

U.S. DEPARTMENT OF COMMERCE
Office of Inspector General



**PUBLIC
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*NATIONAL INSTITUTE OF
STANDARDS AND TECHNOLOGY*

Industry Network Corporation

Audit Report No. DEN-9555-8-0001 / December 1997

Office of Audits, Denver Regional Office





UNITED STATES DEPARTMENT OF COMMERCE
Office of Inspector General/Office of Audits
Denver Regional Office
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Denver, Colorado 80202

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December 11, 1997

MEMORANDUM FOR: Norman L. Osinski, Chief
Acquisition and Assistance Division
National Institute of Standards and Technology

SUBJECT: NIST Cooperative Agreement No. 70NANB6H0011
Industry Network Corporation
Final Audit Report No. DEN-9555-8-0001

The Office of Inspector General, Office of Audits, Denver Regional Office, conducted an accounting system survey and interim financial audit of costs claimed under the subject cooperative agreement awarded to the Industry Network Corporation (INC), Albuquerque, New Mexico, for the 13-month period from January 1, 1996 through January 31, 1997. We provided copies of our draft audit report, dated September 23, 1997, to INC and NIST officials. INC provided a written response dated October 21, 1997, to the draft audit report, which is summarized in appropriate sections of the final audit report, and included in its entirety as Attachment 3.

We have provided a copy of the final audit report to INC and requested INC to prepare a written response to NIST addressing the audit report findings and recommendations within 30 days of the date of the report. Under DAO 213-5, you have a maximum of 60 days from the date of this memorandum to reach a decision on the actions that your agency proposes to take on each audit finding and recommendation and to submit an Audit Resolution Proposal to this office. The format for the proposal is shown in Exhibit 8 of DAO. Under the DAO, the Office of Inspector General must concur with your proposal before it may be issued as a final determination and implemented. The DAO prescribes procedures for handling any disagreements this office may have with the Audit Resolution Proposal.

Any information or inquiry regarding this draft audit report should be directed to me at (303) 312-7655, or John S. Bunting of this office at (303) 312-7663. We appreciate the cooperation and courtesies extended by NIST officials during our survey.

Introduction

The Office of Inspector General, Office of Audits, Denver Regional Office, performed an accounting system survey and interim incurred cost audit of NIST Cooperative Agreement No. 70NANB6H0011, awarded in December 1995 to INC. The cooperative agreement is entitled

“Manufacturing Extension Program Arizona Regional Office”. The project’s purpose is to transfer manufacturing technology techniques to small- and medium-sized businesses to assist in improving their manufacturing process capabilities and market competitiveness.

The 18-month award period from January 1, 1996 to June 30, 1997, has total estimated costs of \$1,590,000, with a federal government share of \$795,000, or 50 percent of allowable costs (see Attachment 1). As of January 31, 1997, INC claimed costs of \$717,097, incurred costs of \$718,343, and requested NIST reimbursement for \$358,548 (see Attachment 2).

Purpose and Scope of Survey

In October 1996, the NIST Manufacturing Extension Partnership Program Office requested the Office of Inspector General to conduct an accounting system survey of the subject cooperative agreement. Our survey covered the 13-month period from January 1, 1996 through January 31, 1997. We conducted our audit fieldwork in February 1997 at INC in Albuquerque, New Mexico.

The purpose of our survey was to (1) determine whether INC's accounting and financial management system complies with federal regulations and MEP requirements, and (2) perform an interim financial and compliance audit of the award. We interviewed INC officials and reviewed program files, award documents, and financial records obtained from both the NIST Grants Office and INC.

NIST awarded two prior cooperative agreements to INC (nos. 70NANB4H1560 and 70NANB5H0164). Final Audit Report No. DEN-7730-5-0001, issued in August 1995 on the first award, questioned \$88,057 in costs claimed, and cited an accounting system deficiency in that reimbursement requests did not reconcile to accounting records.

The audit scope did not include assessing INC’s performance under the award. Since we performed our accounting survey of costs claimed on an interim basis, additional questioned costs could result from subsequent performance or financial audits. We did not perform a review of the general and application controls of INC’s computer systems. We did, however, conduct other substantive tests and procedures to ensure that the computer-processed data was reliable.

