



**FALL 2010 NSF SBIR PHASE I
GRANTEE WORKSHOP**

September 20-22, 2010

Hyatt Regency Crystal City
2799 Jefferson Davis Highway
Arlington, VA 22202

ACCOUNTING WORKSHOP FOR SBIR PHASE I GRANTEES

PARTICIPANT MATERIALS

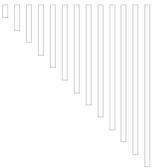
September 20, 2010

ACCOUNTING WORKSHOP FOR SBIR PHASE I GRANTEES

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September 20, 2010



National Science Foundation
SBIR/STTR Program
Accounting Workshop
September 20, 2010

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Notice to Reader

The information in this presentation is intended to assist organizations in their application for Phase II funding under the National Science Foundation's Small Business Innovation Research (SBIR/STTR) program.

The information provided in this presentation is a summary of certain requirements that apply to the Phase II award.

Readers should refer to the NSF's website and other communications from the NSF for all requirements which apply to the Phase II award.



Accounting workshop

Objective of this session:

- To make you aware of the NSF's requirements in the accounting/finance area, and give you the best chance of being funded under the Phase II program
- Two risks:
 - Not being funded at all in Phase II
 - Being funded less than max available (\$500,000)



Four items to remember

1. The NSF wants to see you funded.
2. NSF's requirements are published on the NSF website – read these and be careful to comply with them.
3. Phase II funding is not provided if there is an elevated risk of bankruptcy, or going out of business – NSF conducts financial capability review of every company to support this assessment.
4. Specific rules and policies apply to indirect costs
Subject to Pre-award Audit (if >safe rate)
Rules are frequently misapplied



Accounting and administrative review

Purpose – to ensure that prospective Phase II grantees are maintaining adequate accounting systems, that they have adequate financial capability, and that proposed expenditures with Phase II research funds meet NSF requirements.

There are 3 parts to the review:

- Review of Accounting and Timekeeping Systems
- Review of Financial Capability
- Review of Phase II Budget



General process for review

The review is performed by NSF employees.

Prospective Phase II grantees submit information listed on the NSF's website.

The information is sent to an external CPA reviewer who performs the following functions:

- Performs initial review of information submitted
- Ensures information is complete and responsive to NSF requirements
- Assists with assessment of financial capability and financial viability

NSF personnel are solely responsible for all funding decisions

General process for review

The NSF is reviewing 50-60+ requests for Phase II funding.

- Ensure you have read the latest requirements on the NSF Phase II website at:
 - Overall Requirements <http://www.nsf.gov/bfa/dias/caar/sbirrev.jsp>
 - Indirect Cost Rates and Proposal <http://www.nsf.gov/bfa/dias/caar/docs/fdcsubmissions.pdf>
- Get it right the first time!

Review of Accounting Systems

- Purpose – to ensure that Phase II grantees are maintaining adequate accounting systems to account for government funds

Requirement is in place to reduce possible of fraud, waste and abuse of funds.

Requirements for Accounting Systems

- The NSF's requirements for accounting systems to be maintained are listed in the Financial Management Systems Questionnaire. (located in the Prospective New Awardee Guide)
- The NSF wants to see a functioning bookkeeping system. i.e.
 - Books of account sufficient to prepare complete and accurate financial reports (e.g. financial statements in accordance with GAAP or acceptable basis of accounting)
 - Accounting system has ability to identify costs incurred:
 - by project/grant
 - as direct, indirect or unallowable (if indirect cost rate above 50% is requested)
 - Maintenance of adequate source documentation



Review of Accounting Systems

- Information submitted to support NSF's review of your accounting system:
 - Financial Management Systems Questionnaire
 - Historical financial statements
 - Copies of audit reports (external audit and DCAA)
 - Other, if needed
- Two other comments:
 - Quickbooks and other simple accounting packages are acceptable
 - Limited remediation is possible; if it can be done on a timely basis

Review of Accounting Systems

Basic bookkeeping errors/oversights that have prevented some companies from receiving Phase II funding

- Inability to reconcile retained earnings and share capital accounts (**major** red flag)
- Negative asset balances, obvious errors in preparation and presentation
- Lack of account reconciliations

Why are these important?

(**) Because they raise questions as the integrity of your accounting system/ and can prevent you from being funded

Importance of accounting systems to a small business

- Importance of accounting systems to a growing business
 - Control over cash receipts/disbursements
 - Historical financial information for mgmt/investors
 - Preparation for tax returns
 - Provides needed info for forecasting and budgeting
 - Needed to receive Federal awards

Requirements for Timekeeping System

- Companies are required to maintain a timekeeping system which tracks employees' efforts on Federal projects
- Can use either a manual (paper-based) timesheets or an automated system
- Become familiar with the time and effort reporting requirements related to Federal awards
 - [See link on NSF's website for the requirements which apply to system for recording employees' time.](#)

Accounting systems review

Common problems that are evident in review of accounting systems:

- Inadequate systems maintained
- Incomplete Financial Management Systems Questionnaire - must answer every question.

Common pitfalls and problems

Historical financial statements

- Retained earnings don't balance
- No rollforward schedule provided for the capital accounts
- Obvious presentation errors in financial statements

Possible result:

- the company's accounting systems are deemed inadequate and/or financial capability review cannot be completed leading to:

Request for full-scope audit
Phase II funding being declined !!

Integrity of accounting system and accuracy of financial statements is very important.

Accounting systems review

Recommendation for smaller companies

Hire a CPA and have them read your financial statements prior to submission

- Services available from CPAs typically include:
 - Audit
 - Review
 - Compilation
 - 2-3 hour discussion

Accounting systems review

Questions or comments on the NSF's requirements for accounting and timekeeping systems?

Any specific questions or situations that you would like us to briefly address?

NSF Phase I Grantee Conference

Financial capability review

Financial Capability Review

The NSF performs a financial capability review to obtain reasonable assurance that companies provided with Phase II funding:

- Are financially stable,
- Have, or will have, sufficient financial resources to complete their research program,
- Do not expose the government to fraud, waste or misuse of Federal funds.

Reason: Government does not want to provide grant funding to companies that have significant possibility of bankruptcy or ceasing operations.

Financial Capability Review

**** Very important assessment **** – companies have been declined Phase II funding when the NSF concluded there was an elevated risk of bankruptcy, or going out of business.

- Assessment is particularly important for companies which have limited cash on hand, and/or are in financial difficulty

How does the NSF assess financial capability?

□ The NSF follows a two-step process:

- The NSF reviews a company's financial statements and other information for Indications of Financial Difficulty
- If significant indications of financial difficulty are found in the financial statements, then the NSF requests other information (such as a cash flow projection) to:
 - Better understand your financial capability (i.e. financial position and future prospects)
 - Identify other information and events that suggest a company is stronger than indicated in the company's financial statements.
 - Understand management's plans for improving the company's financial position

Overview of Financial Capability Review

□ There is a focus on the company's financial statements:

- Company's financial statements and other information are reviewed for indications of financial difficulty such as the following:

Indications of Financial Difficulty

On Balance Sheet

- Lack of shareholder investment (negative shareholders' equity)
- Excessive long-term debt in comparison to permanent equity
- Deficiency in working capital or liquid funds, as indicated in the financial statements by:
 - No cash in bank
 - Current ratio less than ___ to 1
 - Quick ratio less than ___ to 1
- Large bank overdrafts
- Loans coming due for which no obvious source of money is available for repayment
- Reliance on credit card debt for funding

Example balance sheet

_____	_____
_____	_____
=====	=====
_____	_____
_____	_____
=====	=====

Indications of Financial Difficulty

On Income Statement

- Recurring operating losses
- Deteriorating revenues, margins or profitability - i.e. negative trends evident
- High level of interest expense, in comparison to operating income
- Other

Indications of Financial Difficulty

From other information reviewed

- Cash flow statement indicating significant cash being used in operating activities over a number of years
- Qualified auditor's opinion (for e.g. - going concern qualification)
- "Cash Burn Rate" that suggests that current cash on hand is not sufficient to fund future operations
- Other

Financial capability reviews

What information will be requested by the NSF if there are indications of financial difficulty in the financial statements? Potentially....

- A cash flow forecast or budget for the two-year period during which Phase II research is underway;
- Information on the company's contracts, backlog, customers and confirmed sources of revenue;
- A description of the new loans and capital/equity investments expected in future, if any
- Management's plans to address the financial viability issue that is evident from the company's financial statements.
- Other, depending on circumstances

Overview of process

- Other information and events could include:
 - Additional equity investments to be made
 - Contracts with customers that have been signed, but are not yet in effect.
 - Loans to be converted into equity
 - The existence of loans or financing facilities that are not reflected on the balance sheet
 - Grants awarded but not yet received (excluding Phase II grant)

---> FOCUS ON PROSPECTIVE INFORMATION
 ---> INFORMATION NEEDS TO BE SUPPORTED WITH AGREEMENTS/DOCUMENTS/ETC.
 -> VOLUNTEER THIS INFORMATION WHEREVER POSSIBLE.

Financial support letter

- When financial viability depends on loans, advances, and credit facilities provided by major shareholders or investors, NSF may ask for **financial support letter(s)** confirming:
 - Their intention to continue providing the loan or credit to the company for the 2-year period Phase II research is underway and indicate the limits of that support
 - That shareholder loans or advances that are outstanding as of the date of the letter and in the amount of \$_____ will not be repaid during the 2-years.

The assessment process

How does the NSF form its conclusion on financial capability?

