

U.S. SMALL BUSINESS ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

SBA's Implementation of the SBIR and STTR Extension Act of 2022



Management Advisory

Report 24-14

April 19, 2024



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NOTICE:

Pursuant to the James M. Inhofe National Defense Authorization Act for Fiscal Year 2023, Public Law 117-263, Section 5274, any nongovernmental organizations and business entities identified in this report have the opportunity to submit a written response for the purpose of clarifying or providing additional context as it relates to any specific reference contained herein. Comments must be submitted to AIGA@sba.gov within 30 days of the final report issuance date. We request that any comments be no longer than two pages, Section 508 compliant, and free from any proprietary or otherwise sensitive information. The comments may be appended to this report and posted on our public website.



**OFFICE OF INSPECTOR GENERAL
U.S. SMALL BUSINESS ADMINISTRATION**

MEMORANDUM

Date: April 19, 2024

To: Isabella Casillas Guzman
Administrator

From: Hannibal "Mike" Ware
Inspector General

A handwritten signature in black ink, appearing to read "H. Ware".

Subject: SBA's Implementation of the SBIR and STTR Extension Act of 2022 (Report 24-14)

The Office of Inspector General (OIG) is issuing this management advisory in accordance with requirements in the SBIR and STTR Extension Act of 2022 (the Act) for OIG to conduct an audit related to small business verification of sales and investments. Specifically, we address our ability to determine whether small businesses are verifying sales and investments in the program and how the Act's requirements were established.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact me or Andrea Deadwyler, Assistant Inspector General for Audits, at (202) 205-6586.

cc: Dilawar Syed, Deputy Administrator, Office of the Administrator
Arthur Plews, Chief of Staff, Office of the Administrator
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Background

The Small Business Innovation Research (SBIR) program was established under the Small Business Innovation Development Act of 1982. The Small Business Technology Transfer (STTR) program was established under the Small Business Technology Transfer Act of 1992. These programs encourage domestic small businesses to engage in federal research/research and development (R/R&D), with the potential for commercialization. Eleven federal agencies participate in the SBIR program, and six of those also participate in the STTR program. Participating federal agencies provide awards directly to small businesses for research and development. The U.S. Small Business Administration (SBA) oversees the SBIR and STTR programs and establishes policy and guidance for participating federal agencies.¹

Through a competitive awards-based system, the SBIR and STTR programs enable small businesses to explore their technological potential and provide an incentive to profit from its commercialization. To be eligible, small businesses must be organized for profit, U.S.-owned/operated, and have no more than 500 employees.

The SBIR and STTR programs consist of three phases:

Phase I: The objective of Phase I is to establish the technical merit, feasibility, and commercial potential of the proposed federal R/R&D efforts and to determine the quality of performance of the small business awardee organization prior to providing further federal support in Phase II. Small businesses are generally awarded funds ranging from \$50,000 to \$250,000 for periods of 6 months (SBIR) or 1 year (STTR).

Phase II: The objective of Phase II is to continue the R/R&D efforts initiated in Phase I. Funding is based on the results achieved in Phase I and the scientific and technical merit and commercial potential of the project proposed in Phase II. Typically, only Phase I awardees are eligible for a Phase II award. Small businesses are generally awarded \$750,000 for 2 years.

Phase III: The objective of Phase III, where appropriate, is for the small business to pursue commercialization objectives resulting from the Phase I and II R/R&D activities. The SBIR/STTR programs do not fund Phase III. At some federal agencies, Phase III may involve follow-on non-SBIR/STTR funded R&D or production contracts for products, processes or services intended for use by the government.

¹ 15 U.S.C. § 638(j), (p); SBA, SBIR and STTR Policy Directive (May 3, 2023).

Per program requirements,² small businesses that have received a certain number of awards must meet transition and commercialization rates. SBA conducts an annual assessment to determine whether the small business met performance standards. Each participating agency uses the results of this assessment to determine if a company is eligible to submit a proposal for a new Phase I award.

