This is not the first time we've typed "A wise man learns from the mistakes of others; a fool learns from his own mistakes." Learning from the mistakes of others, so that you don't make those same mistakes, is one of the themes of this blog.

Come learn from the mistakes of **Sand 9, Inc .**, a small business located in Cambridge, Massachusetts.

Sand 9 is a small business that aims to "disrupt the $4+B timing market with advanced MEMS resonators." According to its website: "Sand 9's piezoelectric MEMS devices enable semiconductor manufacturers to finally eliminate the need for external clock references, heralding a new era in electronic timing." We don't know much about MEMS—especially piezoelectric MEMS—but it seems to be some kind of replacement for traditional quartz timing devices. Is Sand 9's technology truly disruptive? We don't know that either. But if it is disruptive, then this is the kind of company the DoD wants to attract.

We've written an article or three about the DoD's quest to attract the kind of companies who can innovate and create disruptive technological advances. We've been more than a little skeptical about the Pentagon's chances for success.

But before we dive into Sand 9's recent legal problems, let's talk about implied certifications. We heard a panel discuss the topic at the recent Crowell & Moring "Ounce of Prevention Seminar" (OOPS). If you're interested, here's a **link** to a 2008 scholarly article on the topic. And here's **another link** to a more recent article discussing a recent decision by the Court of Appeals (Fourth Circuit) that said –

Abandoning its prior hesitation, the Fourth Circuit then explicitly adopted the implied certification theory of liability, holding that 'the Government pleads a false claim when it alleges that the contractors, with the requisite scienter, made a request for payment under a contract and withheld information about its noncompliance with material contractual requirements.' As applied to this case, the Fourth Circuit concluded that the government had sufficiently pled a valid implied certification claim.

As you may gather from the foregoing, the “implied certification theory” is an argument that a contractor has committed a violation of the False Claims Act (FCA) when it submits an invoice to the government—even though that invoice is accurate in all respects—but there is a violation of the False Statements Act made somewhere during contract performance (or even perhaps prior to contract award). Basically, the argument is that each invoice being submitted contains an “implied certification” that the contractor is in compliance with contract requirements, and when it knows that it is not in compliance then each invoice is a false claim.

Or something like that. We’re not attorneys.

So back to Sand 9, Inc.

On May 14, 2015, the Department of Justice announced that Sand 9 had agreed to pay $625,000 to settle charges it had violated the FCA with respect to SBIR grants it had received from the National Science Foundation (NSF). Now we expect you know what the SBIR program is; if you don’t, then you can do a keyword search on this site or else Google it.

From the DoJ **press release** , we learned that Sand 9 had “misrepresented its accounting and timekeeping systems” to the NSF with respect to “the award and performance of its SBIR grants.” These were SBIR Phase II grants. We’ve discussed the risks and pitfalls associated with moving from Phase I to Phase II before. The Phase II requirements are much tougher than the typical Phase I requirements, and many small businesses stumble as they move into Phase II. Again, you can search those blog articles out on this site.

What was the issue? According to the DoJ announcement—

The United States alleged that Sand 9 misrepresented its accounting and timekeeping systems to obtain the grants, and failed to maintain complete timekeeping records for its employees while receiving grant funding for labor.

The United States further contended that Sand 9’s progress reports certified compliance with the grant terms, and that certain reports also certified that all of the funds committed to the

grant had been expended as designated in the grant budget, even though Sand 9 failed to maintain its accounting system in a manner that tracked expenditures separately by grant or according to categories of the approved grant budget.ÂÂ These progress reports caused the NSF to release incremental payments to Sand 9.

Let's unpack those two paragraphs a bit.

First, when applying for its SBIR Phase II grants Sand 9 allegedly falsely claimed (or "represented") that it had adequate accounting and timekeeping systems. Typically, Section K of a contractor's proposal contains a number of "Reps and Certs," and not a lot of thought goes into ensuring that accurate statements are being made on those Representations and Certifications. Yet there is risk there, and a contractor is well advised to have a process in place to review those Reps and Certs for accuracy.

How does a contractor know if it has an adequate accounting system before DCAA performs an audit? Well, one approach is to take the government's SF 1408 and fill it out, answering honestly. Or you can hire independent firms to evaluate your practices in light of SF 1408 requirements. There is really no excuse for not understanding what the government expects of you in terms of accounting system adequacy.

(That's not to say that a good SF 1408 analysis guarantees that DCAA will pass your accounting system when the auditors do show up in the future. It's DCAA: nobody can guarantee any result.)

It seems, then, that Sand 9 told the NSF through its Reps and Certs that its systems were good to go for its Phase II contracts. Then, during performance, it submitted status reports that said the grant funds were being expended. And the funds may have been expended as described in those reports, but when the auditors showed up, Sand 9 couldn't demonstrate that to the satisfaction of the auditors. Its accounting system did not track expenditures "separately by grant". Meaning it didn't have a good project accounting system. In addition, Sand 9 didn't track expenditures "according to the categories of the approved grant budget". Meaning it didn't have good accounting subsystems and probably lacked good General Ledger control.

So all that cost Sand 9, Inc. $625,000 plus attorney fees. We don't know whether or not they

will continue with development of their disruptive MEMS technology for the Federal government.

Meanwhile, the Small Business Administration **announced** a competition to design a new logo for the SBIR and STTR programs – "America's Seed Fund." The announcement stated that "SBIR/STTR awards enable small businesses to explore their technological potential, stimulate innovation to meet federal R&D needs, and potentially profit from private-sector commercialization of developed technologies."

All that is true, but what is not being well-publicized is the fact that companies wishing to avail themselves of SBIR/STTR funds are subject to most of the same rules as the largest defense contractors. They will be held to the same high standards and subject to the same audit requirements. Getting some of that sweet, sweet "seed fund" money is nice; no doubt about it. But there's a price to be paid—and that price is establishing bureaucratic systems and controls. Some companies aren't willing to pay that price, and they should not accept government funds because of that decision.