- 2-year time horizon is used –an organization should be able to demonstrate it has, or likely will have, sufficient resources to stay in business for the 2-year period during Phase II research is underway
- Conclusions reached:
 - Are based on an evaluation of information in aggregate
 - Depend on individual facts and circumstances of each company
- NSF does not rely solely on financial ratios, statistics to make its judgment on financial capability – all information is considered
- Your company has ability to submit information to support its financial capability

Financial capability review

- What can companies do to improve their financial capability, if there are indicators of financial difficulty?
 - Extend repayment dates on shareholder loans
 - Provide more detail on expected revenues and customers (i.e. future prospects)
 - Provide a plan for controlling or reducing costs
 - Obtain additional equity investment
 - Provide financial support letter (s)

*** WANT TO BE AHEAD OF THE CURVE ON THIS ONE ***

Documentation to be submitted

What information do companies submit to support the NSF's review of its financial capability?

See NSF website

Required information includes.....

Documentation submitted in support of Financial Capability review

- Year-End Financial Statements for the two most recently completed years
 - Balance Sheet
 - Income Statement (P/L – Profit and Loss)
 - Cash flow statement
 - Simple (or summarized) Notes to Financial Statements
 - Prepared in accordance with GAAP or another acceptable basis of accounting
- Interim Financial Statements
 - If most recent year-end statement is >180 days old
 - If company's financial position has significantly changed from most recent year-end statement

Required Documentation

- Notes to financial statements
 - The company should provide a brief description of the basis of accounting used to prepare the year-end and interim financial statements.
 - The NSF wants to see a statement from the company's management or its external CPA accountant indicating whether or not the financial statements were prepared in accordance to Generally Accepted Accounting Principles (GAAP).
 - If not in accordance with GAAP, include a description of the major adjustments needed to present the submitted statements in accordance with GAAP. (description only; quantification not needed)

Required Documentation

All applicants

- Submit your auditor's or accountant's report - if you have one !!
 - Compilation report
 - Review report
 - Audit opinion
- Details of Debt Obligations – Schedule of all loans and long-term debt obligations outstanding
 - Name to whom the balance is owed
 - Balance outstanding at latest balance sheet date
 - Interest rate and interest payment provisions
 - Loan repayment date (s)
 - Other significant terms of the debt (convertibility, etc.)

Required Documentation

All applicants

- Tax Returns
 - If the company's year-end financial statements are unaudited, provide a copy of the company's tax return for its most recent fiscal year – info must reconcile !!
- Other Information, if important to explaining the financial capability of company
 - Details of any additional investments expected from shareholders
 - New contracts or grants received
 - Other financial developments of the company that are relevant to understanding its financial capability and future prospects

Accounting principals to be used for financial statements

- Applicants are encouraged to prepare and submit financial statements in accordance with Generally Accepted Accounting Principles (GAAP)

Required Documentation

- Applicants MAY alternatively use:
 - Accrual basis
 - Cash basis
 - Income tax basis
- IF the Company provides:
 - A description of the basis of accounting and the accounting principles used to prepare the financial statements (i.e Notes to Financial Statements to explain the nature of accounts presented)
 - A listing and description of the major adjustments needed to present the submitted statements in accordance with GAAP (description only; quantification not needed)

Financial capability review

Example financial capability review

Company A

Please take 5 mins to look at an example financial capability review for Company A

Financial capability review

Example financial capability review

Company B

Please take 5 mins to look at an example financial capability review for Company B

Financial capability review

Example financial capability review

Company C

Please take 5 mins to look at an example financial capability review for Company C

Financial capability review

Questions?

Comments?

Any specific questions or situations that you would like us to briefly address?

National Science Foundation

The Phase II Budget Review process

SBIR Budget Review

The Phase II Budget review:

- Performed by NSF staff on all requests for Phase II funding
- Very important element of the accounting and administrative review
 - result determines the level of funding provided
- The budget review and all funding recommendations are made by NSF personnel (and not your CPA reviewer)
- The NSF publishes specific guidance on the documentation that must be submitted to support each proposed expenditure - <http://www.nsf.gov/bfa/dias/caar/sbirrev.jsp>

SBIR Budget Review

Two important comments:

1. The CPA reviewer does not provide any budget advice – their role is only to review the amount requested, review supporting documentation for each category, and request clarifications where necessary.
2. The process does not generally allow Phase II budgets to be resubmitted if errors are found, or the company wishes to spend its money differently.

Budget Reviews

How does budget review work?

- → companies submit a summary of the expected expenditures using Phase II funds

Expenditures are the incremental costs and outlays for salaries, equipment, materials and services and other approved expenditures that will be used and consumed by the company specifically for Phase II research.

Budget Reviews

The expenditures are divided into two types:

- Direct expenditures
 - Direct salaries and wages
 - Fringe benefits (e.g. health ins., holiday, 401(k), FUTA, SUTA)
 - Materials & supplies
 - Equipment purchases
 - Consultant fees and expenses
 - Travel
 - Other
- Indirect Costs

The budget can also include:

- a subaward to a university or other organization
- allowable fee (max of 7% of direct and indirect costs)

Phase II budget is a cost-based budget (cost + fee)

Documentation

- What documentation needs to be provided to support each type of expenditure?

Documentation requirements

Direct costs:

The required information for each category of expense can be found on NSF website at:

<http://www.nsf.gov/bfa/dias/caar/sbirrev.jsp>

More information will be provided at the mandatory session tomorrow

Indirect Costs

□ Safe Rate

No documentation required to support budgeted indirect costs plus fringe with an effective rate of 50% or less of direct salaries and wages (S&W)

□ Indirect Cost Proposal

- Indirect costs greater than 50% of S&W must be substantiated by an indirect rate proposal for the most recently completed fiscal year expenses
- Proposal must clearly reflect total expenses per financial statements and show a reconciliation

□ Maximum

Indirect costs plus fringe limited to 150% of S&W

Overview of indirect costs

What are indirect costs?

A cost that is not directly related to the production of a specific good or service but incurred to support a variety of activities underway. For example, the cost of:

- Maintaining your accounting department
- Renting offices and facilities
- Utilities
- General and admin costs
- Other

These costs are typically allocated to the cost of contracts, and the NSF allows you to include a portion of these costs in your Phase II research budget ("Indirect Costs")

Overview of indirect costs

What is the NSF's approach to handling indirect costs on Phase II research?

Safe rate – up to 50% salaries/wages

Indirect Cost Proposal: 50% - 150% salaries and wages

NSF's rules for indirect cost reimbursements greater than the 50% safe rate

- General - calculation is done in accordance with Federal Acquisition Regulation (FARs) rules for the allocation of indirect costs to contracts
- For example - FAR 31.203 Indirect costs
https://www.acquisition.gov/far/current/html/Subpart%2031_2.html#wp1095599

NSF's rules for indirect cost rate calculations

For SBIR Phase II awards - the NSF has additional restrictions on costs included in the indirect cost pools

- Indirect cost pools cannot contain the following types of costs:
 - Patent and patent related expenses
 - Sales and Marketing
 - Business Development
 - Manufacturing and production
 - IR&D costs (internal research and development)

See also list of unallowable expenses at _____ [ref in FARS] which cannot be charged to Federal government contracts
Examples:

- Interest expense
- Federal income tax expense
- Entertainment
- Other

NSF's rules for indirect cost rate calculations

Limitation on indirect salaries

- Indirect salaries and wages in excess of 35% total salaries and wages, less paid time off, are considered unreasonable and is reclassified to direct costs

□ See example calculation

NSF's rules for indirect cost rate calculations

NSF specific rules

- Subcontract expenses excluded from the allocation base; (i.e. not part of direct costs) → Indirect rates will not be applied to subaward amounts.
- Equipment purchases are excluded from allocation base → Indirect rates will not be applied to equipment.

NSF's rules for indirect cost rate calculations

NSF specific rules

- The following expenses are included in the allocation base and absorb their share of expenses:
 - Sales/marketing
 - Business development
 - Manufacturing/production
 - IR&D
- i.e. they are treated as Final Cost Objectives

NSF's rules for indirect cost rate calculations

NSF specific rules

- Facilities Capital Cost of Money (FCCM) will not be funded as either a direct or indirect cost

Indirect Costs

□ Reconciliation (****)

- The indirect cost proposal Must CLEARLY reflect financial statement information and be accompanied by a reconciliation to total expenses in the financial statements
- NSF staff won't review an indirect cost proposal without this reconciliation; and will recommend funding at the 50% safe rate if it is not provided

NSF's rules for indirect cost rate calculations

What happens if past indirect expenses are not reflective of amounts in future?

--> Companies may submit a budgeted indirect rate for the upcoming year provided two conditions are met:

- The actual indirect rate for last year is calculated and submitted; (together with a reconciliation) and
- Budgeted pool expenses are supported by (a) actual cost data or (b) evidence that a future obligation will be in place and supplier quotation

NSF's rules for indirect cost rate calculations

Example indirect cost proposal : Sunny Graphics

Please spend 5 minutes looking at the example indirect rate proposal for Sunny Graphics

NSF's rules for indirect cost rate calculations

Example indirect cost proposal - Idc Sample Company

Please spend 10 minutes looking at the example indirect rate proposal for IDC Sample company.

Calculate the supported rate for indirect costs; using the worksheet on page ____.

Common pitfalls and problems

- Indirect cost proposal submissions
 - Reconciliation to financial statements not provided
 - NSF rules for IR&D, sales/marketing, patent and other costs are not followed
 - Budgeted pool expenses are not supported
 - Company submit using DCAA approved rates (or ICE model, without adjustments)

Possible result:

- Funding for indirect costs is less than that requested; and/or
- NSF decision to fund indirect costs at the 50% safe rate

Indirect cost proposals

Questions?