We performed a limited review of internal controls applicable to the award to evaluate the effectiveness of the control and accountability systems. Rather than relying on INC’s internal controls, we expanded our substantive testing when we believed it was necessary. Our concerns with INC’s internal controls are discussed in detail in this report.

We reviewed compliance with laws and regulations as they applied to costs incurred, including Office of Management and Budget Circular Numbers A-110, *Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, and A-122, *Cost Principles for Non-Profit Organizations*. 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 terms and conditions.

Our survey was conducted in accordance with generally accepted government auditing standards 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.

Results of Survey

For the first 13 months of operations, we found that INC's accounting and financial management systems were generally adequate for purposes of the award, and INC was materially in compliance with award terms and conditions. However, our survey disclosed \$56,095 in questioned costs, consisting of unsupported or unallowable (1) fringe benefits of \$38,548, (2) travel costs of \$4,182, and (3) contractual discounts of \$13,365 (see Attachment 2). In response to the draft audit report, INC disagreed with our findings. INC's response is included in its entirety as Attachment 3.

Questioned Costs

Questioned Personnel and Fringe Benefit Costs

INC claimed personnel costs (salaries) of \$73,355 and fringe benefit costs of \$62,755, during the audit period. NIST approved an INC subcontract to the City of Tucson, Office of Economic Development, to assist manufacturers under the provisions of this award (No. 70NANB6H0011) and a prior NIST award (No. 70NANB5H0164), and to conduct joint City/INC activities. Under the terms of the subcontract, INC hired two employees and the City hired six employees to fulfill the work requirements.

In our draft audit report, we questioned all salaries and fringe benefit amounts. After receiving new documentation from INC, we now accept all salaries costs and \$24,207 (33% of salaries) in fringe benefit costs for the two INC employees. The remaining \$38,548 of fringe benefit costs claimed consist of performance bonuses for the two INC employees. INC did not provide a required prior agreement between it and its two employees in support of \$13,933 incurred as fringe benefit costs for performance bonuses received by the two employees.

In support of the remaining questioned fringe benefit costs of \$24,615, INC provided payroll records showing payments to City employees. However, INC did not obtain prior activity reports or performance bonus agreements for City employees. The INC Board of Directors evaluate the performance of, and determine bonuses for City employees (who work and reside in a different state). This performance appraisal methodology does not comply with OMB Circular A-122, Attachment B.6, descriptions of allowable compensation for personal services.

Although the subcontract states that INC will pay bonuses, language of the proposal, award documents, or subcontract, do not state that INC would use project funds to pay personnel-related costs in addition to contractual costs of City employees.

We question fringe benefit cost claims of \$13,933 for bonuses to the two INC employees as unallocable, and fringe benefits costs of \$24,615 for bonuses to the six City employees as unallowable, based upon OMB Circular A-122, Attachments A and B.

- Part A.2 states that to be allowable under an award, costs must be reasonable, allocable, and adequately documented.
- Part A.3 describes reasonable costs as those that are necessary for performance of the award and not excessive in amount.
- Part A.4 describes a cost as allocable if it is incurred specifically for the award.
- Part B.6 defines personnel costs as salaries, fringe benefits, and incentive compensation paid by the award recipient for services of employees.
- Part B.6 (l) specifies that the distribution of salaries to awards must be supported by personnel activity reports which reflect the distribution of activity of each employee whose compensation is charged, in whole or in part, directly to awards.
- Part B.6 (h) states that incentive compensation based on performance must be reasonable and paid pursuant to an agreement entered into between the award recipient and its employees before services were rendered.

INC Response

INC disagreed with all findings relative to personnel and fringe benefit costs. INC claimed that its two employees were hired solely for NIST agreement no. 70NANB6H0011. INC further stated that City employees worked specifically on the INC/City of Tucson agreement and that their performance bonuses were reasonable, allocable, and adequately documented. INC provided performance objectives and appraisals for its two employees and project engineers employed by the City of Tucson.

NIST Response

NIST agreed with the OIG findings and recommendations of the draft audit report. Subsequently, NIST merged the two Arizona region NIST awards into one because INC did not properly distinguish the two awards and the objectives are so similar.

