC has an inadequate accounting system that resulted in the inaccurate distribution of labor and overhead costs. As a result, a portion of direct labor costs and related overhead costs, as well as all indirect costs, are currently being considered questioned costs.

NEPIRC Response – Labor Distribution System

NEPIRC disagrees with this audit finding and asserts that its accounting system adequately distributes all labor and overhead costs. NEPIRC believes that this audit finding is the result of three misconceptions: that NEPIRC has more than one program to which labor and overhead costs should be charged; that the salary associated with time coded as Unallocated on staff timesheets is not an allowable program cost or is a cost that should be allocated to more than one program; and that NEPIRC has indirect costs that must be allocated according to an approved cost allocation method. NEPIRC's position is that it has only one program, uses the Unallocated time code to represent staff time spent on administrative functions and employee fringe benefit time away from work, which is then properly charged to NEPIRC's only program, and has no indirect costs. Therefore, all direct labor costs, associated overhead costs and costs labeled as indirect are allowable and properly allocated.

Rationale & Substantiation for NEPIRC Response

NEPIRC in reality has only one program, which consists of both federal and state funding in pursuit of shared program objectives. During the period under audit, NEPIRC received funding from both the National Institute of Standards and Technology (NIST) under its Manufacturing Extension Partnership (MEP) Program and from the Pennsylvania Department of Community & Economic Development (DCED) under its Industrial Resource Center (IRC) Program. As shown in the attached Schedule 1, these two grants accounted for 98.01% of all grant revenue earned by NEPIRC during the period under audit and 97.92% of all NEPIRC expenditures for the period under audit. Since Schedule 1 incorporates amounts from NEPIRC's audited financial statements for the year ended June 30, 2000, they are attached as Appendix 1. Although NEPIRC accounts for its federal and state grants separately for internal financial tracking and grant reporting purposes, the two grants work together to form NEPIRC's only program. NEPIRC believes that it has one overall program because of the following:

a. NEPIRC applies for both grants using a single unified proposal, which is attached as Appendix 2. This unified proposal was made possible due to great cooperation between NIST and DCED representatives, who acknowledged their shared objectives and worked together to arrive at an agreed-upon format.
b. Since a single proposal is used for both grants, they share common goals, objectives and desired outcomes. They both support NEPIRC's mission of working with small to medium-sized manufacturers to help them implement technologies and practices that will improve their competitiveness.
c. Since both grants share the same goals, objectives and desired outcomes, each grantor agency evaluates NEPIRC according to the same metrics, which NEPIRC reports to each agency using the same reporting forms and procedures. Both agencies require NEPIRC to provide quarterly reports and extensive data pertaining to its activities with regional manufacturers. Both NIST and DCED accept the same exact reports and activity logs.

d. Since both grants share the same goals, objectives and desired outcomes, any activity that falls under the scope of work for one grant also falls under the scope of work for the other. There are no activities that are reportable to only one of the two grantors. All activities are mutually reportable to and accepted by each grantor.
e. There is great cooperation between NEPIRC's NIST and DCED Account Managers. NIST and DCED representatives have consistently worked together to present themselves as a unified program that provides financial support to centers such as NEPIRC from both federal and state sources.

For these reasons, NEPIRC views its joint federal and state grants as constituting one program. There are simply too many similarities between the grants to make any programmatic distinctions between them. They both enable and encourage NEPIRC to work with the same regional manufacturers on the same initiatives and activities. They accept identical goals and outcomes and hold NEPIRC accountable using the same evaluative criteria and performance reporting mechanisms. To differentiate between the two programs suggests a programmatic division that, in all reality and practicality, does not exist. The draft report agrees that NEPIRC's NIST and DCED grants comprise one comprehensive program because all references to program grant revenue and program expenditures within that report include both NIST and DCED revenue and expenditures.

Since NEPIRC's NIST and DCED activities accounted for 97.92% of all expenditures during the period under audit, it is clear that NEPIRC had no substantial activities or programs other than the activities and program made possible by its NIST and DCED grants during the period under audit, to which all of its operating costs pertain.