Comments?

SBIR Budget Review

Common pitfalls and problems noted in other expenditure categories

- Direct salaries and wages
- Materials and supplies
- Equipment
- Consulting services
- Subawards

Direct salaries and wages

- Current Employees – current payroll register or pay stub (if salary > \$50,000)
- Yet-to-be-hired Employees
 - If named, provide employment agreement
 - If unknown, provide explanation of rate determination and supporting documents
- Bureau of Labor Statistics Salary Survey (DOL/BLS salary survey)
 - Salaries generally limited to mean annual salaries listed in the [Occupational Employment Statistics \(OES\)](http://data.bls.gov:8080/oes/search.jsp)
<http://data.bls.gov:8080/oes/search.jsp>

Standard Occupational Classifications - Examples

- **11-9041 Engineering Managers**
Plan, direct, or coordinate activities in such fields as architecture and engineering or research and development in these fields. Exclude "Natural Sciences Managers"
- **11-9121 Natural Sciences Managers**
Plan, direct, or coordinate activities in such fields as life sciences, physical sciences, mathematics, statistics, and research and development in these fields. Exclude "Engineering Managers" and "Computer and Information Systems Managers"

Common pitfalls and problems

- Salaries/wages
 - Requested salary is not supported by DOL/BLS surveys;
 - External charge-out rate is used (e.g. \$100 per hour) offered; instead of actual salary cost to company
 - CAL months in Fastlane budget not supported by budget justification

Possible result – funding provided is less than that requested

Materials and Supplies

- Itemized list of items to be purchased including
 - Item identification / brief description
 - Vendor identification
 - Quantity to be purchased
 - Unit Cost
 - Extended Amount (*total cost for entire budget*)
- Provide supplier quotation or other appropriate documentation for items with an extended amount over \$5,000

Materials and supplies (con't)

Prototype manufacturing:

Can be complicated if a company is building prototypes of a product; and needs to complete engineering design work first.

- Include expected Bill of Materials (BOM)
- If needed, indicate best estimates and ranges of quantities to be purchases

Equipment

- Defined as Nonexpendable, tangible personal property with useful life of more than one year
- Documentation required to support purchases of equipment for Phase II research:
 - Three sources: Written quotation and/or copies of pricing information from catalogs, trade journals, etc.
 - Single Source: provide sole source justification (explanation of uniqueness of equipment and why this source is the only supplier). Include written quotation.

Consultant Services

- Provide the following information to support proposed payments to consultants:
 - A description of relationship between consultant and the organization
 - Selection process (competitive or sole source)
 - For each consultant provide a copy of the consulting agreement that describes:
 - Services to be provided
 - Period of performance and consultant's availability
 - Qualifications of the consultant to perform the work
 - Rate of Pay (not to exceed \$____/8-hour day ~ \$____/hour)

Subaward amounts

- Provide the following information to support proposed payments to subawardees:
 - Relationship between the awardee and the subawardee
 - Manner in which the subawardee budget was solicited (competitive or sole source)
 - Type of award contemplated (fixed price or cost reimbursement)
 - Analysis supporting reasonableness of subaward budget
- Subawards to universities:
 - Provide a statement from the university indicating that fringe and indirect costs do not contain tuition reimbursement
- Subawards to commercial organizations:
 - an analysis to support that the subaward budgeted amount is reasonable

Total Award and Fee

- The SBIR/STTR Phase II fixed-price grants typically will not exceed **\$500,000** per award
- NSF allows a reasonable fees for profit not to exceed seven percent of total direct and indirect costs

Factors for success and how to get funded the full amount available

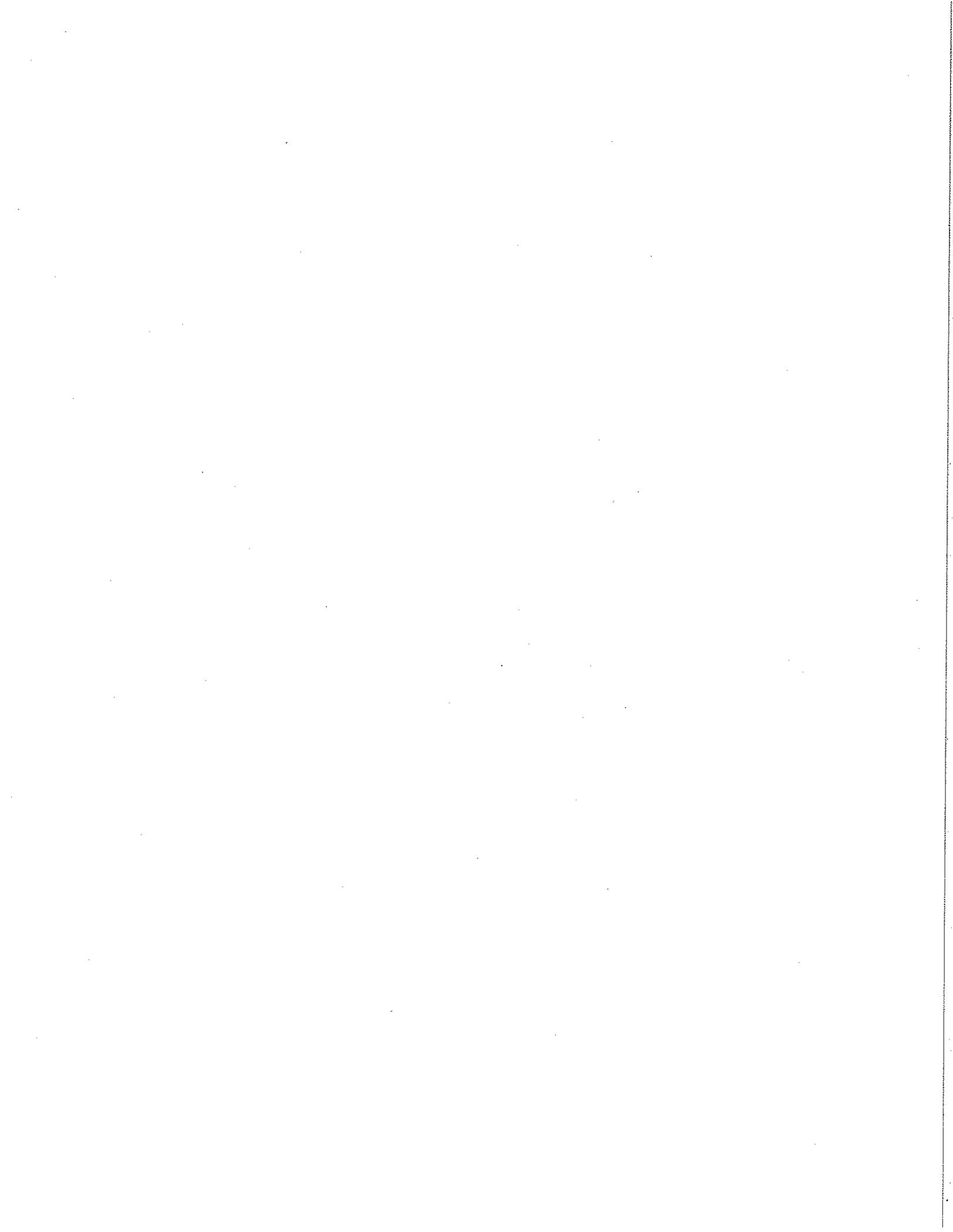
1. Read carefully the NSF's current documentation requirements.
2. Include all requested information on first submission
3. Respond timely to requests for additional information
4. Perform a financial capability self-assessment, and address issues (if necessary) prior to submission of information to NSF
5. Address the common pitfalls and issues which can affect funding (see pages ____ to ____ of the participant materials) and ensure you don't have any!
6. For Indirect Cost Proposal (IDCP) requesting a rate > 50% → take extra care as it is likely your accountant hasn't done one in accordance with NSF's specific policies

Reference sources for additional information

- Overall Phase II Requirements
<http://www.nsf.gov/bfa/dias/caar/sbirrev.jsp>
- Indirect Cost Rates and Proposal
<http://www.nsf.gov/bfa/dias/caar/docs/idcsubmissions.pdf>
- Your NSF contact – For additional questions

National Science Foundation SBIR/STTR Program Accounting Workshop September 20, 2010

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SEARCH

NSF Web Site



SBIR/STTR Phase II Reviews

- [Phase II Grant Terms and Conditions](#)
- [NSF Program Information on the SBIR/STTR Program](#)

CAAR SBIR/STTR Phase II Administrative/Financial Reviews

When an SBIR/STTR Program Official has determined that it is likely that a Phase II proposal will be recommended for funding, the prospective awardee will be referred to this website and requested to provide documentation needed by NSF to conduct various administrative and financial reviews. These reviews are conducted to evaluate a prospective awardee's ability to effectively and efficiently manage a Federal award. If your organization has been directed to this site by an SBIR/STTR Program Official and requested to provide the documentation needed by NSF to conduct administrative and financial reviews, the documentation noted below should be sent within 10 calendar days of the date of request to:

National Science Foundation
Division of Institution and Award Support
Cost Analysis and Audit Resolution Branch
4201 Wilson Boulevard, Room 485
Arlington, VA 22230

NSF uses the services of CPA firms to perform reviews of the documentation submitted. If contacted by NSF staff or a contractor to provide clarification or additional documentation, responses should be provided as soon as possible to expedite the review process. Please direct questions on completing any of the required documentation to 703-292-8244.