The SBIR and STTR Extension Act of 2022 (the Act) increased minimum performance standards for small businesses that received more than 50 Phase II awards over a 10-year period.³ According to the Act, small businesses are required to average \$250,000 per award in aggregate sales and investments if they receive more than 50 Phase II awards over a 10-year period. Small businesses must average \$450,000 per award in aggregate sales and investments if they receive more than 100 Phase II awards over a 10-year period. However, small businesses are only required to provide supporting documentation for sales over a 5-year period.

Small businesses that do not meet the increased minimum performance standards may not receive more than 20 total Phase I and certain Phase II awards⁴ from each participating federal agency for 1 year. Eighteen small businesses were subject to the increased standards during the most recent covered period — fiscal years (FY) 2011 to 2020 — as defined by federal law and, in total, obtained 1,719 Phase II awards totaling \$1.6 billion.

Small businesses subject to increased minimum performance standards may meet the standards for average sales based solely on or a combination of government Phase III contracts (federal sales), investments, and covered sales. Covered sales are sales by a small business 1) that are attributable to an SBIR or STTR award, 2) for which no amount of the payment was made using federal funds, 3) which the small business uses to meet an applicable increased minimum performance standard, and 4) received during an applicable 5-year period.

Although the Act establishes a 10-year covered period for which the small businesses are to demonstrate compliance with the increased minimum performance standards, it only requires small businesses to provide supporting documentation for covered sales for the 5 fiscal years immediately preceding the fiscal year in which they used the covered sales to meet increased minimum performance standards. Additionally, it excludes small businesses from providing supporting documentation to SBA for federal sales and does not require supporting documentation for investments. Because the statutory definition of covered sales includes only sales that are "used" to meet the increased minimum performance standards, SBA's

² SBA, SBIR and STTR Policy Directive, page 38 (May 3, 2023).

³ SBIR and STTR Extension Act of 2022, Pub. L. No. 117-183, § 8 (codified at 15 U.S.C § 638(qq)(3)).

⁴ Phase II awards under 15 U.S.C. § 638(cc).

communication to applicable small businesses indicated if they were not required to provide such documentation, they should provide a document to that effect stating the reason(s) why the documentation requirement does not apply (e.g., if the small business only used federal awards to satisfy the increased minimum performance standards).

Finally, the Act requires SBA's Office of Inspector General (OIG) to conduct an audit and submit a report to Congress within 1 year of the SBA Administrator implementing the increased minimum standards. The Act requires OIG to determine whether small businesses subject to the increased performance standards verified (1) sales and investments used to meet the increased performance standard, (2) third-party revenue listed as investments or income to meet the increased performance standard, and (3) dollar amounts listed as investments or income to meet the increased minimum performance standard, the source of which is unclear.⁵ The Act also required OIG to assess self-certification requirements. The only supporting documentation small businesses were required to provide for verification was for covered sales. Therefore, our review focused on the small businesses' verification of covered sales to accomplish the OIG audit requirement in the Act.

Sales and Investments Verification

We found there is limited assurance that small businesses verified sales and investments as outlined in the Act. According to SBA, to determine whether small businesses met the increased minimum performance standards, it reviewed the small business' self-reported information on the SBIR website.⁶ SBA then performed "spot checks," or limited reviews, of federal sales against two publicly available databases, Federal Procurement Data System (fpds.gov) and USAspending.gov. If federal sales were not sufficient to demonstrate the small business met the performance standards, SBA then performed spot checks of supporting documentation for covered sales.

The combination of SBA's spot checking of supporting documentation, and the Act excluding supporting documentation for federal sales and not requiring investment supporting documentation presents challenges in determining whether the small businesses verified:

⁵ SBIR and STTR Extension Act of 2022, Pub. L. No. 117-183, § 8 (codified at 15 U.S.C. 638(qq)(6)).

⁶ [sbir.gov](https://www.sbir.gov)

- Sales and investments related to the increased minimum performance standards;
- Third-party revenue directly resulting from Phase I or II awards; and
- Investments or income not directly related to a Phase I or II award and of unclear origin.