The draft report indicates that the salary associated with time coded as Unallocated on employee timesheets should not be charged to its NIST/DCED program. If NEPIRC, in fact, has only one program, which accounts for 98.01% of its total grant revenue and 97.92% of its total expenditures for the period under audit, this draft report finding begs the question as to where else these salaries can be charged. It is not possible that the 11,617 staff hours in question, which equate to roughly one-third of all staff hours for the period under audit, could have been spent on another program, if one was found to exist, that accounted for less than 2% of NEPIRC's revenue and 3% of NEPIRC's expenditures. Nonetheless, the following paragraphs provide more accurate information about the Unallocated time code and show that it represents time spent by staff either in the performance of administrative tasks or away from the office for time relating to their employee fringe benefits. Obviously, the salaries associated with either function are allowable expenses under OMB Circular Number A-122, and are therefore chargeable to the program.

NEPIRC's joint NIST/DCED program enables NEPIRC to provide technical assistance to regional manufacturers in order to help them improve their productivity and competitiveness. Whenever a regional manufacturer requests assistance, NEPIRC enters into a contractual relationship with them in order to provide the requested services. NEPIRC refers to these contractual relationships as Engagements with manufacturers. Each Engagement is given a unique identification number within NEPIRC's internal tracking system and is reported to both NIST and DCED within NEPIRC's quarterly progress reports. At the end of each 2-week pay period, every staff member is required to complete a timesheet that documents how he/she spent the 75 working hours within that pay period (two 37.5-hour weeks). Time spent working on Engagements with manufacturers is coded as Billable, Unbillable or Travel. Billable Time represents time that was spent working directly with a client. Thus, the client should be willing to receive a bill for and pay for those hours. Unbillable Time represents time spent in performing research for a client Engagement or doing similar behind-the-scenes work for a client, such as contacting other MEP centers nationwide to obtain their advice or input regarding how to address a client's concern. The client does not receive a bill for these services, but is clearly benefiting from these efforts. Travel Time is time spent in commuting to client manufacturing facilities to assist them at their place of business. NEPIRC staff document their levels of

Billable, Unbillable and Travel time for each pay period by assigning the appropriate number of hours or fractional hours to those time codes on their timesheets and indicating the unique Engagement number(s) to which those hours pertain.

Although NEPIRC tries to maximize its Billable, Unbillable and Travel time, since they together represent the total time NEPIRC staff spent directly assisting manufacturers, not all staff time falls into one of those three time categories. This is particularly true of Administrative Staff time, such as time spent answering phones, typing letters, posting routine accounting transactions and filing paperwork. It is also true of time away from work that is attributable to NEPIRC's employee fringe benefits program or employee continuing education programs, such as sick time, vacation time, organizational holidays, time spent in training activities and so forth. NEPIRC management needed to create a time code that employees could use to account for this time on their timesheets. As a result, the time code of Unallocated was introduced. The time code of "Unallocated" represents time that is not allocable to a particular client Engagement for NEPIRC's internal time-tracking purposes but is, in fact, chargeable to NEPIRC's NIST/DCED program as either time spent on administrative duties that benefit NEPIRC's NIST/DCED program overall, time spent on administrative duties that benefit numerous client Engagements simultaneously, employee benefit time or staff training time. It by no means represents time that is not spent on NEPIRC's NIST/DCED program.

NEPIRC management also created sub-codes that each staff member would have to enter for each hour or fractional hour charged to the Unallocated time code. These sub-codes consist of Admin (as a abbreviation for Administrative Duties), Sick, Holiday, Personal, Vacation, Funeral, Training or Miscellaneous. NEPIRC's analysis of employee timesheets for the period under audit, which was based upon database queries written to extract employee timesheet data directly from the database to which it was entered, identified the correct level of Unallocated time for each employee for the period under audit and determined how many hours were placed within each of the available sub-codes. The results of NEPIRC's analysis appear as Schedule 2.

