




OFFICE OF THE INSPECTOR GENERAL

PRELIMINARY INQUIRY MEMORANDUM

August 1, 2019

TO: Andrew W. Kleine
Chief Administrative Officer

FROM: Edward L. Blansitt III
Inspector General 

SUBJECT: SBIR and STTR Matching Grant Program
OIG Publication #20-003

A Preliminary Inquiry Memorandum (PIM) describes specific issues or complaints received and the outcomes of limited procedures undertaken during a Preliminary Inquiry conducted by the Office of the Inspector General (OIG). Copies of this PIM along with your response, if any, will be provided to the members of the County Council and the County Executive within 10 business days of the date of this PIM.

Background:

Beginning in Fiscal Year (FY) 2019, Montgomery County began offering matching grant funds to local business recipients of National Institutes of Health (NIH), Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR), Phase I or Phase II grants. The OIG conducted this inquiry between January and May 2019 for the purpose of determining whether the new SBIR and STTR Matching Grant Program had enough controls to ensure that grant funds would be utilized for the purposes intended by the legislation.

Summary and Conclusion:

Because the SBIR and STTR Matching Grant Program is funded through the Economic Development Fund, payments can be processed through a Direct Purchase Order, using an exempt transaction code. While grantees sign an award offer letter in order to receive funding, that award offer letter lacks many of the elements of a more formal county contract or agreement, such as the right to audit and a method for dispute resolution. This may create vulnerability for the County should a grantee use the County grant funds for non-project related expenses, or fail to perform under or otherwise abuse their federal grant.

After the first awards were approved at the beginning of FY 2019, Montgomery County Interim Administrative Procedure 2-4, *Agreements between Montgomery County Government and Other Organizations* (Interim AP 2-4) was issued. The new administrative procedure defines a number of required agreement provisions that must be memorialized in an agreement between the grantee and the County prior to issuing a DPO for payments from the Economic Development Fund. Revision of future award offer letters to match the requirements of interim AP 2-4 could alleviate many of the concerns the OIG has identified in this memorandum.

At the time of our review, written procedures regarding program administration had not been approved and were not provided to the OIG. The Department of Finance should take steps to document and approve written policies and procedures as soon as possible. The Department of Finance may also want to consider implementing SDAT checks for SBIR and STTR Matching Grant Applicants, as well as any other similar County grant programs to ensure that County funds are disbursed to awardees authorized to do business in Maryland.

PRELIMINARY INQUIRY DETAILS

The federal SBIR and STTR Programs

The SBIR and STTR programs provide early-stage capital for US-owned and operated small businesses to engage in federal research and development that has a strong potential for commercialization. These programs allow small businesses to develop and commercialize new technologies without giving up intellectual property or company equity.

SBIR requires federal agencies budgeted over \$100 million for federally funded extramural research or research and development to set aside a percentage of that budget for small business. Similarly, STTR requires federal agencies budgeted over \$1 billion for federally funded extramural research or research and development to set aside a percentage of that budget for small business concerns that work in cooperation with universities, federally funded research and development centers, and other non-profit scientific and educational institutions.

Both programs contribute significant funding to early-stage, high risk funding for research and development (R&D) based small businesses and are structured in three phases: Phase I - Feasibility-Related Experimental Study or Theoretical Research/ Research and Development, Phase II – Continued Research/ Research and Development Effort, and Phase III – Commercialization.

A significant amount of federal SBIR and STTR funding is provided by the National Institutes of Health (NIH) which is headquartered in Montgomery County. (See Figure 1 below.) For the larger SBIR program¹, only about 6% (\$42.7 million) of the NIH dollars awarded during fiscal year (FY) 2016 were awarded within the state of Maryland.

	FY 2016 Total Federal Obligation² (All Participating Agencies)	FY 2016 NIH Funding³ (Total NIH Funding)
SBIR	\$2.36 billion	\$752 million
STTR	\$313 million	\$115 million

Figure 1: FY 2016 SBIR/STTR Funding

¹ OIG staff was unable to readily locate comparative numbers by state for the STTR program.

² Total FY 2016 obligation as reported in the SBIR and STTR Annual Report published by the U.S. Small Business Administration 2016.

³ Data regarding total funding for FY 2016 NIH awards obtained from <https://sbir.nih.gov/statistics/award-data>, last accessed July 30, 2019.

Enabling Legislation for Montgomery County Matching Grant Program

On March 20, 2018, the Montgomery County Council (Council) passed legislation amending the law governing the Economic Development Fund⁴ to establish a SBIR and STTR Matching Grant Program. The grant program is administered by the Director of Finance through the Economic Development Fund. The Economic Development Fund was established in FY 1996 “to aid the economic development of the County by assisting private employers who are located or plan to locate or substantially expand operations in the County.”