Administrative/Financial Documentation Required:

Prospective New Awardee Guide - Complete and submit the following contained in the [Prospective New Awardee Guide](#):

- "Awardee Organization and Management Summary" found at Appendix 1 of Guide;
- "Organizational Establishment and Structure" documentation (Articles of Incorporation and State certificate) as detailed at Section B.2 of the Guide;
- "Civil Rights Act Certification" found at Appendix 2 of the Guide; and
- "Financial Management Systems Questionnaire" found at Appendix 4 of the Guide and attach a sample timesheet. ([Sample Timesheet](#)) .

Financial Capability Review - CAAR performs a Financial Capability Review on every prospective Phase II grantee to ensure that the organization is financially stable, has sufficient resources to complete its research program and does not expose the government to the possibility of waste, fraud or abuse of funds. NSF will decline funding when an organization is unable to demonstrate that it has sufficient financial resources as of the evaluation date, or in its opinion, there is a risk of inappropriate use of Federal funds.

The Financial Capability Review includes a review of the organization's solvency (i.e. the level of capital invested by shareholders), debt obligations, liquidity (i.e. cash resources on hand to satisfy financial obligations), historical profit and loss, cash flows, operating trends and financial commitments.

The Financial Capability Review is performed through a review and analysis of the organization's financial statements, tax returns and other information. Additional information may be requested to support an organization's financial capability such as operating budgets, cash flow forecasts, lines of credit, details of liabilities, committed investments, other grant or revenue sources, updated interim financial statements, bank statements, etc.

Financial Information Required: Applicants for Phase II funding should provide the following information to support the Financial Capability Review. Additional information may be requested by CAAR after reviewing the information submitted.

A. Year-end financial statements. An applicant should submit financial statements for the company (including an income statement, balance sheet and cash flow statement) covering the results of operations for the two most recently completed fiscal years.

The financial statements should be prepared using the accounting principles described in the section entitled "Accounting Principles."

The financial statements should also include basic "Notes to Financial Statements" and supplementary information to help

US NSF - About

the reader understand the nature of the accounts presented.

B. Interim financial statements – Interim financial statements for the current year should be provided if any one of the following circumstances exist:

- The year-end financial statements submitted are more than 180 days old. For example, if a company has a December 31 fiscal year-end and is submitting financial statements to CAAR on or after July 1 of the following year, the company should also submit interim financial statements covering operations of the current year up to the latest date such financial information is available.
- The company's financial position has changed in a significant and material manner since the year-end financial statements were prepared. This could occur, for example, if the company received a significant level of new investment since year-end; the company's liabilities/debt obligations changed significantly or other developments occurred affecting the financial position of the company and which would be relevant to assessing its financial capability.

C. Information concerning the basis of accounting - The company should provide a brief description of the basis of the accounting method used to prepare the year-end and interim financial statements. This should include a statement from the company's management or its external CPA/accounting consultant whether or not the financial statements were prepared in accordance with Generally Accepted Accounting Principles (GAAP).

D. Accountant's compilation report, review report or audit opinion - If available, companies should submit a copy of their external accountant's most recent compilation, review or audit report on its financial statements; together with the related financial statements and notes thereto.

E. Details of debt obligations - Provide a schedule of all loans and long-term debt obligations outstanding, including:

- Name of person/organization to whom the balance is owed;
- Balance outstanding at the latest balance sheet date;
- Interest rate and interest payment provisions;
- Loan repayment date (or repayment provisions); and,
- Other significant terms of the debt (convertibility provisions, etc.).

Identify clearly all debt obligations of the company that are payable to shareholders of the company or the company's management personnel.

The total balance shown on this schedule should be equal to (or reconcile with) the loan balance reported in the company's financial statements.

For companies that have issued Preferred Stock, provide details of the dividend requirements, repurchase provisions, convertibility provisions, etc. to the extent such information is not already provided elsewhere in the information submitted.

F. Tax returns - If the company's year-end financial statements are unaudited, provide a copy of the company's tax return for its most recently completed fiscal year.

G. Other information - Prospective Phase II grantees should submit any other information that they believe is relevant to understanding the financial capability and/or financial viability of their company. This includes details of any additional investments expected from shareholders (indicating the amount and timing); new contracts or grants received and other financial developments of the company that are relevant to understanding its financial capability and future prospects.

Additional Financial Information - CAAR performs additional procedures on companies whose financial statements indicate they may be in financial difficulty, or who are addressing financial solvency or liquidity issues. **Applicants for Phase II funding who meet any one of the following criteria should provide the additional information listed below to enable a more complete review of their financial capability:**

Indicators of Possible Financial Difficulty

1. Solvency issue – As indicated by negative shareholders' equity on their latest balance sheet. (i.e. a shareholders' equity balance that is less than zero).

For the purposes of this test, shareholders' equity consists of both (i) shareholders' equity or net worth as of the latest balance sheet and (ii) any shareholder loans or advances made to the company and reflected on the balance sheet, and which will be outstanding for at least the 2-year period while Phase II research is underway.

2. Liquidity issue – indicated by both a Current Ratio of less than 1:1 and a Quick Ratio of less than 0.9:1. The current ratio is the ratio of current assets to current liabilities. The quick ratio is the ratio of quick assets to current liabilities. Quick assets are bank account balances and other liquid funds.
3. Unfunded loan maturities – Significant loans coming due within the next 2 years, and for which the source of repayment is not evident.

Provide the following additional information if an indicator of financial difficulty is present:

- Cash flow forecast or operating budget for the upcoming 2-year period; indicating major categories of cash receipts and disbursements. Evidence must be provided to support the likelihood of actually receiving projected cash receipts;
- Details of additional investments expected from shareholders (indicating the amount and timing);
- New contracts or grants received; and,

US NSF - About

- Other financial information of the company that is relevant to understanding its financial capability and future prospects.

Additional information to support an applicant's financial capability may be requested following receipt and review of the above information.

Financial Support Letters - The financial viability of some companies depends on loans, advances and credit facilities provided by major shareholders or investors. Without these credit facilities, an organization could have difficulty paying expenses and meeting its financial obligations on a timely basis.

If a Phase II applicant's financial viability relies on, among other things, the continuation of loans or credit facilities from shareholder(s) or investor(s), please provide Financial Support Letter(s) signed by such shareholder(s) or investor(s) confirming:

- (i) their intention to continue providing the loan or credit facilities to the company for the 2 year period Phase II research is underway and indicate the limits of that support; and
- (ii) that the shareholder loans or advances that are outstanding as of the date of the letter and in the amount of \$_____ will not be repaid during the 2 year period Phase II research underway if such repayment will affect the solvency of the company or its ability to meet its financial obligations in a timely basis.

Accounting Principles - Applicants for Phase II funding are encouraged to prepare and submit their financial statements in accordance with Generally Accepted Accounting Principles (GAAP).

Phase II applicants are permitted to submit their financial statements on either (a) the accrual basis of accounting; (b) the cash basis of accounting; or (c) the income tax basis of accounting; provided the following requirements are met:

- (i) The company provides a description of the basis of accounting and accounting principles used to prepare the financial statements;
- (ii) The company provides additional Notes to Financial Statements to explain the nature of accounts presented; and,
- (iii) The company provides a listing and description of the major adjustments needed to present the submitted statements in accordance with GAAP. Companies new to financial reporting and preparation of GAAP financial statements should discuss this requirement with its external CPA.

Budget Reviews - Provide documentation as detailed below to support the proposed costs in the following categories. (CAAR Budget Reviews)

Senior Personnel: (1) Provide a current payroll register for each employee and clearly indicate payroll period, i.e., bi-monthly, bi-weekly, etc. (2) For each named individual who is not presently employed by the organization, provide an employment agreement that states the rate of payment with the organization's considerations in determining the rate of pay. (3) For positions where specific individuals have not been named, provide an explanation of how the rates were determined and any related documentation. (4) Salaries that can not be sustained by commercial activities will be limited to the amounts supported by the Bureau of Labor Statistics salary surveys from the Occupational Employment Statistics (OES). CAAR generally does not exceed the OES mean average salaries in its recommendations. CAAR also does not consider small business owners to be "Chief Executives." Standard Occupational Classifications (SOCs) should be suggested, or they will be determined without input from the small business. (See www.bls.gov) (5) NSF will only fund reasonable increases in base salaries.

Other Personnel: For all "other personnel" proposed at an annualized salary in excess of \$50,000, provide cost data as described for senior personnel above. If individual is administrative (i.e., accounting, secretarial, etc.), state reason they are proposed directly and not included in indirect costs.

(see sample timesheet)

Fringe Benefits: Provide the categories of costs (FICA, health benefits, etc.) included and the related amounts. Provide calculation of the actual fringe rate for previously completed fiscal year (total fringe costs / total labor costs). (See Indirect Costs below.)

Permanent Equipment: Defined as nonexpendable, tangible personal property, having a useful life of more than one year and an acquisition cost of \$5,000 or more per unit. However, companies may elect to establish their capitalization threshold at less than \$5,000. Provide cost data from three sources which can be in the form of written quotations and/or copies of pricing information contained in catalogs, trade journals, etc. In situations where equipment can only be provided by one specific source provide a sole source justification and a written quote from that source.

Travel: Provide an itemization of travel which should include the destination, purpose of travel, number of days in travel status, and the estimated costs for items included in the amount (airfare, cab fare, car rental, per diem rates, hotel and other incidentals.) First class and business class fares are unallowable. Per diem in excess of Federal Travel Regulation limits is unallowable. No supporting detail is required for attendance at the annual Grantee Conference budgeted at \$2,000 (or less) per person, limited to \$4,000/year. (Federal Travel Regulation)

Materials and Supplies: Provide an itemized listing of materials and supplies to include the item identification/description, vendor, quantity, price, and extended amount. Provide quotations or other appropriate documentation to support any single material and supply item with an extended amount in excess of \$5,000.