Schedule 2 compares the number of hours actually charged to the Unallocated time code to the number of hours charged to the Unallocated time code per the draft report. Differences between the two analyses were noted for most employees. A copy of the output report generated by a special query that extracted this information directly from NEPIRC's timesheet database is attached as Appendix 3. Please note that NEPIRC also manually reviewed all employee timesheets to verify the accuracy of the output report and noted no discrepancies. Copies of all employee timesheets were provided at the time of the audit.

Schedule 2 shows that the individuals listed in the draft report actually charged 11,761 hours to the Unallocated time code during the period under audit. Of those hours, 8,380.75 (71.26%) were recorded under the Admin sub-code, evidencing that those hours were spent performing administrative functions in support of NEPIRC's NIST/DCED program, such as answering phones, typing letters, attending staff meetings, making copies and processing paperwork. Of those hours, 8,076.75 (96.37%) were recorded by employees [redacted], [redacted] and [redacted]. In the case of [redacted], [redacted] and [redacted], all of their time for the year was coded as either Unallocated-Admin or Unallocated-Authorized Time Off. In the case of [redacted], all but four of her hours for the year were coded as either Unallocated-Admin or Unallocated-Authorized Time Off. Those individuals represent NEPIRC's Administrative team, as their titles below indicate:

- [redacted], Project Analyst: Files all client Engagement paperwork and prepares all progress reports, progress narratives and grantor reports for granting agencies.
- [redacted], Staff Accountant: Performs all routine accounting tasks, such as preparing/posting journal entries, preparing bank deposits, preparing cash disbursement vouchers, invoicing clients and so forth.
- [redacted], Receptionist: Performs clerical duties such as answering phones, typing letters, distributing mail and faxes, filing paperwork and arranging meetings.

- [redacted], Executive Assistant: Performs more intricate administrative functions such as Board reporting and relations, staff scheduling, typing and proofreading reports to clients, press releases and so forth.
- [redacted], Accounting Manager: Reviews work performed by Staff Accountant and prepares more advanced or confidential accounting tasks such as those related to employee benefits and payroll.

Obviously, the work performed by these individuals benefits NEPIRC's NIST/DCED program and is essential to the proper and efficient management of NEPIRC. Questioning the validity of charging the salaries of these five individuals to NEPIRC's NIST/DCED program, which was NEPIRC's only program for the period under audit, is equivalent to suggesting that five of the fifteen NEPIRC employees, or one-third of its entire workforce, were either doing nothing to benefit the NIST/DCED program for an entire year or were working on other activities that together account for less than 3% of NEPIRC's total expenditures for the year. Obviously, that is unreasonable. The administrative time spent by the remaining individuals also represents time expended in staff meetings and other administrative functions. Such time is an allowable cost under OMB Circular Number 122.

In addition to the 8,380.75 hours explained above, another 2,709.75 hours is attributable to staff vacation days, personal days, bereavement time, sick days and holiday time. These hours, which comprise 23.04% of total hours charged to the Unallocated code, are allowed to employees as part of their overall employee fringe benefits package and are allowable expenses under OMB Circular Number A-122.

Schedule 2 also indicates that 514 hours (4.37%) were recorded as Training time, during which NEPIRC staff received continuing professional education in their area of expertise. These are also allowable under OMB Circular Number A-122. The remaining 156.50 hours (1.33%) represent a minor amount of travel time associated with training events and minor amounts of Billable and Unbillable time that was spent on client Engagements for which the staff member did not know the associated unique engagement number.

NEPIRC believes that time charged as "Unallocated" on employee timesheets represents valuable administrative time that is necessary and therefore allowable under the terms of the grants under which NEPIRC operates. They are correctly charged to NEPIRC's single NIST/DCED program and are substantiated by appropriate time records and source documents.