NIST now manages three separate awards to INC, all with different objectives. The merged award services Arizona, another award services New Mexico, and the latest award services Alaska, Hawaii, and Nevada. NIST is concerned that INC may not be tracking its NIST awards separately.

OIG Comments

Based upon new INC documentation and NIST information, we now accept all \$73,355 in personnel claims. We also accept \$24,207 in fringe benefits applicable to those personnel claims at the approved rate of 33 percent. INC still did not provide prior bonus agreements, justifications for bonus amounts, or activity reports for project engineers.

We continue to question (1) \$13,933 in bonuses paid to INC employees as unsupported, and (2) \$24,615 in bonuses paid to subcontractor employees as unallowable.

Other Questioned and Unsupported Costs

INC does not distinguish transactions among its different award programs and often posts transactions improperly. Timing differences exist because INC charges NIST for some costs before they are entered into the accounting system. Although the INC accounting system is a project costing system, the treatment of transactions is not always appropriate--resulting in questioned travel and contractual costs (see below and Attachment 2).

- We question \$4,182 of travel costs claimed. INC lacked support for two trips of a consultant (\$2,702 and \$1,060), and one voucher was \$420 less than the actual claim.
- We question \$13,365 for contractual costs claimed. INC charged NIST for total gross invoice prices rather than the net amount actually paid. Twelve invoices reflected \$13,365 in discounts which reduced INC's cost incurred, but were not appropriately credited to NIST.
- Our draft report questioned \$7,886 for equipment costs claimed, and \$13,902 for other operating costs claimed. INC provided new documentation in support of these costs, and we now accept all claims for equipment and other operating costs.

OMB Circular A-122, Attachments A.4, A.5, and B.33, state that:

- a cost is allocable to a Government award if it is incurred specifically for the award, and
- purchase discounts received by the recipient which relate to allowable costs must be credited to the Government either as a cost reduction or cash refund.

INC Response

INC disagrees with all findings for other questioned and unsupported costs. INC provided new documentation from its accounting system called billing review reports. INC denies improper posting of any transactions, yet made adjustments to correct errors. Specifically in support of questioned costs, INC provided receipts or proof of adjustments for travel, equipment and other operating costs. Also, to dispute questioned contractual costs, INC approached each consultant with a letter which each consultant signed. The letter read:

"On one or more of your invoices to INC, you have shown a 'discount' of your hourly rate or the number of hours invoiced. It is our understanding that you intend for this 'discount' to actually be a donation to INC - a 503@ (3) non-profit corporation. Please verify that you intend for this 'discount' to be a donation by signing below and returning this form at your earliest convenience."

NIST Response

NIST agreed with all findings for other questioned and unsupported costs.

OIG Comments

Although previous monthly project expense reports did not reconcile to INC's cost claims, the billing review reports do. As previously stated, we continue to believe that the accounting system is adequate; however, the treatment of transactions sometimes is not. Our analysis on new INC documentation allows us to now accept all previously questioned cost claims for equipment and other operating costs, which totaled \$7,886 and \$13,902 respectively.

Receipts provided for travel showed that costs were incurred for persons not designated as employees or engineers to work on the NIST project. Receipts did not indicate that the cost was incurred for the project. Also, the majority of questioned costs were incurred for travel to China by two persons, which is nowhere near the project region. We continue to question \$4,182 as unsupported because the costs do not appear allocable.

Lastly, we find the INC letters, which were signed by consultants, as inadequate. Previous intent to match is lacking. Presentation of consultant invoices clearly label amounts in question as "discounts." Although the INC letters attempted to reclassify "discounts" as "donations", we are not convinced by these letters. It is apparent that these credits were not intended to be donations, perceived as donations, or documented as donations. We continue to question \$13,365 of contractual costs as unallowable.

Revised Conclusions

Final results of our survey disclosed \$56,095 in questioned costs, consisting of unsupported or unallowable (1) fringe benefits of \$38,548, (2) travel costs of \$4,182, and (3) contractual discounts of \$13,365 (see Attachment 2).

Recommendations

We recommend that the Chief, NIST Acquisition and Assistance Division (1) disallow \$56,095 in questioned costs, and (2) recover \$28,047 of excess federal disbursements. We further recommend that the Chief request that INC undergo a program-wide audit to determine whether cross-billing, double-billing, misallocation or improper posting of transactions is occurring between INC's various award programs.