Consultant Services: For each consultant, provide an agreement which includes the following information: (1) the services to be provided; (2) the period of performance and the consultant's availability; (3) the qualifications of the

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consultant to perform the work; and (4) the rate of pay, not to exceed \$600 per 8 hour day. Consultants should be chosen using a competitive selection process; otherwise, sole source justifications should be maintained.

Subawards: For each subaward provide (1) a statement detailing the relationship between the awardee and the subawardee; (2) a statement describing the manner in which the subawardee budget was solicited; e.g., sole source or competitive; (3) the type of award contemplated; e.g., fixed price or cost reimbursement; and (4) an analysis to support that the subaward budgeted amount is reasonable. Subawards should be chosen using a competitive selection process; otherwise, sole source justifications should be maintained.

Indirect Costs: No documentation is required to support budgeted indirect costs plus fringe with an effective rate of 50% or less of direct salaries and wages (S&W). Documentation is required to support indirect costs with an effective rate greater than 50% S&W and is limited to 150% S&W. Indirect costs budgeted at an effective rate greater than 50% must be substantiated by a current indirect rate proposal for the most recently completed fiscal year expenses. The indirect rate proposal must clearly reflect total expenses per your financial statement and show a reconciliation. Rate proposals that do not have a clear reconciliation to total expenses as reported in the financial statements will not be reviewed and the 50% S&W "safe rate" will be recommended for funding. If available, the corresponding rate agreement should be provided; however, NSF reserves the right to make adjustments for forward pricing purposes. In the event the most recently completed fiscal year of activity does not reasonably reflect performance under the Phase II award, a budgeted rate proposal may be submitted in addition to the most recently completed fiscal year actual calculation. Budgeted rate proposals submitted without an actual calculation for the most recently completed fiscal year will not be reviewed. Budgeted pool expenses must be supported by actual cost data or evidence must be provided that a future obligation will be in place accompanied by a reliable quotation. Budgeted indirect rate proposals must include a reference column for each pool expense and each supporting document must be attached and labeled accordingly. ([Sample indirect cost proposal](#))

Indirect Rate Proposal Adjustments:

- IR&D must be treated as a direct cost and included in the indirect rate allocation base.
- The following expenses will not be funded as part of indirect cost pools:
 1. Patent and patent related expenses;
 2. Sales and marketing;
 3. Business development; and
 4. Manufacturing and production.
- Indirect salaries and wages in excess of 35% total salaries and wages, less paid time off, is considered unreasonable and will be reclassified to direct costs.
- Subcontracts will be excluded from the base unless subcontracts in the indirect cost proposal are proportionate to subcontracts budgeted in the SBIR/STTR proposal. ODCs to outside organizations may be treated as subcontracts.
- Equipment will be excluded from the base. Indirect rates will not be applied to equipment.
- Sales/marketing, business development, and manufacturing/production must be allocated its share of general and administrative expenses and included as part of the allocation base.
- Facilities Capital Cost of Money (FCCM) will not be funded.

Small businesses are cautioned that it is their responsibility to provide adequate explanation and documentation to support budgeted costs. Funding recommendations will not be revised based on new documentation or explanations that are provided subsequent to the completion of budget reviews.



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Celebrating 60 Years of Discovery

Last Updated: May 11, 2010

Indications of Possible Financial Difficulty

Item Present ?

1. On Balance Sheet

Lack of shareholder investment (as indicated by negative shareholders' equity and minimal loans from shareholders)

Excessive long-term debt in comparison to permanent equity. This could be indicated by:

- Debt to Equity Ratio greater than 3:1
- Debt Service Ratio¹ less than 2:1

Deficiency in working capital or liquid funds (i.e. cash) balances. This could be indicated by:

- Current Ratio² less than 1:1, and
- Quick-Ratio³ of less than 0.9:1

Large bank overdrafts

Excessive use of credit card financing (in case of smaller companies)

Loans coming due in next 1-2 years (for which no obvious source of money is available for repayment)

Unfavorable trends in balance sheet accounts (e.g. large decreases in bank account balances, current assets, or total assets which could indicate the organization is shrinking in size and may not be continuing as a going concern)

High level of intangible assets; such as deferred costs and goodwill.⁴ in comparison to other assets on balance sheet.

¹ Debt Service Ratio – ratio of earnings before interest expense and taxes to Interest Expense. A ratio of 2:1 or higher could be considered healthy; a lower ratio could possibly need more review.)

² Current Ratio: Ratio of Current Assets to Current Liabilities

³ Quick Ratio: Ratio of Liquid Assets to Current Liabilities. Liquid Assets often include Cash balances and near cash assets

2. On Income Statement

Recurring operating losses

Deteriorating revenues, margins or profitability (which could indicate the loss of important customers, contracts or funding)

High level of interest expense

3. From Other Information

Cash flow statement indicating significant cash being used in operating activities over a number of years;

Qualified auditor's opinion (for e.g. –a going concern qualification)

Current budgets and/or forecasts which indicate that significant future losses are expected

Significant value of supplier payments in arrears (i.e. company is not current in paying its creditors, as evidenced by large balances due to suppliers amounts more than 90 days overdue)

Unfavorable legal proceedings that may be ongoing

⁴ A high level of intangible assets can indicate a problem in solvency. If such assets are written off, or have no value, the company could have a shareholders' deficit.

Financial Capability

Company A

Background

Founded in 2003 and employs 25 people; Company generates commercial revenues in the range of \$2 million and \$4 million per year;

The company submitted financial statements which indicated the following:

	9 Months Ended September 30, 2009	Year Ended December 31, 2008	Year Ended December 31, 2007
Revenues	\$ 4,046,896	\$ 2,030,429	\$ 315,963
Gross profit	1,139,309	415,461	55,686
Admin expenses and other	1,707,670	1,009,119	1,174,440
Interest expense	331,639	156,633	-
Net income (loss)	\$ (900,000)	\$ (750,291)	\$ (1,118,754)

Company A

Summarized Balance Sheet

	September 30 2009	December 31, 2008	December 31, 2007
Cash in bank	\$ 125,000	\$ 650,000	\$ 103,125
Accounts Receivable	688,080	747,674	100,000
Other current assets	280,000	409,000	31,500
Total current assets	<u>1,093,080</u>	<u>1,806,674</u>	<u>234,625</u>
Fixed assets, net	135,000	104,000	17,000
Deferred development costs, net	5,200,000	4,915,467	290,000
Other assets	4,000	75,000	-
TOTAL ASSETS	<u>6,432,080</u>	<u>6,901,141</u>	<u>541,625</u>
Current liabilities			
Accounts payable and other	820,000	901,318	96,511
Balance due under bank loan (*)	3,290,940	3,685,000	-
Total current liabilities	<u>4,110,940</u>	<u>4,586,318</u>	<u>96,511</u>
Advances from shareholders	3,687,317	3,000,000	1,275,000
Other long-term liabilities	419,000	400,000	355,000
Shareholders' Deficit			
Common stock	500,000	500,000	500,000
Preferred Stock	1,200,000	1,000,000	150,000
Retained earnings (deficit)	(3,485,177)	(2,585,177)	(1,834,886)
Total Deficit	<u>(1,785,177)</u>	<u>(1,085,177)</u>	<u>(1,184,886)</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 6,432,080</u>	<u>\$ 6,901,141</u>	<u>\$ 541,625</u>

(*) this bank loan is due and is repayable in February 2010

Capital raising activities

Company A has a program in place to additional capital from angel and other financial investors. The company stated that its growth in sales provides a strong business case to raise addition equity from investors, and believes that it will be successful in this regard. The company has two fund raising efforts taking place currently:

- One directed towards angel investors and fund managers which oversee smaller investments in the range of \$500,000 to \$4,000,000. The company is discussing investments from NAME and NAME, and expects to receive financing sometime in 2011.
- A fund raising effort directed towards large institutional investors (through an investment broker).

As of December 2009, the company has identified investors willing to invest another \$290,000; to be closed sometime in March 2010.

Bank loan

The company has a large bank loan which is coming due in February 2011.

The company did not provide any additional information as to how it would refinance the loan, or whether the current bank would extend repayment.

Investor support letter

The company's shareholders provided an investor support letter stating a willingness to continue funding the company, and to delay the repayment of any of its loans until the company is in a stronger financial position.

Financial forecast

The company stated it has a “good chance” of breaking even in 2010 based on its current business plan.

QUESTIONS TO CONSIDER

Based on the information presented ----

- Does this company have adequate capital and financial resources that provide it a reasonable chance of remaining in business for the two year period during which Phase II research is underway?
- What is the level of risk associated with providing funds to this organization?
i.e. Low, medium or high

Financial Capability

Company B

Background

Company B was founded in 2006 and employs 6 people.

The company generates revenue from consulting revenues, and the sale of its products and systems to external customers.