Beginning in FY 2019⁵, the legislation states that the “Director of Finance must pay, subject to appropriation, a SBIR or STTR Matching Grant to each business who meets certain eligibility standards.” These require that the business:

1. has been awarded a NIH SBIR or STTR Phase I or Phase II grant during the current calendar year, and
2. conducts at least 51% of its research and development operations at a physical location within the County.

Grants must be awarded on a first come, first served basis and grantees are eligible to receive a 25% match of a federal grant up to a defined maximum of \$25,000 for Phase I grants and \$75,000 for Phase II grants.

The law provides that the Director of Finance must require a business to pay back the grant funds if the business does not remain in the County for at least two years following receipt of the grant payment, but does not appear to place any specific restrictions on the use of County grant funds or specify the repayment of grant funds should they be used for purposes unrelated to the project.⁶

County Program Implementation

During FY 2019, \$650,000 was appropriated to fund the County program. At the time of our review, the SBIR and STTR Matching Grant Program Manager (Program Manager), an Economic Development Manager within the Department of Finance, Division of Fiscal Management provided a SBIR/STTR Matching Grant Program Tracking Summary spreadsheet reflecting that 14 local businesses had been approved to receive matching funds totaling \$550,000.

The County Code provides that the Executive may adopt regulations to implement this program. In reference to the Economic Development Fund, the Code of Montgomery Regulations (COMCOR) allows each subprogram of the Economic Development Fund, to adopt policy for the administration of the program, as long as the policy does not conflict with COMCOR or the law in regards to eligibility standards and the award process. At the time of our review, the Program Manager stated that written policies and

⁴ Montgomery County Code, Section 20-76E

⁵ Montgomery County Council Bill 41-17 was effective as of July 2, 2018.

⁶ We note that for several other programs administered through the Economic Development Fund which are also established within Montgomery County Code Chapter 20, Article XIII, the legislation establishing the program specifically states that any applicants who submit false or fraudulent applications, or withhold material information, to obtain payment have committed a Class A violation. For these programs the law requires repayment of the amounts improperly paid, with interest and penalties.

procedures regarding program administration were under development. However, the Program Manager described the process which was followed in disbursing grant funds during an interview with OIG staff.

Applicants to the County program are required to submit a copy of their NIH SBIR/STTR grant award notification and complete an online application which includes information regarding the company and its location, as well as a brief description of their SBIR/STTR grant. The online application does not request any information regarding the applicant's intended use of the County funds. Applications are time and date stamped by the online system, and grant funds are disbursed on a first come, first served basis.

Upon receipt of the application and federal award letter, program staff confirm the location of the company in CoStar, a commercial real estate intelligence database. If the applicant appears to be at least 51% based in Montgomery County and there are available funds, the application is funded. Successful applicants receive an award offer letter from the Department of Finance.

The award offer letter states that subject to the applicant signing and returning the award offer letter, self-registering online with the County's Central Vendor Registration System, and providing banking information to allow an ACH electronic payment, funds will be disbursed. The letter states that the funding is conditional on the company maintaining operations and business interests within the County for a minimum of 2 years from the date of the grant disbursement to the business. The sample letter reviewed by the OIG also states that, "This conditional grant is to be used to further your research on [federal project name] and for no other purpose."

Because the program was still in its first year at the time of our review, the Finance Department had not yet asked for any follow-up reporting from grantees. The Program Manager stated that following the first year of the program (in approximately September 2019), she intends to request proof that each of the grantees continue to have operations in the County. The Program Manager did not intend to ask grantees how the funds were spent.

Comparative Local Programs

OIG staff attempted to identify similar local government SBIR and STTR matching grant programs for comparative purposes and found 14 states with similar grant programs. OIG staff reviewed program guidelines or spoke with program staff for 8 of these programs. We learned that, on average, the state programs we reviewed provide \$69,000 in matching funds for Phase I grant recipients and \$147,000⁷ to Phase II recipients.

Unlike the Montgomery County Program, none of the state programs reviewed limited the match to a particular federal agency, such as NIH. Virginia does limit grants to grant recipients conducting research in particular industry sectors including: clean energy, cyber security, data analytics, life sciences, and unmanned systems.

⁷ North Carolina was one of the 8 programs reviewed but does not provide Phase II funds. Based on information published on their website, their program awards appear to be awarded to Phase I recipients only.

All of the state programs reviewed by the OIG required recipients to submit outcome reporting. Additionally, all required grant recipients to submit a proposed budget or specific information regarding how funds would be or were utilized to further project goals.

