

More Problems for SBIR Firms

Written by Nick Sanders
Monday, 24 April 2017 00:00 -

We have often warned companies about the increased risks that come from growth in the government contracting space. In that regard, one of the specific areas we've noted is the acceptance of SBIR (Small Business Innovative Research) awards that require compliance with accounting regulations. We've pointed out that recipients of such awards are too often unaware of the increased requirements that come along with them, and are thus ill-prepared to comply with those requirements.

They are surprised when the auditors come calling. They are surprised when they are asked to provide supporting documentation for time and expenses for which they've billed the government customer. They are surprised when costs are questioned, or disallowed. The questioning and/or disallowance of costs can significantly disrupt those small businesses. Just supporting an audit is disruptive enough, but hiring outside attorneys to argue against the findings in court can be even more disruptive. Finding sufficient cash to make refunds associated with alleged overpayments can be a serious challenge. In extreme cases, the end result of the process is bankruptcy.

Unfortunately, by definition those companies are all small businesses. Small, innovative, businesses. Thus, contractors that may have offered promising technology to the government are financially harmed or bankrupted, and the government ends up with nothing.

We have argued that such companies should not be subjected to the full panoply of government compliance regulations. It is unrealistic to expect them to have sophisticated accounting systems and to have the kind of documentation maintained (and retained) by the biggest contractors. It is, however, what it is. Those small businesses that receive Federal funds (of any type) are expected to comply with contract terms and conditions. Period. There is no free pass.

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We were reminded, once again, of this lesson, courtesy of a recent Department of Energy (DOE) Inspector General (IG) [audit report](#) .

The DOE IG reviewed eight grants and one cooperative agreement awarded to small businesses by the DOE under the SBIR and Small Business Technology Transfer (STTR) programs. According to the report, the IG found (among other things) that—

Three recipients had not properly accounted for, or maintained adequate supporting documentation for, a portion of their project expenses [and] the Department had not ensured that three recipients met all terms and conditions of their awards. Specifically, we identified instances where recipients had not obtained required audits, had not ensured adequate participation by a nonprofit research institution, or had not adequately documented involvement of the principal investigator, as required by their awards.

The IG reported that the root cause(s) of the findings were (1) ignorance and (2) limited oversight. The IG reported—

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The issues that we identified were primarily due to recipients having a *lack of awareness of regulations and specific award terms and conditions* and, at times, Department officials providing limited oversight. We identified several areas in which the Department could improve, including additional training for recipients and reevaluation of staffing needs. ... Considering that many small businesses with limited Department program experience are receiving funding, it is important for the Department to ensure that recipients are fully aware of Federal and Department requirements that were designed to help the SBIR and STTR programs meet their intended goals and objectives in an efficient and effective manner.

(Emphasis added.)

What were the specific findings? Quoting from the IG's audit report:

- Light Foundry LLC, which had received an award of over \$1.1 million, provided a full list of expenses; however, the recipient had comingled award expenses with other business expenses. From this list, we sampled several project-related expenses and asked the principal investigator to provide us with specific invoices; however, the principal investigator had to search through his email accounts for each invoice, some of which he could not locate. Therefore, we concluded that Light Foundry LLC did not have a sufficient records management system in place to maintain award documentation. While it appeared the majority of the expenses were project-related, we could not reasonably determine or verify which expenses were specifically paid for using Science funds. As a result, we were unable to make a determination on the allowability, allocability, and supportability of the \$1.1 million in funds charged to the award.

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- SixPoint Materials, Inc., an ARPA-E [cooperative agreement] recipient, required employees to record actual hours on a monthly timesheet, but instead of using those recorded hours, it charged a fixed percentage of each employee's time when charging labor against its award. As a result, our analysis showed that of about \$357,000 in labor, fringe, and indirect expenses through August 2015, SixPoint Materials, Inc. had overcharged ARPA-E by approximately \$42,000, an amount we questioned as unallowable.

- Atmospheric Observing Systems, Inc., a Science [grant] recipient, had not maintained adequate support for subcontractor labor charges of \$4,050 charged to its award. Atmospheric Observing Systems, Inc. hired a former employee as a subcontractor to complete work on its project. The subcontractor, however, did not provide any invoices for work completed. Rather, there was an informal arrangement between the recipient and the subcontractor regarding compensation. Accordingly, we question these contractual expenses charged to the award as unsupported.

- Stratton Park Engineering Company, Inc. and Tech-X Corporation, had not ensured that annual audits had been conducted as required by the terms and conditions of their awards and Federal regulations on financial assistance awarded to for-profit organizations. Federal requirements in place at the time the awards were administered, and incorporated in the terms of the agreement, mandated an independent audit on any recipient that expended Federal awards of \$500,000 or more in a year. These audits are intended to determine whether the recipient has an internal control structure that provides reasonable assurance that the recipient is managing its award or awards in compliance with Federal laws and regulations as well as the terms and conditions of the award. We found that both recipients had expended over \$500,000 per year for FYs 2012, 2013, and 2014, but neither had arranged to have the required audits performed.

- Stratton Park Engineering Company, Inc. had not been properly charging labor hours for its principal investigator and, therefore, was unable to show that it met a grant requirement that the principal investigator devote no less than 3 hours on average per week for the duration of

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the project. The principal investigator had not charged time to the award during the last 2 years. Based on his presentation of the project and our discussions with the principal investigator during our site visit, we believe that he had been substantially involved but mistakenly had not recorded his time. Further, the principal investigator indicated that he was unaware of the requirement to track his time on the project. Had we not visited this company, it would have appeared to us that this individual had no involvement with the project during the last 2 years.

Small businesses are vital to the economy and they are a vigorous source of innovation. For those reasons, there are special Federal programs to help them move forward. However, too often those businesses are focused on technical achievement and do not devote sufficient attention to accounting and other administrative requirements associated with their Federal awards. As this recent DOE IG report shows – *once again* – those small businesses ignore those non-technical requirements at their own peril.