Notwithstanding the spot checks performed by SBA on supporting documentation for covered sales, we found small businesses in the SBIR and STTR programs with more than 50 Phase II awards did not always provide sufficient supporting documentation for all covered sales for the 5 fiscal years immediately preceding the fiscal year in which the small business concern used such sales to meet an applicable increased performance standard. SBA notified these small businesses that sufficient support may include, but was not limited to, purchase orders, contracts, sales agreements, receipts, invoices, and other documentation that supports covered sales. However, we reviewed 196 awards provided to nine small businesses and found at least 144 of the awards had insufficient supporting documentation to verify covered sales.⁷ For example, documentation:

- Did not meet the established list of appropriate support;
- Was outside of the 5-year period;
- Was not provided;
- Was not reliable (i.e., Excel printouts); or
- Was not clearly linked to awards.

According to SBA officials, small businesses only had a short timeframe in which to submit covered sales information for the 5-year period. This may have contributed to their lack of sufficient supporting documentation.

Also, while SBA officials stated they spot checked federal sales and supporting documentation for covered sales, they did not have formal procedures to obtain and review supporting documentation or to address issues with insufficient documentation submitted by small businesses. SBA officials stated the agency has limited resources to verify the supporting documentation.

As a result of insufficient supporting documentation provided by small businesses and SBA not always reviewing supporting documentation, there is limited assurance that small businesses verified covered sales. This increases the risk that small businesses could exceed the maximum number of 20 total Phase I and certain Phase II awards from each participating federal agency for

⁷ We did not determine whether any of the nine small businesses made an assertion that they were not subject to the requirement to submit supporting documentation for covered sales.

1 year. Taxpayer funds awarded to small businesses that do not meet established performance standards are at increased risk because the small businesses may not have the ability to achieve program goals for commercialization as intended by the Act.

The Standards for Internal Control in the Federal Government state that management should use quality information to achieve the entity's objectives. Quality information is appropriate, current, complete, accurate, accessible, and provided on a timely basis. In addition, management should develop and maintain documentation of its internal control system.

Self-Certifications

SBA established self-certification requirements for the SBIR and STTR programs, requiring small businesses to self-certify when they submit reports to SBA through the SBIR website, including sales and investment information. To self-certify, small businesses must check multiple boxes when submitting reports, including confirmation that the submitted information is accurate and that they are following certain guidelines. These certifications include, for example, attestation that no Phase I or Phase II SBIR or STTR funds have been counted as sales or investments.

Self-certification is “the practice of making an official declaration that something complies with regulatory standards or procedures without independent substantiating evidence.” The Act’s requirement for program participants to provide supporting documentation could mitigate the risks associated with self-certification. However, because SBA established a self-certification process and does not always review the supporting documentation, the risks associated with self-certification still exist. As noted in prior OIG reports, and most recently, in our *Top Management and Performance Challenges Facing the Small Business Administration in Fiscal Year 2024* report, we continue to believe that actions to eliminate self-certification in SBA’s programs should be a priority to mitigate the risk of fraud and increase program integrity.

Conclusion

We were unable to determine whether small businesses subject to increased minimum performance standards verified covered sales and investments. The combination of SBA spot checking supporting documentation, along with the Act excluding supporting documentation for federal sales and not requiring supporting documentation for investments, was not sufficient to make such a determination. Also, the Act could be strengthened to align the covered period and documentation requirements. The Act establishes a 10-year covered period for which the small

businesses are to demonstrate compliance with the increased minimum performance standards. However, it only requires small businesses to provide supporting documentation for covered sales for a 5-year period and does not require supporting documentation for investments.

In addition, self-certifications are not adequate to ensure that small businesses met program requirements. As a result, taxpayer funds awarded to small businesses that do not meet the established performance standards are at increased risk because the small businesses may not have the ability to achieve program goals for commercialization as intended by the Act.

Recommendations

To address concerns with procedures for assessing whether small businesses are verifying sales and investments in the SBIR and STTR programs and to address risks associated with SBA's reliance on self-certifications, we recommend the Administrator direct the Associate Administrator of the Office of Investment and Innovation to:

Recommendation 1: Establish formal procedures for obtaining and reviewing appropriate supporting documentation to ensure sales and investments are accurately reported.

Evaluation of Agency Response

SBA management provided formal comments to the draft report, which we considered when preparing this final report. Management agreed with the recommendation. See Appendix 1 for management's comments, in their entirety.

