

The Devil Is in the Details: Distinguishing Subrecipient Awards From Subcontracts

The importance of distinguishing between a subrecipient of federal assistance funds and a contractor acting as a vendor to a federal grant recipient has been receiving more and more attention from college and university grantees. The reason for this increased attention stems from the impact of misidentification in two key areas: the longstanding impact on single audits under OMB Circular A-133 and the relatively new impact on reporting under the American Recovery and Reinvestment Act and Federal Funding Accountability and Transparency Act.

In a recent interview, Robert M. Lloyd, a well-respected grants consultant, noted that “This is one of the most common issues I am seeing right now.” The confusion exists in part because there is a widespread misuse of the terminology, which stems from a lack of clarity in some applicable guidance, Lloyd says. Grantees, and, in fact, federal officials, often refer to all subawards as subcontracts or use the even more ambiguous phrase “partner relationships.”

However, it is not the terminology that determines what the award or instrument really is, but its content — what it is intended to do and how it is executed. Because different entities use different labels, it often is not clear what type of agreement is involved until multiple factors are examined. A key determinant in deciding whether an award is a vendor contract or a subaward, says Lloyd, is who benefits from the funds.

The concept of who benefits is addressed in Circular A-133 (covering single audits), in § __.210(b)(5), which states, “Characteristics indicative of a Federal award received by a subrecipient are when the organization... [u]ses the Federal funds to carry out a program of the organization as compared to providing goods or services for a program of the pass-through entity.”

Determination Affects Audit Scope

The distinction between subawards (pass-through grants) and procurements under grants (contracts) has been an issue in single audits conducted under Circular A-133 as far back as 1997, when the circular was revised, according to Lloyd, because funds received as a recipient or subrecipient are subject to audit under A-133, while payments to a vendor for goods and services are not.

Similarly, subawards of grant funds are subject to the same grants management requirements as are the funds in the original award from the federal government to the prime grantee. And, the prime grantee is responsible for ensuring compliance with the requirements by both the subrecipient as well as itself.

Funds that a recipient awards to subrecipients are subject to the recipient’s compliance audit under A-133 to the extent that the auditor will examine how well the recipient monitors the subawardee to ensure that it follows all federal requirements related to spending funds under the original grant. However, funds expended as subcontracts by the recipient to vendors are examined in the recipient’s audit only to determine if they were allowable expenditures and awarded properly.

In A-133 audits, the problem is primarily associated with the Schedule of Expenditures of Federal Awards, which the grantee must prepare and the auditor uses to identify which funds to audit. Subawards listed on SEFAs of colleges and universities are generally subject to the grant administration requirements of Circular A-110 and the cost principles of Circular A-21, and those requirements pass down to the subrecipient as well.

On the other hand, vendor contracts under grants are subject only to the rules for procurement under grants (Sections 40-48 of A-110; 2 CFR 215.40-48), and once the funds are paid to the vendor, they are considered to be earned income and generally not subject to further audit. Thus, proper determination of awards of grant funds as subawards or vendor contracts has a significant impact on the scope of the A-133 audit.

The auditor is required to render an opinion on the SEFA and, accordingly, will examine which awards are included on the SEFA and why each is there. If in the course of conducting the audit, the auditor identifies other subawards of assistance funds that are not reported on the SEFA, the auditor will qualify its opinion on the SEFA. The grantee would then be required to issue a restatement, adding the missing awards to the SEFA.

Transparency Reporting May Differ

Lloyd points out that nothing in the regulations or circulars prevents a recipient from establishing a robust contract administration policy affecting vendors. For example, in a cost-reimbursable contract, a grantee might retain the right to review the contractor's records to ensure compliance with the terms and conditions of the contract and performance. In other words, even though federal grant auditing requirements do not require auditing of vendor contracts under grants, they can be auditable if the prime grantee so chooses.

Although ARRA requires recipients of ARRA funds to report expenditures of payments to subrecipients *and* vendors (contracts over \$25,000), FFATA reporting specifically excludes grantees from reporting on payments to vendors. So the distinction between subawards and vendor contracts has a significant impact on how the recipient satisfies these reporting requirements. This will have an impact on the single audit, as well, because auditors are now specifically required to examine the ARRA reports as part of the compliance audit.

Recipients also must answer to the federal agencies that awarded the funds in the first place. The inspectors general at those agencies have taken a particular interest in the reporting under ARRA, with numerous examinations focused on this. Now that FFATA subrecipient reporting has begun, this will likely also engender heightened scrutiny at the IG level.

So grantees may have to justify to independent auditors *and* IGs their determinations of which transactions were contracts for goods and/or services and which were subawards.

Both ARRA and FFATA regulations refer to § __.210 of Circular A-133 for the definition of a subaward, but Lloyd maintains that § __.210 captures only some of the general characteristics of a subaward, and that to truly understand the difference, one should go back to the underlying parameters in OMB's administrative circulars (A-102 and A-110) on which portions of the A-133 definition are based. "This is important," he says, "because the determination should be made at the time the award is made — not at the point where its expenditures become subject to audit coverage."

The Determination Is a 'Process'

Subawards and contracts under grants have the same "life events" in common, says Lloyd, which is why making the subaward versus vendor contract determination can be so difficult. To make the determination, the grantee should look at all the relevant features of the award, which are actually more extensive than those identified in Circular A-133 (see box, below).

At each stage of the process, the grantee should ask the question, "Is this more like a contract to a vendor or more like a subaward?" The response may differ for each stage, but the ultimate decision must consider all of the features taken together.

Based on a review of the applicable regulations and circulars, Lloyd suggests there are about 15 relevant considerations in making the decision about whether an award is a subaward to an entity to further the purposes of the original grant or a contract with a vendor for goods and/or services.