William R. Suhre December 11, 1997
Regional Inspector General for Audits

Attachments

INDUSTRY NETWORK CORPORATION
NIST Cooperative Agreement Number 70NANB6H0011

SOURCE AND APPLICATION OF FUNDS
January 1, 1996 through January 31, 1997

	<u>Approved Budget Amount (a)</u>	<u>Receipts and Expenses</u>
<u>SOURCE OF FUNDS:</u>		
Federal	\$ 795,000	\$358,548
Non-federal	<u>795,000</u>	<u>359,795</u>
Total	<u>\$1,590,000</u>	<u>\$718,343</u>
 <u>APPLICATION OF FUNDS:</u>		
Personnel	\$ 61,200	\$ 73,355
Fringe Benefits	20,196	62,755
Travel	36,000	29,166
Equipment	245,725	33,861
Supplies	3,000	3,965
Contractual	1,120,309	448,882
Other Operating	<u>103,570</u>	<u>66,359</u>
Total	<u>\$1,590,000</u>	<u>\$718,343</u>

Note:

(a) Approved award budget through June 30, 1997.

INDUSTRY NETWORK CORPORATION
NIST Cooperative Agreement Number 70NANB6H0011

SUMMARY OF INTERIM FINANCIAL/COMPLIANCE AUDIT
January 1, 1996 through January 31, 1997

Description	Budget (a)	Costs Claimed	Results of Audit		
			Costs Questioned	Costs Unsupported	Costs Accepted
Personnel	\$ 61,200	\$ 73,355	\$ -0-	\$ -0-	\$ 73,355
Fringe Benefits	20,196	62,755	38,548 (b)	13,933	24,207
Travel	36,000	29,166	4,182 (c)	4,182	24,984
Equipment	245,725	33,861	-0-	-0-	33,861
Supplies	3,000	3,965	-0-	-0-	3,965
Contractual	1,120,309	448,882	13,365 (d)	-0-	435,517
Other Operating	<u>103,570</u>	<u>66,359</u>	<u>-0-</u>	<u>-0-</u>	<u>66,359</u>
Total (Incurred)	\$1,590,000	\$718,343	\$56,095	\$18,115	\$662,248
Unclaimed	<u>-0-</u>	<u>(1,246)</u>	<u>-0-</u>	<u>-0-</u>	<u>(1,246)</u>
Total (Claimed)	<u>\$1,590,000</u>	<u>\$717,097</u>	<u>\$56,095</u>	<u>\$18,115</u>	<u>\$661,002</u>

Federal Funds Disbursed	\$358,548
Costs Claimed	\$717,097
Less: Questioned Costs	<u>56,095</u>
Costs Accepted	661,002
Federal Cost Sharing Ratio	<u>x 50%</u>
Less: Federal Funds Earned	<u>330,501</u>
Refund Due the Government	<u>\$ 28,047</u>

Notes:

- (a) Approved award budget through June 30, 1997.
- (b) See pages 3-4 for details.
- (c) See page 5 for details.
- (d) See page 5 for details.



CORPORATE HEADQUARTERS
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505-843-4250
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Facsimile: 505-843-4255

"An affiliate of the NIST Manufacturing Partnership"

October 21, 1997

William R. Suhre, Regional Inspector General for Audits
United States Department of Commerce
Office of Inspector General/Audits
Denver Regional Office
900 19th Street, Suite 765
Denver, Colorado 80202

Dear Mr. Suhre:

The following is Industry Network Corporation's response to the Draft Audit Report No. DEN-9555-7-XXXX dated September 23, 1997. We wish to thank you and your staff for their assistance during the Site Visit in February 1997 and the follow-up Audit Reports. We also appreciate your feedback and recommendations. The following is our response to your findings:

Questioned Costs

Questioned Personnel Costs

The audit stated that there was not adequate support to accept the personnel costs for INC's two employees. It was stated that the employees did not "allocate" their time between the three individual activities (the two NIST agreements and the joint City/INC activity) and that INC's agreement with the City of Tucson "does not state that INC would use project funds to pay personnel-related costs in addition to contractual costs of City employees".