NEPIRC Response – Indirect Costs

The draft report questions NEPIRC's treatment of indirect costs. NEPIRC's first response is to note that the costs in question are clearly immaterial. NEPIRC is of the opinion that since it has only one program, a joint NIST/DCED program, which accounted for 97.92% of all of its expenditures for the period under audit, it has no true indirect or shared costs. NEPIRC has only one activity, which is to provide technical assistance to regional manufacturers, and it does that through one program. By definition, therefore, it can have no true indirect costs. All costs directly benefit NEPIRC's sole program.

Rationale & Substantiation for NEPIRC Response

NEPIRC's ledger for the period under audit included certain expenses that were labeled as Indirect Costs. However, just as the time code of Unallocated was used only for NEPIRC management purposes, the term Indirect Costs is also intended for use only by NEPIRC management. Indirect Costs, as used by NEPIRC, represent costs that NEPIRC cannot identify as relating to either specific client Engagements or administrative functions. NEPIRC strives to identify each invoice it pays, and therefore each cost it incurs, as relating to either a client Engagement or a general administrative purpose. For example, if NEPIRC purchases several cases of 3-ring binders, it attempts to identify how those binders will be used. If they are intended for use during an Engagement with a client, they are categorized internally as Engagement Costs. If they are simply being used to store internal reports and so forth, they are categorized as Administrative Costs. NEPIRC tracks Engagement and Administrative Costs in order to calculate the percentage of total expenditures that is tied directly to client Engagements. Understandably, not all expenses are easily categorized as Engagement or Administrative. Thus, NEPIRC management created an "Indirect Cost" category to contain items that cannot be assigned to its internal Engagement or Administrative categories. That amount does not represent shared or joint costs that should be shared with another program or activity. They are simply costs that await further internal classification as either Engagement or Administrative.

Summary – Accounting System

NEPIRC has provided adequate documentation to support that it has only one program, a joint NIST/DCED program that enables it to work with regional manufacturers. Data within the draft report also supports that assertion. NEPIRC has shown that the time code of Unallocated is used by NEPIRC staff to account for time that is spent either in the performance of administrative tasks, in training events, or away from work for time relating to NEPIRC's employee fringe-benefits program, all of which are allowable program costs. These costs are then accordingly charged to the NIST/DCED program. NEPIRC has clarified that it has no true indirect costs, since NEPIRC uses the general ledger category of Indirect Costs only for internal tracking purposes and has only one program to which costs can be charged. Thus, NEPIRC believes there are no questionable costs relative to NEPIRC's payroll costs, associated overhead costs or indirect costs. NEPIRC's existing accounting system adequately and accurately distributes NEPIRC's operating costs.

FINANCIAL REPORTING

Audit Finding

The draft report indicates that costs reported to NIST do not agree with its financial records and are incomplete or inaccurate, that NEPIRC did not report any program income to NIST, and that NEPIRC understated its program outlays for the period under audit.

NEPIRC Response

NEPIRC agrees that the final costs reported to NIST were lower than those subsequently contained within our annual financial statements. This is due to the fact that NEPIRC prepared its final report to NIST prior to the completion of its financial audit and before its ledgers were adjusted for items such as accounts payable and accrued expenses. Following the completion of its financial audit, NEPIRC did not submit a revised final report to NIST. NEPIRC has recently implemented internal controls and procedures that will prevent this from occurring in the future and will ensure the proper reporting of program income.

NEPIRC strongly disagrees with the finding that NEPIRC had excess program income for the period under audit. NEPIRC disagrees with this finding very strongly because no agency ever authorized the disposition of program income in accordance with the methods suggested within 15 CFR, Part 14, Sections 14.24(b)(1) or 14.24(b)(2), and such authorization must be made in order for 15 CFR, Part 14, Section 14.24(c) to apply, and because no limit to program income was ever stipulated or communicated to NEPIRC. Program income in the draft report is also incorrectly calculated because it includes earned manufacturer revenue, which is <u>not</u> program income, as it was not generated (directly or indirectly) by a federally-funded program during the period under audit or any previous period. It is the result of prior years' activities funded entirely with Pennsylvania Department of Community & Economic Development Industrial Resource Center grants.

