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Grant Administration

Managing Program Income Generated by Federally Sponsored Research Projects

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A significant number of sponsored projects have the potential to generate program income. It is, however, not always a simple matter to identify exactly what does and does not constitute program income. Likewise, determining how to account for and whether to report program income to a sponsor is not always straightforward. Moreover, because an institution's management of program income is subject to audit by both federal sponsors and through the annual A-133 audit process,[1] an inability to properly identify, account for, and report program income may result in adverse audit findings and/or financial penalties.

This article provides an overview of the relevant federal guidelines governing program income, discusses some of the more common program income-related issues, and provides some suggested practices for managing program income-related compliance obligations.

What Is Program Income?

Generally speaking, any revenue derived from a sponsored project that is not received from the sponsor is potentially program income. It is therefore important that an institution be able to identify when a sponsored project has generated program income. The starting point for such an analysis is Office of Management and Budget (OMB) Circular A-110, which defines program income as "gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award."[2] In addition to defining program income, Circular A-110 also provides the following examples of program income:

- income from fees for services performed;
- the use or rental of real or personal property acquired under federally funded projects;
- the sale of commodities or items fabricated under an award;
- license fees and royalties on patents and copyrights; and
- interest earned on loans made with award funds.[3]

Although not specifically discussed in A-110, a classic example of program income is registration fees for a conference, symposium, or workshop put on with federal assistance. Likewise, sales of tapes, brochures, or publications derived from a federally supported conference, symposium, workshop, or other project are common sources of program income. Other examples of program income might include sales of research materials such as tissue cultures, blood samples, or research animals.

Circular A-110 also provides a couple of examples of sponsored research-related revenue that is not considered program income:

- interest earned on advances of federal funds, and
- unless there is a specific statement to the contrary, the receipt of principal on loans, rebates, credits, or discounts (or interest earned on such funds).[4]

Additional examples of revenue related to sponsored projects that generally is not considered program income are gifts and donations to support a project and revenue earned after the project period ends.

As evidenced by the Circular A-110 guidance, it is not always going to be clear whether revenue related to a sponsored project is program income within the meaning of applicable regulations and the terms of the award. For example, consider the situation where an institution has established a specialized service center[5] that is supported by a federal award, user fees, and an institution's discretionary funds. OMB Circular A-21 provides that such centers are not supposed to be revenue generators and are instead expected to "break even" over time. To achieve that goal, Circular A-21 requires institutions periodically to adjust the user fee to facilitate achieving the desired equilibrium. However, it is possible that in any given year a specialized service center will generate surplus funds. Whether the surplus should be considered program income is an issue open to interpretation. For example, one could take the position that a surplus is not program income and should instead be used to support a reduction in user fees for the next year.

Given the potential complexities in this area, it is important that institutions foster awareness of program income-related compliance obligations through training and other educational efforts of principal investigators and other members of its sponsored research community. If a potential program income issue is brought to the institution's attention in a timely manner, there is an opportunity to consider the situation, and, if necessary, work with the sponsor to arrive at a shared understanding of how to proceed.

Accounting for Program Income

In general, recipients of federal awards are entitled to retain program income as long as the revenue is used in accordance with applicable sponsor regulations and the specific terms and conditions of the award.[6] The importance of carefully reviewing the award document to confirm the appropriate accounting treatment is underscored in the National Science Foundation (NSF) Grant Policy Manual, which contains the following provision:

> Special Treatment. In exceptional circumstances, the NSF Grants Officer, in collaboration with Program Officers and other appropriate NSF offices, may approve use of a special grant provision to restrict or eliminate a grantee's control of income earned through NSF-supported activities if it determines that this would best serve the purposes of a particular program or grant. The special provisions may require the federal share of program income be kept in a separate account, reported on and/or remitted for such periods as may be reasonable under the circumstances.[7]

Barring some form of "special treatment," OMB Circular A-110 provides the three alternative accounting treatments applied to program income:

- Additive Alternative, under which program income is added to the committed program funds;

- Deductive Alternative, under which the program income is deducted from the total allowable costs to determine the net allowable federal share; and

- Matching Alternative, under which program income is used to satisfy a project's matching requirement.[8]

The National Institutes of Health (NIH) adds a fourth alternative referred to in the NIH Grants Policy Statement as the "combination alternative."[9] Under the combination alternative, the initial $25,000 of program income is added to the committed program funds. Program income above that amount is handled under the deductive alternative.

Depending on the applicable accounting treatment, the generation of program income will have a varying impact on the underlying sponsored project. The following examples illustrate the different effects on the underlying project under each of the alternatives described above. For each example, assume an approved budget of $500,000 and $75,000 of program income.