In comparison, the Montgomery County program does not ask grantees what the funds will be used for or how County funds are spent. Additionally, it does not appear that the County intends to request any outcome reporting.⁸

Use of County Grant Funds

OIG staff asked the Program Manager whether award recipients were required to sign any contract or agreement containing the County's usual contractual terms and conditions, such as the right to audit.⁹ The Program Manager indicated that other than the award offer letter and the application, no other document is signed by the grantee to memorialize their agreement with the County.¹⁰ There also does not appear to be any provision for audit outlined within the enabling legislation.

OIG staff asked the Program Manager what steps would be taken in the event that the County received allegations that a grantee used the funds for a purpose unrelated to the federal SBIR or STTR project attached to the County grant, such as a personal expenses.¹¹ The Program Manager stated that she would contact the awardee and ask how the County funds had been used, but provided no additional information regarding what further steps would be taken in the event funds were misspent.

Because the County does not require any written agreement specifically outlining how funds will be used or allowing the County to audit or seek recovery of misspent funds, it is unclear whether the grantee would be required to even answer any County questions regarding the expenditure of funds.

The federal SBIR and STTR programs employ a number of controls to aid in the prevention and detection of fraud waste and abuse, including established rules and policies, and regular communication with grantee. The federal government also lays out the acceptability of dozens of different types of costs. For example, costs such as charitable contributions and alcoholic beverages are "generally unallowable." Violators may face criminal, civil, and administrative penalties.

On the other hand, the County program does not appear to have any control over how funds are spent. At the same time, the award offer letter and legislation do not specifically describe circumstance under which the County could demand repayment of the grant, other than under circumstances wherein the grantee leaves the County less than 2 years after receiving the grant payment. There does not appear to be any defined

⁸ Other than verifying that the business continues to maintain operations in the County.

⁹ As previously stated, applicants are required to sign and return the County's award offer letter in order to receive grant funds.

¹⁰ The online application for the County program does have a caveat that states "By typing your name and submitting this application, you certify that this application and all other information furnished now and in the future to Montgomery County are and shall be true and complete."

¹¹ The Program Manager was given the specific example of a grantee who used funds for a vacation and asked how she would react to such an allegation.

process discussed in the documents which would enable the County to require the repayment of the grant should the awardee default on the project, engage in fraud related to the federal award, or fraudulently claim receipt of a federal award in order to gain funding.

Montgomery County Administrative Procedure 2-4 “Agreements between Montgomery County and Other Organizations”

The SBIR and STTR Matching Grant Program is a part of the Economic Development Fund. The program is not subject to Procurement Regulations and program expenditures may be processed using exempt transaction codes under a Direct Purchase Order (DPO).

On September 11, 2018, Montgomery County Interim Administrative Procedure 2-4, *Agreements between Montgomery County Government and Other Organizations* (Interim AP 2-4) was issued. Following, the issuance of Interim AP 2-4, a workgroup was formed to develop enhancements to Interim AP 2-4, prior to the issuance of the final Administrative Procedure. The draft final Administrative Procedure is undergoing final review with the County. The OIG has been told that the draft final AP 2-4 requires that an agreement “provide a clear and comprehensive description of work to be conducted.”

The County’s current *Consolidated Exemption List* indicates that purchases made using the Economic Development Fund are subject to this AP 2-4 and requires that an agreement be in place in order to issue a DPO for payments from the Economic Development Fund. SBIR and STTR Matching Grant Program recipients do enter into a signed agreement with the County in that they are required to sign their offer letter in order to receive funding.

The bulk of FY 2019 SBIR and STTR Matching Grant Program awards were approved prior to the issuance of interim AP 2-4, including the award resulting from the sample offer letter provided to the OIG. However, for comparative purposes, we compared the offer letter to interim AP 2-4 to determine whether changes would need to be made in order for the letter to meet the requirements of an agreement as outlined in the procedure.

We found that the sample award offer letter used during FY 2019 does not comply with Interim AP 2-4 which states that the agreement shall be subject to general terms and conditions, defined, maintained and updated by the Office of the County Attorney and requires that the agreement contain a number of specific provisions including a termination/cancellation clause, a right to audit clause, and a section addressing the resolution of disagreements. None of those elements are contained in the sample award offer letter provided to OIG.

While we note that interim AP 2-4 was not in place when the awards began to be approved for FY 2019, we would expect that future award offer letters will be revised or a separate agreement be written to incorporate the requirements of AP 2-4. The OIG has not been provided any information indicating that the final version of AP 2-4 would not include the same requirements.