Response- Personnel Costs

b(6) [redacted] and [redacted] (the two employees whose time is questioned above) were hired SOLELY for NIST agreement # 70NANB6H0011. The two positions in question were not part of the INC/City of Tucson agreement. These positions were part of the Operating Plan submitted to NIST in support of the NIST agreement. See Exhibit A.

When Industry Network entered into an agreement with the City of Tucson, Office of Economic Development, paragraph 4 of the contract states that "Whereas, INC desired OED to perform the statement of work as it relates to the NIST contract and whereas OED desires to perform such work according to such NIST contract provision." It would be impossible to separate the City's project activities from the NIST project activities. The OED activity (referred to as joint City/INC activity by the auditor) is part of the NIST contract and has the same program functions. Therefore, it would be illogical to try to separate the two programs.

INC is not agreeing with this finding and we are claiming that these costs of \$73,355 are both allocable (100% to our NIST agreement 70NANB6H0011) and allowable. At our exit conference on the last day of the site visit, this item was not included in the list of financial findings which the auditor gave us. See Exhibit B.

- Alaska
- Arizona
- Hawaii
- Nevada
- New Mexico

Questioned Fringe Costs - Employees

It was stated that INC did not provide a required prior agreement between it and its two employees or performance appraisals in support of \$13,933 incurred as fringe benefit costs for performance bonuses received by the two employees.

Response - Fringe for Employees

INC's employee files contain performance objectives which are filled out at the beginning of each year. These SAME forms are completed at the end of the year to evaluate the performance of both INC employees and partner employees. The files for the two employees in questions DO contain both the prior agreements and the performance appraisals which support the \$13,933 incurred as fringe benefit costs. Please see Exhibit C for copies of these forms. Therefore, INC is disputing these questioned costs.

Questioned Fringe Costs - Partner Employees

It was stated the INC did not obtain prior activity reports or performance bonus agreements for City employees.

Response - Fringe Costs for Partner Employees

INC obtained prior activity reports and performance appraisals for City employees. Each City employee was evaluated at the end of the year based upon objectives determined at the beginning of the year. The costs for these performance bonuses were reasonable, allocable and adequately documented. They were also necessary for the performance of the agreement and were not in an excessive amount. The costs were allocable because the objectives performed to earn the performance bonus were performed specifically for the NIST agreement. Please see Exhibit D for copies of these forms. Therefore, INC is also disputing these questioned costs.

Other Questioned and Unsupported Costs

Reconciliation of general ledger expense reports to Form SF-270

It was stated by the auditor that INC's monthly general ledger project expense reports do not reconcile to the monthly requests for reimbursement and the SF-270 forms.

Response - Reconciliation of general ledger expense reports to Form SF-270

Exhibit E contains copies of our SF-270 forms from 1/1/96 to 12/31/96 for both of our Arizona grant agreements. Each SF-270 form reconciles both to our general ledger and to the project expense reports for the particular month. INC uses a project-management based accounting system which allows for the grants to be set up as "projects" and to accumulate charges for each unique project. When invoices or timesheets are entered through accounts payable or payroll, each cost is assigned to a "project". At the end of each month, we print a "billing review" report which includes all charges which have been entered and allocated to each grant agreement for the month. This billing review report actually generates the "invoice" to NIST which calculates the amount of the request for reimbursement which is the same as the SF-270 form. It is impossible for an items to be charged to NIST before it is put into the accounting system because the accounting system generates the "invoice" to NIST. See Exhibit E which show the general ledger reconciled to each project expense report and to each SF-270.

Improper posting of items

The auditor stated that INC often posts items improperly.

Response - Improper posting of items

This statement is untrue and unsupported. Since each grant has its own budget, it is fairly easy to distinguish which grant should be charged for each invoice that comes to accounts payable. This audit report provides no evidence that transactions were posted improperly. Exhibit F includes a copy of our last Fiscal Audit report which reported zero findings. The audit included a thorough review of INC accounting practices and software.

Questioned Travel Costs

Travel costs of \$4,182 were questioned. The auditor stated that INC lacked support for two trips of a consultant (\$2,702 and \$1,060) and one voucher was \$420 less than the actual claim.