- *Additive Alternative:* The $75,000 of program income must be used to further eligible project objectives.[10] The total project funding is increased to $575,000.

- *Deductive Alternative:* Decreases the federal share of the project to $425,000; total funding (including program income) remains at $500,000.

- *Combination Alternative:* The first $25,000 of the program income could be used to further eligible project objectives. However, the remaining $50,000 of the program income would decrease the federal share of the project to $450,000. Total funding is $525,000, of which $75,000 comes from program income.

- *Matching Alternative:* Under this regime, if the institution had a matching obligation of $100,000, the program income would satisfy $75,000 of the commitment (assuming that the program income is used for eligible cost-matching expenditures). The available federal funding remains the same--$500,000.

The accounting treatment applied to program income depends on the nature of the award and the sponsor. For example, it is NIH's general policy to apply the additive alternative to its awards.[11] Likewise, NSF uses the additive alternative as its default rule.[12] Where a sponsor does not specifically address the accounting treatment to be accorded program income, Circular A-110 provides generally applicable default guidance. Under Circular A-110, sponsored projects involving research apply the additive alternative.[13] All other types of projects would apply the deductive alternative as the default rule.[14]

Another accounting issue relevant to program income is the requirement set forth in Circular A-110 that

> [t]o the extent available, recipients shall disburse funds available from repayments to and interest earned on a revolving fund, program income, rebates, refunds, contract settlements, audit recoveries and interest earned on such funds before requesting additional cash payments.[15]

In effect, A-110 requires institutions' accounting systems to be able to track and account for program income as it is generated. An institution that is unable to do so risks running afoul of the requirement that program income be used prior to drawing down additional federal funds. Another implication of this rule is that at the end of a project there should be little, if any, unused program income.

The importance of having an accounting system able to manage program income cannot be overstated. For example, HHS has published a series of Frequently Asked Questions (FAQs) that accompany its Grants Policy Directive covering program income. FAQ #2 provides as follows:

> How does a grantee demonstrate that it has met program income accounting and use requirements?
>
> From a system standpoint, a grantee must have records that adequately identify program income and controls that ensure the timing of use and eligible uses comply with award terms and conditions. The grantee must also report to the HHS [Department of Health and Human Services] awarding office in its applicable financial, cash management, and other reports when program income is earned and spent. If a grantee is accountable for program income earned after the end of the project period, it should consult with the awarding office on the means of satisfying that accountability as well as the form and content of reporting, unless it is specified in the award (for example for income from patents and copyrights).[16]

As reflected in that guidance, HHS auditors are likely to expect a grantee to possess records identifying any program income and demonstrating that such revenue was accurately reported and expended in accordance with Circular A-110's cash management procedures.

Reporting Program Income

An institution must be able not only to identify and account for program income in accordance with sponsor rules, but also to report to its sponsor on the amount and use being made of program income.

A common issue that arises in this area of program income management is whether the program income generated is reportable. In general, sponsor regulations and/or the terms and conditions of a specific award will provide recipients with guidance concerning their program income-related reporting obligations. Grantees should carefully review the specific terms and conditions of a particular award as they may provide additional guidance on reporting requirements.

In addition to determining whether program income must be reported, an institution must determine how long its reporting obligation lasts. The general rule in that regard is that unless there is specific guidance to the contrary in the project's terms and conditions, a recipient has no obligation to the federal government for program income earned after the end of the project period. Both NIH and NSF apply that general rule.[17]

Although Circular A-110 and sponsor rules provide significant guidance with respect to reporting program income, there are areas left open to interpretation. For example, if a conference is supported by both federal and institutional funds, are all of the registration fees considered program income, or just the amount proportional to the level of federal support? Although the regulations do not specifically address this question, it would seem reasonable and equitable to take the position that if a federally sponsored project provides 50 percent of the support, 50 percent of the revenue generated should be considered program income.

In any event, when an institution is required to report program income, a common mechanism used for doing so is the quarterly SF 269 Financial Status Reports form.[18] Although, as described above, program income is defined as "gross income," OMB Circular A-110 appears to allow some movement away from true "gross" income when it comes to an institution's reporting obligation. Specifically, the circular recognizes that "authorized ... costs incident to the generation of program income may be deducted from gross income to determine program income, *provided these costs have not been charged to the award*."[19] NIH is one sponsor that expressly allows its grantees to report "net" program income. Specifically, the NIH GPS provides that "[a]ny costs associated with the generation of the gross amount of program income that are not charged to the grant should be deducted from the gross program income earned, and the net program income should be the amount reported."[20]

Suggested Management Practices

As reflected in the many different rules and regulations discussed above, managing program income issues is a complex part of any institution's sponsored research program. Therefore, implementation of a robust set of program income policies and procedures will substantially reduce the chances of incurring adverse audit findings and/or monetary disallowances. The following are some suggested methods for managing program income:

1. Draft program income policies and procedures that not only define program income and the various accounting treatments and reporting obligations related to program income, but also set forth roles and responsibilities for each relevant member of your institution's sponsored research community. For example, address the institution's expectations for the principal investigator, departmental administrators, department heads, deans, and pre- and post-award sponsored research officials.