Rationale & Substantiation of NEPIRC Response

Allowable uses of program income earned on projects financed in whole or in part with Federal funds are detailed within 15 CFR, Part 14, Section 14.24(b) as follows:

(1) *Added to funds committed to the project by the federal awarding agency and recipient and used to further eligible project objectives.*
(2) *Used to finance the non-Federal share of the project.*
(3) *Deducted from the total project allowable cost in determining the net allowable costs on which the Federal share of costs is based.*

Guidance regarding how a recipient should proceed to treat program income in the presence or absence of any specific guidance from the federal awarding agency appears at 15 CFR, Part 14, Sections 14.24(c) and 14.24(d) as follows:

(c) *When an agency <u>authorizes</u> the disposition of program income as described in paragraph (b)(1) or (b)(2) of this section, program income in excess of any limits <u>stipulated</u> shall be used in accordance with paragraph (b)(3) of this section.*
(d) *In the event that the awarding agency <u>does not specify</u> in its regulations or the terms and conditions of the award how program income is to be used, paragraph (b)(1) of this section shall apply automatically to all projects and programs.*

Clearly, in order for a recipient to have excess program income, the awarding agency would have to first authorize the disposition on program income as described in 15 CFR, Part 14, Sections 14.24(b)(1) or 14.24(b)(2) and then stipulate to the recipient any limits on program income. The Terms and Conditions of NEPIRC's NIST grant remain silent on the topic of program income, and NEPIRC received no additional guidance from NIST regarding the proper treatment of program income during the period under audit. The granting agency never authorized the disposition of program income as described in 15 CFR, Part 14, Sections 14.24(b)(1) or 14.24(b)(2). Without such authorization or specification, the treatment of program income suggested within 15 CFR, Part 14, Section 14.24(b)(1) applies, as per 15 CFR, Part 14, Section 14.24(d), but with no limits on program income because the awarding agency did not stipulate any limit on program income. Excess income is defined as income in excess of any stipulated limits. In order for NEPIRC to have had excess program income, NIST would had to have authorized NEPIRC to dispose of program income in accordance with 15 CFR, Part 14, Sections 14.24(b)(1) or 14.24(b)(2) and stipulated a specific limit on program income. NEPIRC contends that neither of those two events occurred.

The calculation of program income within the draft report is incorrect because it includes payments that were received from manufacturers during periods for which NEPIRC had only DCED funding that allowed it to retain those payments and apply them to center operating costs in future years. During the first few years of its existence (1988 – 1994), NEPIRC received only DCED funding for its operations. The terms and conditions of the DCED grant allowed NEPIRC to retain certain manufacturer payments and apply them to future periods on an as-needed basis. The DCED grant was structured this way because the original IRC program had a sunset clause and DCED believed that allowing grant recipients to retain the payments they received from manufacturers would allow them to continue to exist after their grant funding ended. Ultimately, the sunset clause of the IRC program was removed, and centers such as NEPIRC continue to receive DCED funding each year. However, NEPIRC is allowed to apply this historical deferred revenue to cover certain operating costs in excess of those covered by current grants. The differentiation between program income and the current-year application of prior manufacturer payments is identified on NEPIRC's Statement of Activities for the year ended June 30, 2000, which can be found on Page 3 of Appendix 1. That Statement of Activities shows *"Project and fiscal agent fees"* as a line item separate and distinct from *"Earned manufacturer revenue"*. Only *"Project and fiscal agent fees"* should be included in any program income calculation, since *"Earned manufacturer revenue"* represents the application of monies received prior to NEPIRC becoming a participant in NIST's MEP program.

Program income should be reduced for amounts invoiced for services rendered but subsequently written off as uncollectible. The calculation of program income in the draft report does not consider such bad debts, but instead reports program income at its gross amount. As noted on the Statement of Cash Flows for the year ended June 30, 2000, which is found on Page 4 of Appendix 1, NEPIRC incurred bad debt expense of $28,653 for the period under audit, of which $25,129 relates to the current year NIST/DCED program. This amount should be deducted from *"Project and fiscal agent fees"* to arrive at true program income for the period.