Some of the features presented below are so similar for both subawards and vendor contracts that they do not weigh in on either side of the equation. For instance, both subawards and vendor contracts can be awarded on either a cost-reimbursement basis or as a fixed obligation, and just because one approach is taken (say cost-reimbursement) does not automatically determine one type of instrument or the other.

Many of these “features” flesh out the concepts discussed in § __.210 of A-133. No single feature or any special combination of features is determinative. Consequently, the determination should be made through the preponderance of features indicative of a subaward or vendor contract.

(1) *Stated Intent of the Awarding Agency.* Does the first paragraph of the award document say something like, “This is an award of federal financial assistance” or “This is a purchase of goods and/or services”?

(2) *CFDA Number.* Does the agreement cite the source of the funding by CFDA number? There is no need to do this for a vendor contract, but it is required for a subaward.

(3) *Competition and Solicitation.* Is there competition involved? Competition to the maximum extent practical is required for awarding contracts, but there is no governmentwide requirement for competition for subawards (although in practice competition is often involved).

(4) *Number of Awards.* It is unlikely that there will be multiple contracts for the same goods and/or services, but it is quite common for a grantee to make several subawards to fund similar goals and activities.

(5) *Criteria for Selection.* Contracts are most often awarded to vendors based on factors such as price and capability, whereas subawards are awarded based on the need to further the goals of the main grant, often considering the most egregious problems that must be dealt with or the financial needs of the subawardee.

(6) *Creation of the Statement of Work.* Who created the statement of work or scope of services? For contracts, these are always created by the awarding entity, and prospective vendors are precluded from involvement. It is quite common, however, for a subawardee to propose to the grantee what will constitute the work and how it will proceed.

(7) *Timing of Payment.* Federal regulations require that grant recipients advance funds to their subrecipients when they receive advance payment themselves. This is why cash management of federal funds advanced is a type of compliance requirement that must be tested under A-133. On the other hand, normally contracts with vendors do not involve advancing funds because to do so sacrifices a degree of leverage over performance.

(8) *“Costing” of the Agreement.* This is on the list because it is often (erroneously) thought to be dispositive — that all subawards are settled on a cost-reimbursement basis, whereas contracts can be fixed-price or cost-type. In fact, both types of instruments could be handled as cost-type or fixed-obligation.

(9) *Performance Criteria.* Does the instrument contain performance criteria? These are common for subawards, whereas vendor contracts tend to identify specific deliverables.

(10) *Special Conditions.* Federal regulations affecting subawards permit special conditions to be attached for high-risk entities. However, contracts do not because high-risk organizations are generally precluded from being engaged to perform work or simply fail to meet minimum qualifications.

(11) *Cost Participation.* Subawardees are occasionally required to commit some of their own resources to match or cost-share on a project, whereas it is unusual for contractors to do so.

(12) *Risk to Awardee.* Contractors nearly always assume a certain amount of risk — if the contractor does not perform adequately, there will be no payment and the possibility of other adverse consequences exists. Subawardees, on the other hand, do not run the same risk, and awarded funds are claimed even when the quantity or quality of work falls short of expectations.

(13) *Property Purchased with Award Funds.* Title to property purchased with subaward funds generally rests with the subawardees, with some residual financial interest for the pass-through entity. This means that after the subaward is finished, the pass-through entity could require return of the property or request appropriate settlement if the subawardee wants to keep it. Vendors, on the other hand, generally own the property they purchase and build the cost of any contemporaneous purchase into their contract pricing.

(14) Applicable Federal Rules & Public Policy Provisions. A key distinction exists here. The applicable terms of the OMB administrative and cost circulars (A-110 and A-21) flow down to subawardees — but not to contractors. Instead, the grantee must flow down Section 48 (Contract Provisions) and Appendix A of A-110 to the contractor. Similarly, federal public policy provisions that apply to grantees because they receive federal funds flow down to subawardees. These provisions are identified in the standard statement of assurances used in grant applications and awards (Standard Form 424B). Contract provisions, however, addressing public policy requirements that flow down are found in Appendix A of A-110.

(15) Termination. Federal regulations permit grantees to terminate their vendor contracts for cause or convenience, but they allow grantees to terminate subawards only for default. Subscribers who have questions about the issues raised in this article are welcome to contact Mr. Lloyd at 202-775-0066 or consultlloyd@aol.com. G

Subrecipient or Vendor: A-133 Provides Some Guidance

OMB Circular A-133 states that “Federal awards expended as a recipient or a subrecipient would be subject to audit under this part. The payments received for goods or services provided as a vendor would not be considered federal awards” and thus not subject to an A-133 audit.

A-133 defines the terms subrecipient and vendor by specific actions and responsibilities and provides the following guidance:

- ◆ **Subrecipient.** Section __.210(b) of A-133 states that an organization is considered to be a subrecipient of a federal award when it
 - determines who is eligible to receive what financial assistance;
 - has its performance measured against whether the objectives of the federal program are met;
 - has responsibility for programmatic decision-making;
 - has responsibility for adherence to applicable federal program compliance responsibilities; and
 - uses the federal funds to carry out a program of the organization as compared to providing goods or services for a program of the pass-through entity.
- ◆ **Vendor.** Under § __.210(c) of A-133, an organization is considered to be a vendor when it
 - provides goods and services within normal business operations;
 - provides similar goods and services to many different purchasers;
 - operates in a competitive environment;
 - provides goods and services that are ancillary to the operation of the federal program; and
 - is not subject to compliance requirements of the federal program.

For a further discussion of the distinction, see ¶2602 at www.ManagingFederalGrants.com.