Summary of Actions Necessary to Close the Recommendation

The following section summarizes the status of our recommendation and the actions necessary to close it.

Recommendation 1

To address concerns with procedures for assessing whether small businesses are verifying sales and investments in the SBIR and STTR programs and to address risks associated with SBA's reliance on self-certifications, we recommend the Administrator direct the Associate Administrator of the Office of Investment and Innovation to establish formal procedures for

obtaining and reviewing appropriate supporting documentation to ensure sales and investments are accurately reported.

Status: Resolved

Management agreed with this recommendation and stated they have already started developing formal procedures which they should complete by March 31, 2025.

Management's planned actions satisfy the intent of this recommendation. We consider this recommendation resolved and will close it when management provides evidence they have established formal procedures for obtaining and reviewing appropriate supporting documentation.

Scope and Methodology

This management advisory presents the results of our engagement on SBA's implementation of the SBIR and STTR Extension Act of 2022. Our objectives were to determine if small businesses in the SBIR and STTR programs performed required verifications related to sales and investments and to assess SBIR and STTR program self-certification requirements for the minimum performance standards. To answer our objectives, we reviewed laws, regulations, policies, procedures, and guidance pertaining to SBIR and STTR program requirements. Our scope of work covered 18 small businesses in the SBIR and STTR programs with more than 50 Phase II awards.

We interviewed SBA officials from the Office of Investment and Innovation to gain an understanding of SBIR and STTR program requirements. We analyzed awards data to identify small businesses that were required to meet increased minimum performance standards and reviewed a judgmental sample of 9 of the 18 small businesses. We then reviewed supporting documentation to determine whether the nine small businesses verified covered sales and investments. However, we were unable to make a conclusive determination because the Act does not require small businesses to provide supporting documentation for a 10-year period and does not require any supporting documentation for investments.

This management advisory was prepared in alignment with OIG quality control standards and the Council of the Inspectors General on Integrity and Efficiency *Quality Standards for Inspection and Evaluation*. These standards require that we adequately plan and perform the evaluation to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objective. We believe the evidence provides a reasonable basis for our conclusions based on our objectives.

Use of Computer-Processed Data

We relied on data from the public SBIR website to conduct our evaluation. We identified the population of small businesses subject to increased minimum performance standards and compared our results to SBA's analysis and found the data was accurate. As a result, we believe the data used in this report is sufficiently reliable to support our report conclusions.

Appendix 1: Agency Response

SBA RESPONSE TO THE MANAGEMENT ADVISORY



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

To: Hannibal “Mike” Ware
Inspector General
U.S. Small Business Administration

From: Bailey G. DeVries
Associate Administrator, Office of Investment and Innovation

Digitally signed by Bailey DeVries
Date: 2024.04.15 15:37:29 -04'00'

Date: April 15, 2024

Subject: SBA’s Response to SBA’s Implementation of the SBIR and STTR Extension Act of 2022
(Project 23016)

The report notes that the SBIR and STTR Extension Act of 2022, signed into law on September 30, 2022, increased the minimum sales and investments requirements for small businesses receiving more than 50 Phase II awards during defined thresholds. Implementation of these new standards were required by April 1, 2023. SBA, consistent with the Act, identified and notified all firms triggering these increased requirements, provided guidance on the Act’s definition of covered sales, and provided guidance and a mechanism for firms to transmit the required documentation to demonstrate covered sales. As outlined in the report, SBA prioritized reviewing federal government sales (i.e., federal Phase III awards), which can be of sufficient value to surpass the required minimum sales and investment thresholds, including limited reviews with other federal databases, before reviewing covered sales.

We anticipate remediation of the below recommendations by March 31, 2025.

Recommendation 1 – Establish formal procedures for obtaining and reviewing appropriate supporting documentation to ensure sales and investments are accurately reported.

SBA Response: SBA agrees with the recommendation. SBA has already started development of formalized documentation for the performance benchmark processes. This documentation will be maintained in the division’s internal SharePoint site. SBA has also enhanced current processes by requiring earlier submission of supporting documentation to provide SBA more time to review and assess the documentation prior to final benchmark assessments.