Summary – Financial Reporting

NEPIRC has acknowledged that center costs and program income reported to NIST for the period under audit did not agree with its financial records. NEPIRC has since implemented internal controls that will prevent such discrepancies from occurring in the future. NEPIRC sufficiently supported its position that NIST did not authorize any specific treatment of program income and did not stipulate any limits to program income. Thus, there is no excess program income for the period under audit. NEPIRC has also shown that program income is incorrectly calculated in the draft report because it includes earned manufacturer revenue, which is not program income, and because it did not take bad debt expense into consideration.

RESULTS OF FINANCIAL AUDIT

NEPIRC believes that it has provided information and documentation sufficient to support its position relative to the allowability of certain questioned payroll, overhead and other costs. NEPIRC also believes that it has provided sufficient information and documentation to support its position that it has no excess program income for the period under audit. Based upon its positions, NEPIRC has prepared the following joint program summary, depreciation and bad debt expense, source and application of funds and program income schedules:

NIST-MEP / DCED-IRC
Joint Program
For The Year Ended June 30, 2000

Summary

Costs incurred	$ 2,146,774	
Program service expenses		
Industrial Resource Center (DCED)	$ 1,324,739	
Manufacturing Extension Partnership (NIST)	800,685	
Year 2000 Readiness Amendment (NIST)	81,183	
Total service expenses	$ 2,206,607	(a)
Less: Applicable depreciation expense	(40,858)	
Less: Applicable bad debt expense	(25,129)	
Add: Equipment purchases	16,468	
Total costs incurred	$ 2,157,088	
Less: Auto lease expense	(8,586)	
Less: Interest expense	(976)	
Less: Program income	(0)	(b)
Allowable costs	$ 2,147,526	
NIST award percentage	33.33%	
NIST share of allowable costs	$ 715,770	
NIST share of allowable costs in excess of award	$ (105,770)	
NIST award for period	$ 610,000	
Amounts received from NIST	$ 572,418	
Balance due to NEPIRC	**$ 37,582**	

Depreciation and Bad Debt Expense

Depreciation

Industrial Resource Center	$ 26,230	
Manufacturing Extension Partnership	13,548	
Year 2000 Readiness	1,080	
Applicable depreciation	$ 40,858	
School to Work	400	
Management and General	1,663	
Total depreciation	$ 42,921	(a)

Bad Debts

Industrial Resource Center	$ 3,204
Manufacturing Extension Partnership	21,925
Year 2000 Readiness	0
Applicable bad debts	$ 25,129
School to Work	400
Management and General	3,124
Total bad debts	$ 28,653 (a)

Source and Application of Funds

	Budget	Actual
Source:		
NIST/MEP	$ 500,000	$ 500,000
NIST/Year 2000	110,000	72,418
DCED/IRC	1,071,602	1,071,602
Program Income		387,034
Other	648,398	126,034
Total	$ 2,330,000	$ 2,157,088
Application:		
Internal staffing	$ 1,171,000	$ 1,088,297
Outside consultants and professional fees	789,000	665,614
Occupancy costs	71,000	61,954
Staff training and development	53,022	75,620
Office and operating expenses	185,500	212,694
Miscellaneous	20,000	18,649
Auto lease expense		8,586
Interest expense		976
Other costs		24,698
Total	$ 2,291,522	$ 2,157,088

Program Income

Project and Fiscal Agent Fees:

	Gross	Bad Debts	Net
Industrial Resource Center	$ 37,369	$ (3,204)	$ 34,165
Man. Extension Partnership	374,794	(21,925)	$ 352,869
Year 2000 Readiness			
	$ 412,163	$ (25,129)	$ 387,034
Revolving Loan Fund	4,260		
Total	$ 416,423 (a)		

(a) June 30, 2000 financial statements.
(b) Allowable costs exceed total NIST, DCED and program income source of funds.