Response - Questioned Travel Costs

We did not have proper documentation for these charges on file at the time of the audit, but in a letter to Karen Blechschmidt dated March 14, 1997, we sent backup for the two charges of \$1,060 and \$2,702. Please see Exhibit G for a copy of the letter. A copy of the backup is also included. A copy of the backup for the questioned charge of \$420 is also included in Exhibit G. All of these charges were allowable under the contract.

Questioned Equipment Costs

Equipment costs of \$7,886 were questioned. Two computers were purchased prior to the award date and the auditor stated that one equipment claim was \$2,020 more than the invoice amount for the purchase of five computers.

Response - Questioned Equipment Costs

Copies of all invoices for computer equipment were faxed to Karen Blechschmidt on March 21, 1997. They are again included in Exhibit H. In our March 97 billing, the \$5,866 was reversed. This was to adjust for the computers which were purchased prior to the award date. One of the computers in question was sent to B.J. Smith (Tucson, AZ engineer) when her original computer which was purchased after the award date was sent back to headquarters for repair. The nature of INC's operations often require the transfer of equipment among various state operations. All of the backup for the computer equipment is attached in Exhibit H. A spreadsheet is also attached. There is not an error of \$2,020. The equipment claim was the same as the invoice amount.

Questioned Contractual Costs

Contractual costs of \$13,365 were questioned. It was stated that INC charged NIST for total gross invoice prices rather than for the net amount actually paid.

Response - Questioned Contractual Costs

Consultants incorrectly described "in-kind" donations as discounts on their invoices. Each consultant has corrected this error and we have attached letters from each consultant to show that the discount was in fact meant to be an "in-kind" donation. We have included a letter from each consultant whose invoices were charged through to NIST agreement 70NANB6H0011. Please see Exhibit I.

Questioned Other Operating Costs

Other Operating Costs of \$13,902 were also questioned. \$12,502 related to a fee on the contract and \$1,400 was for an unsupported other operating cost.

Response - Questioned Other Operating Costs

Mid-way through 1996, we had a verbal agreement with NIST to split Arizona into two geographic regions for the purpose of billing charges through to our two Arizona agreements. This was possible because the two Arizona agreements had the same basic program functions. The northern region was billed through to agreement 70NANB5H0164 and the southern region was billed through to 70NANB6H0011. Cheryl Rauh, our NIST contact, said that we did not have to have a written revision to our budget to make the changes. The fee distribution was then changed from the original allocation of 75% to 70NANB5H0164 and 25% to 70NANB6H001 to a 50/50 split for each agreement.

At your direction, however, we adjusted the fee portion of this finding in our February 97 billing. Please see Exhibit J.

Exhibit K includes the backup for the \$1,400 check to the US Trade Center. The back-up documentation for this check was not in the file at the time of the audit, but it has since been recovered. This item was paid to help a client participate in a trade exposition which would result in increased sales.

In closing, INC has accepted and corrected \$18,368 of the questioned costs. These costs include the computers purchased prior to the award date of \$5,866 and the fee adjustment of \$12,502. Exhibit H shows the NIST credit for the equipment and Exhibit J shows the credit for the fee.

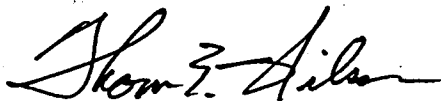
INC continues to dispute the remaining questioned costs:

Salaries of INC employees	\$ 73,355
Fringe for INC employees	24,207
Fringe for Partner employees	38,548
Travel costs	4,182
Equipment costs	2,020
Documented donations	13,365
Other Operating costs	<u>1,400</u>
Total Disputed Items	\$ 157,077

We apologize for all the time spent in preparing both the Audit Report and in analyzing this response. In the future, it would greatly help if the audit team could ask more questions while they are on-site. Supporting documents for questioned costs could be easily obtained and explained preventing lengthy reports and responses.

Please review our comments and our completed corrections. Please notify us if you see any further steps which should be taken. We look forward to your response.

Sincerely,



Thomas E. Wilson
Vice President - Finance/CFO

Enclosure

cc: Norman L. Osinski, Chief, NIST Acquisition and Assistance Division
William A. Rector, President and CEO, Industry Network Corp.
Roger D. Kilmer, MEP Program Operations, NIST
Gail Case, Controller, Industry Network Corp.