Maryland Department of Assessments and Taxation (SDAT) Certificates of Good Standing

OIG staff asked the Program Manager whether applicants were compared with the Maryland Department of Assessments and Taxation (SDAT) Business Entity database to confirm that the company is eligible to do business in Maryland, prior to any funds being disbursed. For County contracts (including Council grants), it is the responsibility of the Contract Administrator within the using department to obtain a SDAT certificate of good standing prior to entering into a contract with an incorporated entity. The Program Manager indicated that this was not a current practice, but stated that they would likely be willing to adopt this practice. The OIG believes that it would be in the best interests of the County for the Program Manager to incorporate this step into the grant process.

cc: Fariba Kassiri, Deputy Chief Administrative Officer
Michael Coveyou, Acting Director, Department of Finance
Robert Hagedoorn, Division Chief, Treasury Division, Department of Finance

CAO Response to the Memorandum

On August 16, 2019 the Chief Administrative Officer (CAO) responded:



OFFICE OF THE COUNTY EXECUTIVE

Marc Elrich
County Executive

Andrew W. Kleine
Chief Administrative Officer

MEMORANDUM

August 14, 2019

TO: Edward L. Blansitt III
Inspector General

FROM: Andrew W. Kleine *AWK*
Chief Administrative Officer

SUBJECT: SBIR and STTR Matching Grant Program, OIG Publication #20-00x

Thank you for the opportunity to respond to the conclusions and recommendations resulting from the limited procedures performed and conveyed in the August 1, 2019 *Preliminary Inquiry Memorandum – SBIR and STTR Matching Grant Program – OIG Publication #20-00x* (Memorandum). Following are the responses to the Memorandum's recommendations.

Memorandum Summary and Conclusion:

Because the SBIR and STTR Matching Grant Program is funded through the Economic Development Fund, payments can be processed through a Direct Purchase Order, using an exempt transaction code. While grantees sign an award offer letter in order to receive funding, that award offer letter lacks many of the elements of a more formal County Contract or Agreement, such as the right to audit and a method for dispute resolution. This may create vulnerability for the County should a grantee use the County grant funds for non-project related expenses or fail to perform under or otherwise abuse their federal grant.

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SBIR and STTR Matching Grant Program, OIG Publication #20-00x
August 14, 2019
Page 2

At the time of our review, written procedures regarding program administration had not been approved and were not provided to the OIG. The Department of Finance should take steps to document and approve written policies and procedures as soon as possible. The Department of Finance may also want to consider implementing SDAT checks for SBIR and STTR Matching Grant Applicants, as well as any other similar County grant programs to ensure that County funds are disbursed to awardees authorized to do business in Maryland.

CAO Response:

The Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs are subject to the requirements of the Interim AP 2-4, issued September 11, 2018. Prior to the issuance of the Interim AP, the form and content of the offer letter agreement for SBIR and STTR grants were approved by the Office of the County Attorney (OCA), working with the Department of Finance (Finance). This offer letter Agreement template was consistent with the specific provisions of County Code 20-76E, Small Business Innovation Research and Small Business Technology Transfer Matching Grant Program. For example, grants are subject to repayment to the County if the business does not remain in the County for at least two years after receiving the grant payment, and Finance's procedures include a validation of compliance with this legal requirement.

Finance has been coordinating with OCA to identify and implement any revisions to the offer letter Agreement necessitated by the Interim AP; for example, inclusion of general terms and conditions. Under the Interim AP and in appropriate situations, OCA can waive certain required Agreement provisions. Finance and OCA are in the process of evaluating and determining the applicability of each of the Interim AP required Agreement provisions to the SBIR and STTR offer letter Agreements, based on County Code 20-76E. Once the final AP 2-4 is issued, which we expect shortly, Finance and OCA will ensure the offer letter Agreements are revised, as necessary, to fully comply with the Final AP.

As it relates to written policies and procedures, Finance has developed standard operating procedures for the SBIR/STTR Local Matching Grant Program, which include language regarding confirming good standing with the State of Maryland through SDAT. These standard operating procedures will be subject to revision once a final determination is made of any impact of AP 2-4 on the offer letter Agreement and related processes.

Thank you again for the opportunity to review and respond to the findings of this inquiry. If you have any questions, please contact Mike Coveyou at 240-777-880.

Cc: Fariba Kassiri, Deputy Chief Administrative Officer
Mike Coveyou, Acting Director, Department of Finance
Rich Madaleno, Director, Office of Management and Budget
Ash Shetty, Office of Procurement
Robert Hagedoorn, Division Chief, Treasury Division, Department of Finance