2. Ensure that your policies and procedures are widely disseminated to all of the appropriate individuals.

3. Continually educate the key players on their obligations to support the institution's ability to meet its program income-related compliance obligations.

4. Begin focusing on program income issues early on in the sponsored project process. To a certain extent, institutions seeking Public Health Service funding, such as that from NIH, essentially are required to consider program income-related issues at the proposal development phase of a project since the PHS 398 Grant Application requires the applicant to indicate whether it believes the project will generate program income. However, even if you are not seeking PHS funding, giving early consideration to potential program income issues is important. For example, requiring investigators to indicate on their submissions to the sponsored research office whether they anticipate generating program income will help raise the level of awareness of program income issues among all of the key players.

5. Remember to carefully review award documents to confirm the appropriate accounting treatment to be accorded any program income, as well as any other relevant award-specific terms and conditions.

6. Make sure that your accounting system is able to meet all applicable program income accounting and reporting obligations.

7. Be aware of program income issues when making subawards or entering into subcontracts. For example, NIH includes consortium participants and contractors as potential generators of program income.[21] It is therefore important that the terms of the subaward or subcontract are consistent with the terms and conditions governing the "prime" award.

8. Develop processes and procedures that allow you to monitor your institution's compliance with its program income-related obligations.

Conclusion

Program income issues can be complex. It therefore is important to develop and implement policies and procedures that will help your institution to manage its program income compliance obligations. It is equally important to ensure that your institution has the practical ability to comply with its program income obligations, *e.g.*, assessing whether the institution's financial system has the ability to appropriately account for program income and document that it has done so. By addressing program income-related obligations early on and ensuring that an adequate infrastructure is in place, institutions will increase their ability to meet their compliance obligations regarding program income.

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[1] *See, e.g.,* FAQ #3 accompanying DHHS Grants Policy Directive 3.03 "Program Income," available at http://www.hhs.gov/grantsnet/faqs/proginc.htm#program%20income%20faq%203; *see also* Office of Management and Budget Circular A-133 §__.320(b)(2)(xii)(J).

[2] OMB Circular A-110 §__.2(x).

[3] *Id.* Although A-110's examples of program income mention license fees and royalties on patents and copyrights, the circular explains in a separate section that "[u]nless Federal awarding agency regulations or the terms and condition of the award provide otherwise, recipients shall have no obligation to the Federal Government with respect to program income earned from license fees and royalties for copyrighted material, patents, patent applications, trademarks, and inventions produced under an award." Circular A-110 at §__.24 (h). It is important to remember, however, that the Bayh-Dole implementing regulations, set forth at 37 C.F.R. Part 401, do require institutions to report income derived from certain patents and inventions.

[4] *Id.*

[5] *See* OMB Circular A-21 at §J.47 for a definition of specialized service centers. Essentially, specialized service centers charge a fee to perform a specific service such as DNA analysis.

[6] OMB Circular A-110 at §__.24(b).

[7] NSF Grant Policy Manual (hereinafter NSF GPM) at §753(b).

[8] OMB Circular A-110 §__.24(b).

[9] NIH Grants Policy Manual (hereinafter NIH GPS) at 122. The National Cancer Institute's Cancer Center awards are an example of a type of project where NIH's default treatment of program income uses the combination alternative. *See* Policies and Guidelines Relating To the Cancer Center Support Grant, available at http://www3.cancer.gov/cancercenters/.

[10] The NIH GPS interprets the concept of eligible project objectives as being equivalent to allowable costs under applicable cost principles and the terms and conditions of the award. *See* NIH GPS at 121.

[11] NIH GPS at 121.

[12] NSF GPM at §753(a).

[13] OMB Circular A-110 §__.24(d).

[14] *Id.*

[15] *Id.* at §__.22(g).

[16] Available at http://www.hhs.gov/grantsnet/faqs/proginc.htm#program%20income%20faq%203.

[17] NIH GPS at 121, NSF GPM at §753(a).

[18] The SF 269 used for financial reporting purposes contains specific line-items for institutions to report their program income. A copy of the SF 269 is available at http://www.gsa.gov/Portal/gsa/ep/formslibrary.do.

[19] OMB Circular A-110 §__.24(f) (emphasis added).

[20] NIH GPS at 123.

[21] *See* NIH GPS at 121.

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