Connecticut Innovations – June 3, 2014



How to Develop an Indirect Rate for Your SBIR Proposal

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How to speak Greek – Indirect rates

- 1. THE **SECOND** MOST EXPENSIVE MISTAKE A NEWBIE MAKES
- 2. THE MULTIPLIER
- 3. WHAT YOUR GOVERNMENT CUSTOMER THINKS IS A "NORMAL" INDIRECT RATE
- 4. WHAT DRIVES YOUR INDIRECT RATES
- 5. How will your key people spend their time?
- 6. Which is more important the project or the business?

What Auditors look for prior to your Phase II Award

1. "Acceptable" accounting system

2. Reasonable cost proposal (believable indirect rates)



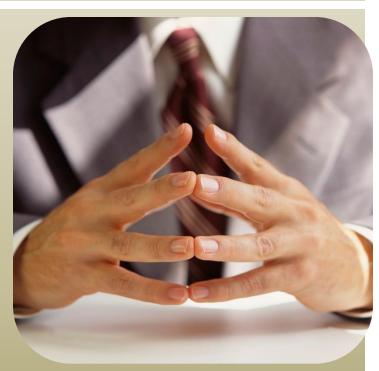
SBIR PHASE **II** = **FAR** 52.216-7

Phase I = FFP

Phase II = CPFF

Award and ongoing compliance hinges on maintaining an "Acceptable" accounting system

A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost that is inadequately supported.



AN "ACCEPTABLE ACCOUNTING SYSTEM"

1. Does your General ledger segregate:

Direct costs

Indirect costs

Unallowable costs

Lab jackets polling question...

2. Written accounting policies and procedures

The Jameson Pass/Fail quiz:

A. Can you produce monthly job cost reports at billing/target/proposed indirect rates

B. Can you tell me how your indirect rates are running now?



FAQ - How indirect rates affect your business

We are in a business incubator and wanted to put as much money as possible into the scientific project, so we did not ask for fee, overhead or fringe benefits.

We intend to develop a commercial product and the strategy seemed to work well for getting our project's initial funding.

Will this decision affect future grants???

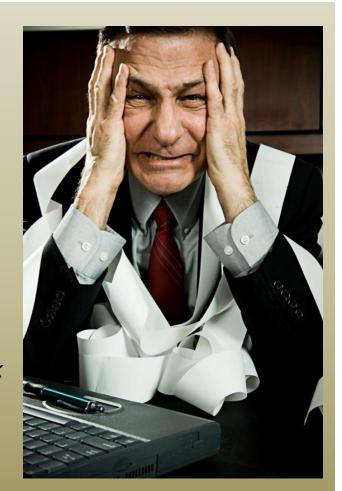
You've either made a good strategic move or created a huge financial problem for yourself....let's explore.

STRATEGY - HOW YOU PLAN TO USE GOVERNMENT FUNDING?

(AND DEAL WITH ALL THE RED TAPE)

- 1. A one-off award as a way to prove concept (Qualcomm) as you are largely VC funded or your technology is almost at the goal line.
- 2. You believe the government can benefit from your technology and winning government contract and grant awards is a valid way to fund the development of your technology.

Reality check – in 35 years in this industry the biggest fallacy of newbies is to think they can do \$5M of work with \$1.5M. Then as time unfolds, they realize that \$20M+ is really needed to develop their technology and carve out a niche... so a multiple award strategy may be needed!



"WORKING BACKWARDS"

Total Award	<u>1,500,000</u>
7% Fee	100,000
Total Costs	1,400,000 in here?
Indirect costs (plug)	1,400,000 200,000 What's in here?
Total Unloaded Costs	<u>1,200,000</u>
Prominent Consultant #1	50,000
Prominent Consultant #2	50,000
Subcontract costs	400,000
Materials costs	200,000
Subtotal labor costs	<u>500,000</u>
Fringe benefits	75,000
Labor Costs	425,000

Second most expensive mistake

Proposing indirect rates that are too low creates almost immediate cash flow problems proportional to the degree of the "miss".

If you bill the government for your direct costs plus say 25% for provisional (a.k.a. projected, billing, targeted, proposed) indirect costs and your <u>actual</u> indirect rates run at 75%, you have a 50% "miss" which will cause cash flow problems.

This adds up to hundreds of thousands of dollars PER PROJECT!



HOW TO FIND THE RIGHT FIT - THE MULTIPLIER

2.68

Direct labor	\$1.00
Overhead @ 100%	1.00
Subtotal	2.00
G&A @ 25 %	50
Subtotal	2.50
Fee @ 7%	<u>.18</u>

For every \$1.00 you pay labor, you charge the government \$2.68

Total



How does your burn rate compare?