The company's submitted financial statements indicate the following:

INCOME STATEMENT DATA	September 30, 2009	December 31, 2008	December 31, 2007
Total revenues	\$ 750,000	\$ 1,500,000	\$ 500,000
Operating expenses	680,000	1,340,000	300,000
Net income (loss)	\$ (16,934)	\$ (96,598)	\$ 189,626

Company B
Summarized Balance Sheet

	September 30, <u>2009</u>	December 31, <u>2008</u>	December 31, <u>2007</u>
CURRENT ASSETS			
Cash in bank	\$ 10,000	\$ 6,000	\$ 2,500
Accounts receivable	101,301	-	8,655
Inventory (*)	35,000	70,000	-
Other current assets	15,000	10,000	-
Total current assets	<u>161,301</u>	<u>86,000</u>	<u>11,155</u>
 Total fixed assets, net	 <u>100,000</u>	 <u>75,000</u>	 <u>25,000</u>
 Total assets	 <u><u>261,301</u></u>	 <u><u>161,000</u></u>	 <u><u>36,155</u></u>
 CURRENT LIABILITIES			
Commissions payable	162,145	84,833	-
Balances due on credit cards (**)	105,000	66,610	-
Interest payable	27,217	25,000	-
Total current liabilities	<u>294,362</u>	<u>176,443</u>	<u>-</u>
 Loan from shareholder	 175,471	 176,155	 131,155
 SHAREHOLDERS' DEFICIT			
Common stock	5,000	5,000	5,000
Accumulated deficit	(213,532)	(196,598)	(100,000)
Net shareholders' deficit (equity)	<u>(208,532)</u>	<u>(191,598)</u>	<u>(95,000)</u>
 Total liabilities and shareholders' deficit	 <u><u>\$ 261,301</u></u>	 <u><u>\$ 161,000</u></u>	 <u><u>\$ 36,155</u></u>
 (*) Credit card balances			
Advanta business Master card	\$ 10,944		
Bank of America credit line	40,000		
Dell credit line	13,000		
Visa credit card	41,056		
	<u><u>\$ 105,000</u></u>		

Capital raising activities

The company's CEO advised that no new loans are anticipated to Company B, although the founder and other investors have indicated a willingness to provide them.

The company states that "it is also considering an equity investment in the amount of \$1 to \$4 million in 2010 and 2011"; although no further details were provided.

The Company has been financed heavily by credit card debt over the past year. This has a high rate of interest and it is not clear why the company is not pursuing additional equity funding, if it is actually available.

Revenue and costs

Revenues amounted to \$1.5 million in 2008, but were significantly lower in 2009 as a result of cancelled projects. The company believes this was the result of the economic slowdown in 2008; which reduced discretionary spending by its customers.

The company believes its business is recovering, and provided a list of expected new customers in 2010 and 2011. The sales cycle time for their products/system is relatively long, and as a result – it will take time for the company to rebuild its backlog.

The company signed contracts which will bring in revenues of approx. \$185,000 in 2010.

Cash flow forecast

The NSF requested a cash flow forecast for the upcoming two years during which Phase II research would be underway, but the company declined to provide it.

Investor support letter

The company's shareholders provided an investor support letter stating a willingness to continue funding the company, and to delay the repayment of any of its loans until the company is in a stronger financial position.

QUESTIONS TO CONSIDER

Based on the information presented ----

- Does this company have adequate capital and financial resources that give it *a reasonable chance* of remaining in business for the two year period during which Phase II research is underway?
- What is the level of risk associated with providing funds to this organization?

Low, medium or high ?

COMPANY C

Financial Capability Example

Company backed by external investors

The company's financial statements for the years ended September 30, 2008 and 2007 (the two most recently completed years), and the interim statements for the 7 months ended April 30, 2008, showed that the company has struggled with profitability and cash flow in recent years:

BALANCE SHEET DATA

	April 30, 2009	September 30, 2008	September 30, 2007
Cash in bank	\$ 6,997	\$ 7,778	\$ 58,533
Accounts receivable	263,558	568,137	554,658
Other current assets	701,595	637,986	297,864
Total current assets	<u>972,150</u>	<u>1,213,901</u>	<u>911,055</u>
Less: current liabilities	(953,196)	(1,404,321)	(1,956,811)
Net current assets	<u>18,954</u>	<u>(190,420)</u>	<u>(1,045,756)</u>
Long-term debt payable to shareholders	2,980,000	2,480,000	6,822,393
Shareholders' equity (deficit)	\$ (2,763,652)	\$ (2,476,589)	\$ (7,704,731)

INCOME STATEMENT DATA

	Seven months ended April 30, 2009	Year Ended September 30, 2008	Year Ended September 30, 2007
Revenues	\$ 2,095,641	\$ 4,302,152	\$ 2,580,682
EBITDA	(128,049)	453,498	(107,238)
Net income (loss)	<u>\$ (286,921)</u>	<u>\$ 232,257</u>	<u>\$ (296,395)</u>

Company C is backed by venture capital owners who have provided loans and credit facilities to the company to finance operations. Its primary investor (NAME) has been involved with the company since the 1980s and continues to back the company and believe in its technology. We received a statement from the company's major shareholder that it intends to continue its financial backing of the company.

OTHER INFORMATION

The Company's financial position is weaker than many companies as indicated by the following:

- minimal cash in bank
- shareholders' deficit
- significant level of loans outstanding

However, there are indicators that the company's financial position is improving:

- The company hired a new CEO in 2008, and took steps to reduce its costs and bring them more in line with expected revenues.
- The company completed a recapitalization with its shareholders during the year ended September 30, 2008; including the conversion of certain shareholder loans into permanent equity. This has the effect of reducing interest costs, as well as providing additional evidence the company's major shareholders continue to back the company and believe in its future;
- The company earned positive net income and cash flow (as measured by EBITDA) in its most recently completed fiscal year.
- The company continues to receive the backing of its shareholders. The company provided a statement from the investor that it intends to continue its financial backing of the company, and has no intention of calling the shareholder loans.

QUESTIONS TO CONSIDER

Based on the information presented ----

- Does this company have adequate capital and financial resources that give it *a reasonable chance* of remaining in business for the two year period during which Phase II research is underway?
- What is the level of risk associated with providing funds to this organization?

Investor Support Letter

The financial viability of some companies depends on loans, advances and credit facilities provided by major shareholders or investors. Without these credit facilities, an organization could have difficulty paying expenses and meeting its financial obligations on a timely basis.

If a Phase II applicant's financial viability relies on, among other things, the continuation of loans or credit facilities from shareholder(s) or investor(s), the company should provide a Financial Support Letter(s) signed by such shareholder(s) or investor(s) confirming:

- (i) their intention to continue providing the loan or credit facilities to the company for the 2-year period during which Phase II research is underway; and
- (ii) an undertaking that such groups or shareholders will not cause any existing loans or advances to the company to be repaid during the 2-year period Phase II research is underway; if repayment affects the solvency of the company or ability to meet its financial obligations on a timely basis.

The following is an example financial support letter which should be provided by an organization which relies on loan or credit facilities provided by shareholders or investors.

(Example Financial Support Letter)

(On Shareholder or Investor Letterhead)

National Science Foundation
Division Institution & Award Support
Cost Analysis and Audit Resolution Branch
4201 Wilson Blvd
Arlington, VA
22230

Date _____

To the National Science Foundation:

[Name] [Address] is a shareholder or investor in [company name] [Address]
("Company") and provides the following credit and loan facilities to the Company:

(Describe)

We understand that Company has requested funding from the National Science Foundation for Phase II research to be performed under the Small Business Innovation Research (SBIR) & Small Business Technology Transfer (STTR) Program.

We hereby confirm:

- (i) our intention to continue to provide loan or credit facilities to the Company for the 2-year period during which Phase II research is underway; and
- (ii) an undertaking that we will not cause any existing loans or advances or to the Company to be repaid during the 2-year period Phase II research is underway; if repayment affects the solvency of the Company or ability to meet its financial obligations on a timely basis.

Signed:
[Shareholder/Investor Name]

BY:

Name/title

SUNNY GRAPHICS
EXAMPLE

Sunny Graphics
Sample – Profit Indirect Cost Rate Proposal
FYE 12/31/00

		Elimina-	Indirect	Direct	Project A	Project B	Project C	(4)
Salaries & Wages	Total	tions	Costs	Costs	NSF	DOE	NASA	IR&D
B. Able, President	70,000		25,000	45,000	15,000	5,000	15,000	10,000
J. Brue, Sr. Scientist	65,000		15,200	49,800	23,800	10,000	8,000	8,000
P. Dent, Engineer	60,000		4,800	55,200	0	40,000	10,000	5,200
C. Kipe, Scientist	50,000		4,000	46,000	30,000	12,000		4,000
S. Smith, Typist	30,000		12,400	17,600	10,000	6,000	1,000	600
M. Jones, Accounting	45,000		45,000	0	0	0	0	0
Total Salaries & Wages	320,000		106,400	213,600	78,800	73,000	34,000	27,800

(3) (B)

FICA	24,480		24,480					
Health Insurance	28,000		28,000					
Consultant Fees	49,000		3,000	46,000	13,000	27,000	3,750	2,250
Depreciation	10,000		10,000					
Entertainment/Penalties	3,500	3,500						
Equipment	23,000	23,000						
Legal & Accounting	5,000		5,000					
Materials & Supplies	20,000		1,500	18,500	9,400	2,500	900	5,700
Office Supplies	2,000		2,000					
Computer Services	6,500		1,000	5,500	4,500	1,000		
Postage & Telephone	1,500		1,500					
Printing & Publication	3,000		400	2,600	1,400	700	500	
Rent	12,000		12,000					
Utilities	2,400		2,400					
Travel	6,000		600	5,400	3,600	800	750	250
Subawards	95,000	95,000						
Total Expenses	611,380	121,500	198,280	291,600	110,700	105,000	39,900	36,000

(1) (2) (A) (C)

Indirect Cost Pool (divided by) (A) 198,280
 Salaries and Wages Distribution Base (B) 213,600 = 92.8%
 OR
 Indirect Cost Pool (divided by) (A) 198,280
 Modified Total Direct Cost Distribution Base (C) 291,600 = 68.0%