Our experience with established *DoD SBIR-type* government contractors:

<2.4 inexpensive

2.4 – 2.7 normal

2.7 – 3.0 expensive

>3.0 prohibitive

Computer jockeys from UCal Berkeley (BAA)
Dayton, Ohio (IDIQ)
White Plains, NY (SBIR)



HOW DOES THAT TRANSLATE INTO NIH-EASE

NIH pools costs differently....

Direct labor	1.00
Fringe benefits @ 35%	.35
Subtotal	1.35
F&A @ 85%	1.15
Subtotal	2.50

85% is NOT the answer.

Fringe range 28-35% (low 40's max)

F&A range (60-70% is "normal")

> 40% = PLEASE AUDIT ME!!!



Run indirect rate projection

What drives your indirect rates — how do your key people charge their time?

	Now	Goal
Working ON the business (indirect labor):		
Building strategic alliances	0%	15%
Diversifying the revenue stream	0%	20%
Advancing the technology	0%	15%
Working IN the business (direct labor):		
Project - technical work	100%	50%

Indirect labor (vs. direct labor) is what DRIVES your indirect rates

Indirect rates give you the money to build your infrastructure (people, facilities, processes) and allow you to work ON the business rather than being forced to work IN it



WORKING BACKWARDS - REVISITED

Total Award	<u>1,500,000</u>
7% Fee	100,000

Total Costs <u>1,400,000</u>

Indirect costs (plug) 200,000 (16.7%)

Total Unloaded Costs 1,200,000

Prominent Consultant #1 50,000

Prominent Consultant #2 50,000

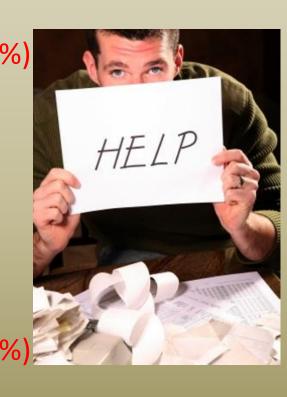
Subcontract costs 400,000

Materials costs 200,000

Subtotal labor costs <u>500,000</u>

Fringe benefits 75,000 (17.6%)

Labor Costs 425,000



Multiplier = 1.166*1.176 = 1.37

Cost of blowing indirect rates in proposal...

- If you miss *too low* on the rates used in your cost proposal <u>you will have cash flow problems & losses</u>.
- If you miss too high you could lose the award and you will owe the money back.
- If done properly, cost-type work can be used to help fund your growth rather than <u>diluting yourself or</u> <u>going into debt</u>

But doesn't a higher rate hurt my ability to win???



NIH Scored Review Criteria

Significance.

Investigator(s).

Innovation.

Approach.

Environment.





DOD AWARD SELECTION CRITERIA

- The technical and scientific merit of the proposed approach;
- Key personnel's qualifications in this area of research; and
- The potential for transition into a commercial product.

So where does it say anything about indirect rates or pricing?



INDIRECT RATES - BALANCING ACT

Indirect rates too high = uncompetitive

Indirect rates too low:

- 1. Restrict the growth of the business by underspending and cutting corners to mitigate your mistake (fire everyone between projects)
- 2. Dig the business into a financial hole:
 - a. <u>borrowing</u> from credit cards, personal savings, banks, family and friends
 - b. dilute yourself by <u>selling equity</u> prematurely.
- 3. Commit unintentional fraud by overbilling the government, or begin a corporate culture of lying.



Some Policies and procedures you must have

A. Timesheets

- 1. Filled out in ink daily
- 2. Must record all time, signed by the employee
- 3. Signed by the supervisor
- 4. Changes must be crossed out (not erased) and initialed
- B. Accounting for uncompensated overtime
 - 1. \$60,000/2,000 = \$30/hour
 - 2. Bill the government at \$30/hr.
 - 3. Actually works 2,500 hours
 - 4. Actual hourly rate is \$24/hr.



7 DCAA audits – problems surface

- 1. Pre-award audit Review of the adequacy of your accounting system. You will not receive an award unless you pass.
- 2. Indirect rate projection audit A review of the underlying projections used in establishing your provisional billing (and bidding) rates. Your invoices will be rejected until you proactively have your indirect rates approved by DCAA.
- 3. Progress payment audit The DCAA judgmentally selects an invoice that you submit and traces all direct costs back to their originating source documents (timesheets, vendor invoices, expense reports, etc.).
- 4. Surprise floor check DCAA will visit your facility and randomly (?) select your employees for audit to ensure that they are following the government's strict timekeeping rules. Employees must be ready to properly answer questions on timekeeping procedures and must be able to demonstrate that their timesheets reflect those procedures.
- 5. Financial capacity audit
- 6. Annual Incurred Cost Audit With a Phase 2 SBIR, your contract contains Federal Acquisition Regulation (FAR) clause 52.216-7

 The Allowable Cost Clause. This clause requires you to submit an annual "true up" report known as an Incurred Cost

 Submission 180 days after your fiscal year end. This submission has a 100% chance of being audited by DCAA and is their main event!