- (1) Indirect cost proposal should be based on actual cost data for the most current ended accounting year and should be submitted with the financial statements (F/S) for that year. The total amount of expenses per the indirect cost proposal should be reconciled to the total expenses reported in the F/S. A second "budgeted" indirect cost proposal(s) should be provided if it is expected that the indirect cost rate will change significantly during the actual period of the award (if covering more than one accounting year, a proposal should be provided for each year). Where projected costs in any particular cost category have significantly increased, an explanation for the increase should be provided.
- (2) Both direct costs and indirect costs shall exclude capital expenditures. Unallowable costs are also excluded, unless they 1) include the salaries of personnel, 2) occupy space, and (3) benefit from the organization's indirect costs; in which case they are included as a direct cost (see applicable cost principles which identify other unallowable costs). Distorting items such as subawards and participant support costs should be excluded from the distribution base.
- (3) Fringe benefits, including FICA, non-work time, health, etc., in this example are included in the indirect cost pool and therefore would not be proposed as a separate direct cost element. (Although not separately itemized, vacation, holiday and sick are included in the indirect salaries and wages amounts in this example.) It can be appropriate, however, to segregate fringe type costs and allocate these costs to direct and indirect salary and wage categories in determining total indirect and direct amounts. It would then be appropriate to propose fringe benefits as a separate rate applied to direct salaries and wages.
- (4) NSF does not fund Independent Research and Development (IR&D) costs either directly or indirectly. Therefore, while IR&D should not be proposed as direct costs, these costs must be treated as a direct cost in indirect cost rate calculations.

IDC SAMPLE COMPANY
Statement of Income
December 31, 20XX

Revenues		
Contract research	\$2,000,000	
Commercial product sales	700,000	
License fees and royalties	<u>250,000</u>	
	2,950,000	
Cost and expenses		
Cost of contract resesarch	995,099	
Cost of manufacturing	325,000	
Selling and marketing	100,000	
General and administrative expenses	<u>1,500,000</u>	P ₁₁
	2,920,099	
Income from operations	29,901	
Other income (expenses)		
Interest Expense	<u>16,500</u>	P ₁₁
Net Income before taxes	13,401	
State & Local Taxes	2,500	} P ₁₁
Federal Income Tax	<u>200</u>	
	2,700	
Net Income	<u><u>\$10,701</u></u>	

Schedule A

IDC Sample Company
Summary of Claimed Indirect Rates
Fiscal Year Ended 12/31/XX

COST ELEMENT CLAIMED REFERENCE

FRINGE RATE

POOL	P ₈	612,000	Schedule D
BASE	P ₈	1,290,000	Schedule D
FRINGE RATE		47.4%	

OVERHEAD RATE

POOL	P ₇	431,175	Schedule C
BASE	P ₉	990,000	Schedule E
O/H RATE		43.6%	

G&A RATE

POOL	P ₆	595,845	Schedule B
BASE	P ₉	2,323,954	Schedule E
G&A RATE		25.6%	

Schedule B

IDC Sample Company
G&A Expenses for FY Ended 12/31/XX

DESCRIPTION	Per G/L	Adjustments	Claimed	Notes
G&A Labor	170,000		170,000	
B&P Labor	80,000		80,000	
B&P Other Costs	2,000		2,000	
IR&D Labor	10,000		10,000	} P10
IR&D Other Costs	2,000		2,000	
Corporate Bonus	10,000		10,000	
Office Supplies	17,000		17,000	
Office Equipment Depreciation	6,000		6,000	
Rent & Utilities (10%)	12,000		12,000	
Legal & Accounting	75,000		75,000	
Patent Amortization	7,000		7,000	
Janitorial	4,000		4,000	
Business Insurance	30,000		30,000	
Officer Life Insurance	2,000		2,000	P10
Bank Charges	500		500	
Shipping & Mailing	3,100		3,100	
State & Local Taxes	2,500		2,500	
Federal Income Tax	200		200	P10
Interest Expense	16,500	(16,500)	0	1
Entertainment Expense	3,000	(3,000)	0	2
Subtotal	452,800	(19,500)	433,300	
				P11
Fringe Benefits on G&A Labor			80,651	
Fringe Benefits on B&P Labor			37,953	
Fringe Benefits on IR&D Labor			4,744	P10
Overhead on B&P Labor			34,842	
Overhead on IR&D Labor			4,355	P10
TOTAL G&A EXPENSE POOL			595,845	P11

Notes

- 1 Interest expense not allowable per FAR 31.205-30
- 2 Entertainment expense not allowable per FAR 31.205.15

P7

Schedule C

IDC Sample Company
Overhead Expenses for FY Ended 12/31/XX

<u>DESCRIPTION</u>	<u>Per G/L</u>	<u>Adjustments</u>	<u>Claimed</u>
Overhead Labor	40,000		40,000
Marketing/Sales Labor	90,000		90,000 P10
Travel (Indirect)	32,000		32,000
Lab Supplies	25,000		25,000
Maintenance & Repairs	500		500
Memberships & Fees	12,000		12,000
Equipment Depreciation	50,000		50,000
Outside Services	12,000		12,000
Rent & Utilities (90%)	108,000		<u>108,000</u>
Subtotal			369,500
Fringe Benefits on OH Labor			18,977
Fringe Benefits on Mktg/Sales Labor			<u>42,698</u> P10
TOTAL OVERHEAD POOL			431,175

Schedule D

IDC Sample Company
Fringe Benefits for FY Ended 12/31/XX

<u>DESCRIPTION</u>	<u>Per G/L</u>	
Time-off Paid	130,000	
Time-off Accrued	2,500	
Sick Pay	27,000	
Holiday Pay	57,000	
Personnel Insurance	141,000	
Workers Compensation	6,000	
FICA/Medicare Tax	96,500	
Fed/State Unemployment	2,000	
Pension	150,000	
Total fringe benefit costs	<u>612,000</u>	(A)

<u>BASE: WORKED LABOR</u>		<u>Allocation</u>
G&A Labor	170,000	<u>80,651</u>
B&P Labor	80,000	37,953
IR&D Labor	10,000	4,744
Overhead Labor	40,000	18,977
Marketing/Sales Labor	90,000	42,698
Direct Labor	<u>900,000</u>	<u>426,977</u>
TOTAL SALARIES EXPENSE PER G/L	1,290,000 (B)	612,000

FRINGE RATE: 47.4% = (A) / (B)

Schedule E

IDC Sample Company
Claimed Allocation Bases for FY 12/31/XX

OVERHEAD POOL 431,175

<u>OVERHEAD BASE</u>		<u>O/H Allocation</u>	<u>O/H Allocation</u>	<u>Diff</u>
Direct Labor	900,000	391,977	271,343	120,635 - P10
IR&D Labor	10,000	4,355	3,015 P10	1,340
B&P Labor	80,000	34,842	24,119	10,723 - P10
Total Overhead Base	<u>990,000</u>	431,175	<u>298,477</u>	<u>132,698</u>
Overhead Rate	<u>43.6%</u>		<u>30.1%</u>	

G&A POOL 595,845

<u>G&A BASE</u>	
Direct Labor	900,000
Travel	30,000
Materials	300,000
Other Direct Costs	200,000
Subcontracts	75,000 - P10
Total Direct Costs	<u>1,505,000</u>

Fringe Benefits Direct Labor	426,977
Overhead on Direct Labor	<u>391,977</u>
Total Cost Input	2,323,954 - P11

G&A Rate 25.6%

IDC Sample Company Answer Worksheet

	Fringe Rate	Overhead Rate	G&A Rate
Allocation Base	Total Labor Dollars	Direct Labor	Total Cost Input
Pool, before adjustment - (A)	\$ 612,000	\$ 431,175	\$ 595,845
Adjustments:			
Adjustment 1			
Adjustment 2			
Adjustment 3			
Adjustment 4			
Adjustment 5			
Adjustment 6			
Adjustment 7			
Adjustment 8			
Adjustment 9			
Total Supported Pool (C)			
Base, before adjustment (B)	1,290,000	990,000	2,323,954
Adjustment 1			
Adjustment 2			
Adjustment 3			
Adjustment 4			
Adjustment 5			
Adjustment 6			
Total Supported Base - (D)			
Rate as submitted - (A)/(B)	47.4%	43.6%	25.6%
Rate as supported (C)/(D)			

IDC Sample Company

Allocation Base	Fringe Rate	Overhead Rate	G&A Rate	Comments
	Total Labor Dollars	Direct Labor	Total Cost Input	

	\$ 612,000	\$ 431,175	\$ 595,845	
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Pool, before adjustment - (A)

Adjustments:

1 Marketing/sales labor	P7 (90,000) } A			Market/sales expenses are not funded by NSF; either as direct or indirect cost
2 Fringe benefits on marketing/sales	(42,698) } A			All marketing/sales expenses are eliminated from pool
3 Equipment depreciation	(xxx) } A			Possible adjustment; if depreciation relates to manufacturing equipment
4 Lab supplies	(xxx) } A			Possible adjustment; if lab supplies are budgeted as direct costs
6 IR&D labor				
7 Fringe on IR&D labor				IR&D expenses are not funded by NSF; either as direct or indirect cost
8 O/H on IR&D				IR&D expenses are not funded by NSF; either as direct or indirect cost
9 IR&D - other costs				IR&D expenses are not funded by NSF; either as direct or indirect cost
10 Legal & accounting				IR&D expenses are not funded by NSF; either as direct or indirect cost
11 Patent amortization				Possible adjustment, if legal expenses relate to patents/IP
12 Officer life insurance				Patent expenses are not funded by NSF; either as direct or indirect cost
13 Federal income tax expense				Unallowable expense FAR 31.205-19
14 O/H on B&P labor				Unallowable expense FAR 31.205-41
				Adjust allocation to revised O/H rate
Total Supported Pool (C)	612,000	298,477	554,823	

Base, before adjustment (B)

Adjustments:

1 Marketing/sales labor	A { 90,000			Marketing/sales absorbs share of G&A pool
2 Fringe on marketing/sales	42,698			Marketing/sales absorbs share of G&A pool
6 IR&D labor	B { 10,000			IR&D program absorbs share of G&A pool
7 Fringe benefits on IR&D labor	4,744			IR&D program absorbs share of G&A pool
15 Overhead on IR&D labor	P9 3,015			Adjusted allocation to revised O/H rate
9 IR&D other costs	C - 2,000			IR&D program absorbs share of G&A pool
16 Subcontracts	(75,000)			Represents pass-through costs that do not absorb portion of pool
17 Overhead on direct labor	P9 - (120,635)			Adjust allocation to revised O/H rate
Total Supported Base - (D)	\$ 1,290,000	\$ 990,000	\$ 2,280,776	
Rate as submitted - (A)/(B)	47.4%	43.6%	25.6%	
Rate as supported (C)/(D)	47.4%	30.1%	24.3%	

Reconciliation of Indirect Cost Proposal to Financial Statements

IDCP components:

General and admin expense pool	P6 - 595,845
G&A allocation base (total cost input)	P9 - 2,323,954
Exclusions	P6 19,500 - (A)

Total per indirect cost proposal 2,939,299 (A) ←

Total expenses per income statement

Costs and expenses	P4 2,920,099
Interest expense	16,500
State and local taxes	2,500
Federal income tax	200

Total expenses per income statement 2,939,299 (A) ←

MUST BE EQUAL

ADJUSTED IDCP

Adjusted G&A Pool	P10 - 554,823
Adjusted G&A base	P10 2,280,776
Exclusions from IDCP	(A) 19,500
Subcontracts	T 75,000
Patent amortization	P10 7,000
Officer life insurance	2,000
Federal income tax	200

2,939,299 (A) ←

Common Errors and Pitfalls Which Can Affect Funding

Issue Present?
(Yes/No)

I. Accounting system and timekeeping system review

Financial Management Systems Questionnaire not filled out completely

Details of audits underway or completed not provided (if any)

Company is not maintaining sufficient books and records (as indicated by responses on Financial Management Systems Questionnaire and other information provided)

Example timesheet in use by the company not provided

For companies with automated (or web-based) timekeeping applications – applicant does not provide screen shots demonstrating how system works

II. Issues affecting financial statements and financial information submitted

Retained earnings are not arithmetically correct or do not carryforward correctly from one period to another

No rollforward schedule provided for the capital and equity accounts

Obvious presentation or accounting errors in financial statements

Common Errors and Pitfalls Which Can Affect Funding

Issue Present?
(Yes/No)

Notes to financial statements do not adequately explain the basis of accounting or accounting methods used to prepare them

Company's financial statements do not contain the necessary adjustments and accruals necessary for fair presentation of the company's financial position and results of operations

Financial statements prepared on a pro forma basis; or reflecting transactions which haven't happened yet. (i.e. not on historical cost basis)

The financial statements do not contain a statement from the company's management or its external CPA/accounting consultant whether or not the financial statements were prepared in accordance with Generally Accepted Accounting Principles (GAAP).

If the financial statements are not prepared in accordance with GAAP, then the company should provide:

1. A brief description of the adjustments necessary to present the statements in accordance with GAAP; and
2. Quantification of the adjustments; if this information is known.

Financial information on tax return is not consistent (or reconcilable) to financial statements of the same year.

Common Errors and Pitfalls Which Can Affect Funding

Issue Present?
(Yes/No)

(III). Financial capability review

Financial information submitted is not responsive to requirements on NSF website

Details of debt obligations are not provided (such as interest rate and repayment provisions)

Cash flow projection not provided (if needed to support financial capability). If submitted,

- Cash flow projection showing unusually optimistic assumptions
- Details and support for expected capital investments not provided
- Details/reasonable support of expected revenues not provided

Indications of financial difficulty in financial statements, with no clear plan by management for addressing

Documentation or support not provided for future capital investments

Substantial loans coming due for which no obvious source of repayment is available

Investor support letters not provided (i.e. for companies dependent on continuing financial support from its investors or lenders)

Draft

Common Errors and Pitfalls Which Can Affect Funding

Issue Present?
(Yes/No)

(iv) **Budget review process**

Salaries/wages

Current pay stub(s) not provided for employees

Employment agreement or employment letter not provided for employees to be hired

Requested salary is in excess of the amount supported by DOL/BLS surveys for the specific metropolitan location where work will be conducted

Requested salary is not consistent with the employee's current salary or pay rate.

SOC classification not consistent with employee's role on project

CEO or VP-level employment classification used to determine the average salary per the DOL/BLS salary survey

External charge-out rate is used for an employee (e.g. \$100 per hour) rather than an employee's actual salary cost

CAL months of effort (in Fastlane budget) not consistent with the number of hours to be worked in budget justification

Excessive escalation requested for salaries in Year 2

Equipment

Details of the items to be purchased not provided

Common Errors and Pitfalls Which Can Affect Funding

Issue Present?
(Yes/No)

(including description, estimated cost, vendor name, etc.)

Travel

Details not included per NSF website (e.g. destination, purpose of travel, number of days, and the estimated costs)

Materials and supplies

Budget submission does not include a clean, detailed list of items to be purchased

Description of items to be purchased is vague or incomplete. (NSF reviewer unable to determine what was being purchased)

Supplementary information to support purchases is not provided (such as name of vendor; vendor quote (if >\$5,000); expected quantity, etc.)

For manufacturing of prototypes - Expected Bill of Materials (BOM) not provided.

Consultant services

A copy of the signed consulting agreement not provided

Consulting agreement does not meet the minimum requirements of the NSF (NSF website)

Consultant's rate is greater than the maximum rate of \$ _____ per 8 hour day; or \$ _____ per hour.

Subawards

Information submitted does not meet the minimum

Draft

Common Errors and Pitfalls Which Can Affect Funding

Issue Present?
(Yes/No)

requirements listed on NSF website

For subawards to universities - company does not provide a confirmation from university that the fringe and indirect costs budgeted in the sub-award budget do not contain any reimbursement for tuition expenses not provided.

For subawards to commercial organizations – company did not provide (a) a detailed budget on how the subaward would be spent and (b) an analysis to support that the subaward budgeted amount is reasonable.

Indirect Cost Proposal (IDCP)

Reconciliation of IDCP to total expenses in company's financial statements is not provided

NSF specific rules for the treatment of IR&D, sales/marketing, patent and other costs are not followed

Company does not have a Cost Policy Statement

Unallowable costs are not fully identified and excluded from the indirect pool

If budgeted indirect cost rate is requested:

Budgeted pool expenses are not supported by external documentation

Budgeted allocation base does not include all activities which are expected to absorb indirect costs

FINANCIAL MANAGEMENT SYSTEMS QUESTIONNAIRE

===== **Organizational Data** =====

Name of Organization: _____

Address: _____

Representative Name and Title: _____

Phone: _____ Fax: _____ Email: _____

Year Established : _____ Employer Identification Number (EIN): _____

DUNS Number: _____

Organization Type: Non-Profit For Profit Educational State/Local Govt.

Description of Service/Product: _____

Approx. Number of Employees: Full Time _____ Part Time _____

===== **Federal Audit Data** =====

Prior Audits/Reviews:

OMB A-133 Incurred Cost Accounting System Timekeeping

Date of Last Federal Audit/Review: _____ Audit Agency/Firm: _____

If Findings Reported, Explain: _____

===== **Financial Statement Audit Data** =====

Date of Last Financial Statement Audit: _____ Fiscal Period Audited: _____

Audit Firm: _____

Auditor's Opinion on Financial Statements Qualified: Yes No

If Qualified Opinion, State Reason: _____

=====**Accounting System Data**=====

What books of account are maintained?

- General Ledger YES NO Cash Receipts Journal YES NO
 Project Cost Ledger YES NO Payroll Journal YES NO
 Cash Disbursements Journal YES NO

Does the accounting system provide for the recording of grant/contract costs according to categories of the approved budget? YES NO

Does the system identify the receipt and expenditure of funds separately for each grant or contract? YES NO

Does the system provide for the recording of cost sharing/matching for each project, and ensure that documentation is available to support recorded cost sharing/matching? YES NO

Does the system provide for the recording of participant support costs as a separate cost category? YES NO

=====**Timekeeping System Data**=====

Are time distribution records maintained for each employee to account for his/her TOTAL effort (100%)? YES NO

(Attach a sample timesheet and procedures for completing timesheets and for allocating salary and wage charges to Federal awards.)

Is your organization familiar with the time and effort reporting requirements related to Federal awards made to your type organization? YES NO

=====**Purchasing System**=====

Are asset inventory records maintained? YES NO

Does your organization have policies relating to buy/lease analysis and competitive purchases over \$25,000? YES NO

What is the dollar threshold for capitalization of equipment? \$ _____

=====**Funds Management**=====

Is a separate bank account maintained for Federal grant/contract funds? YES NO

If a separate bank account is not maintained, can the Federal grant/contract funds and related expenses be readily identified? YES NO

Does your organization have procedures in place to minimize the time elapsing between the transfer of funds to your organization by a Federal agency and your organization's expenditure of such funds? YES NO

Prepared by: _____ Date: _____
 Name & Signature