This audit is when you discover if your accountants knew what they were doing, or not - years after the fact.

7. Contract close out

NIH Grantee checkpoints

- 1. Pre-award almost no resistance (J.I.T.)
- 2. Annual indirect rate negotiation with DFAS if F&A rate > 40%
- 3. SF425 Reconcile the money drawn from the Payment Management System with what you've *earned* (in accordance with the federal acquisition regulations).
- 4. OMB A133 (Revenue earned > \$500,000)

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Paperwork Burden Statement

According to the Paperwork Reduction Act, as amended, no persons are required to respond to a collection of information unless it displays a valid OMB Control Number. The valid OMB control number for this information collection is 0348-0061. Public reporting burden for this collection of information is estimated to average 1.5 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding the burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to the Office of Management and Budget, Paperwork Reduction Project (0348-0060), Washington, DC 20503.

OMB Approval Number: 0348-0061 Expiration Date: 10/31/2011

NORTHWESTERN PAYS \$3MM FOR FRAUD

According to the Wall Street Journal, Northwestern University agreed to pay nearly \$3 million to settle claims that a former cancer researcher fraudulently used federal grant money for personal expenses, including food, hotels and airfare for family trips between 2003 and 2010.

The whistleblower, Melissa Theis, worked as a purchasing coordinator, processing invoices when she 'noticed some red flags,' according to her attorney.

The federal False Claims Act allows private citizens who allege government programs are being defrauded to file actions on behalf of the government and receive a portion, usually 15% to 30%, of any recovered damages.

Ms. Theis will get \$498,100 in settlement proceeds, according to the agreement.

Defense Contractor MPRI Settles \$3.2 Million Lawsuit Brought by Whistleblower

PR Newswire

ATLANTA, Feb. 13, 2014

March 3, 2014 - Wall Street Journal

Sprint Sued for Allegedly Overbilling for Surveillance

Company Accused of Inflating Bills Sent to Law-Enforcement Agencies

Sprint Corp. overcharged the Federal Bureau of Investigation, the Drug Enforcement Administration and other law-enforcement agencies by more than 50% to facilitate eavesdropping on phone calls, the U.S. Justice Department alleged in a lawsuit filed Monday.

"Agencies went ahead and overpaid, because they were more concerned about investigations than their bills"

2 UH physics professors indicted on charges

Jill Courtney Sr. Web Editor, Click2Houston.com

Published On: Apr 28 2014

The indictment, returned on Thursday, alleges one count of conspiracy, seven counts of making false statements and 21 counts of wire fraud, all in connection with the Small Business Innovation Research (SBIR) program, according to federal authorities.

According to the indictment, both men allegedly started Integrated Micro Sensors Inc. (IMS), a small business which applied for and received SBIR grants or contracts from NASA, National Science Foundation, Department of Energy and the United States Air Force.

Authorities allege Bensaoula and Starikov made false statements in the application and proposal processes and in filing electronic claims for payment after they were awarded grants or contracts.

Officials said if convicted of the conspiracy, both face up to a five-year prison term, as well as another five years upon each conviction of making false statements. For the wire fraud charges, the men face up to 20 years for each conviction. All charges also carry a possible \$250,000 fine.

"FREE PROJECT MONEY" CAN LEAD TO HUGE LOSSES IF THIS TURNS INTO A REAL BUSINESS...

- You want to limit your personal financial risk
 - Taking on debt
 - Raising outside funding and diluting your equity
- You have a multi award strategy and want to avoid firing key people when the project ends, or have funding glitches
- Charging the Government for your reasonable, allowable costs is your right!
- You don't want to commit financial fraud...
- And, yes, auditors look at history when negotiating indirect rates - "we decided to stop lying this year"



STRATEGY Q REVISITED — YOUR PLAN FOR GOVERNMENT FUNDING?

Pick ONE:

- 1. A one-off award as a way to prove concept (Qualcomm), your technology is almost at the goal line, or you're offsetting your SBIR losses with commercial profits, debt, or dilutive funding.
- 2. You believe the government can benefit from your technology and you believe that winning government contracts and grant awards is a valid way to fund the development of your technology.



NEXT STEPS TOGETHER

Our \$495 Phase 1 Analysis:

- 1. Accounting system adequacy our analysis will include a review of specific areas of your Company's accounting system, including job costing, time reporting, and underlying documentation.
- 2. Unallowable cost assessment
- 3. Program management
- 4. MENTION THIS WEBINAR AND THAT YOU'D LIKE US TO LOOK AT THE ADEQUACY OF YOUR INDIRECT RATES.

TO SEE IF YOUR BUSINESS QUALIFIES PLEASE CONTACT:

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