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MEDICAL RESEARCH LAW & POLICY

REPORT

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Subawards Versus Contracts: Implications for Federally Sponsored Research

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Institutions engaged in federally sponsored biomedical research routinely enter into agreements with other organizations in order to achieve their project's programmatic objectives. These agreements can range from complex scientific collaborations with a peer institution to the routine acquisition of necessary goods or services. Although the purposes of these agreements vary, in each instance, federal funds entrusted to the grantee are passed through to a lower-tier organization. There are two principal vehicles through which a grantee passes funding through to a lower-tier organization—''subawards'' and ''contracts.''[1] The mere designation, however, of an agreement as one or the other vehicle is not dispositive. Moreover, the compliance obligations for both the grantee and the lower-tier organization differ depending on the nature of the agreement used to transfer the federal funds.

This article addresses some of the primary compliance issues associated with the designation of an agreement as a subaward or a contract and then provides some guidance on how to distinguish between the two.

[1] In practice, subawards and contracts may bear any number of designations. Moreover, it is not uncommon for a subaward to be designated a subcontract.

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I. Compliance Issues

The following section of this article highlights some of the compliance issues that are raised by the subawardee/contractor distinction. As reflected below, these issues begin to arise even before the award is made, extend throughout the term of the agreement, and, in the event of, for example, an audit, can arise after an agreement has concluded.

Selection Criteria and Procedures: A common compliance issue involves the process and documentation necessary to support the making of a subaward versus the award of a contract. Because the requirements differ depending on the nature of the agreement, a grantee must consider the subaward/contract distinction before entering into an agreement.

Sections 40-48 of Office of Management and Budget Circular A-110 (now located at 2 C.F.R. Part 215) set forth a series of ''procurement standards'' that the circular states apply to ''procurement transactions'' involving federal funds. These standards require competition, multiple bids, cost and price analysis, and sole source justifications. Compliance with these standards requires a substantial effort on the part of the grantee and also requires the grantee to maintain a significant amount of documentation supporting its award decision.

The recently issued Department of Health and Human Services Grants Policy Statement provides that a grantee's selection of subawardees need not comply with A-110's procurement standards.[2] Thus, the initial decision to classify a transaction as a subaward or con-

[2] *See* HHS Grants Policy Statement (Jan. 1, 2007) II-81 (describing minimum requirements for subaward agreements). ''Subrecipients should be selected by the recipient using its established policies. HHS does not require that subawards comply with the procurement standards and requirements outlined [in HHS's implementation of Circular A-110].''

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tract has compliance implications. For example, if a grantee unreasonably classifies a transaction as a subaward as opposed to a contract, it may find itself lacking the documentation called for by A-110. This could result in an adverse audit finding. Likewise, classifying a subaward as a contract has the potential to impose an unnecessary administrative burden on the grantee.

OMB Circular A-110 Financial and Administrative Requirements: Circular A-110 provides that ''[u]nless sections of this Circular specifically exclude subrecipients from coverage, the provisions of this Circular shall be applied to subrecipients performing work under awards if such subrecipients are institutions of higher education, hospitals or other non-profit organizations.''[3] Thus, subawards are normally subject to all the circular's pre-award and post-award requirements, including the provisions on property management, procurement standards, and program income. In contrast, contractors generally are not bound by all of the provisions of A-110.

The A-110 requirements are significant because one of the key compliance obligations the government places on a *grantee* is the obligation to monitor its subawardees.[4] Thus, it is important for a grantee to make an accurate designation so that the grantee is able to perform its monitoring obligations. For example, if a grantee treats an agreement as a contract when it is not, and the lower-tier organization does not follow A-110's financial and administrative requirements, the grantee could be criticized for failing in its monitoring obligations.

Cost Principles: Subrecipients generally are required to operate under the applicable federal cost principles, *e.g.*, circulars A-21, A-87, or A-122 and, for hospitals, OASC-3. Thus, among other obligations, subrecipients must seek reimbursement only for allowable costs, avoid profits, and maintain a compliant payroll allocation system. Moreover, as noted above, a grantee is expected to monitor its subrecipient's compliance with these requirements. In contrast, a contractor does not have to be monitored in the same way and has more leeway in terms of charging for its services.

Sponsor-Specific and/or Public Policy Requirements: Generally speaking, both agency-specific and award-specific programmatic and public policy requirements flow down to subrecipients through the subaward agreement. On the programmatic side, such obligations may include, among others, special project reporting timetables, publication and media release rules, population planning restrictions, program review panel requirements, or special accounting or audit requirements. Not all of those issues need be addressed with contractors providing routine goods and services. The public policy and public safety objectives applicable to subawardees and contractors also may have some differences. The NIH Grants Policy Statement provides, for example, that contractors need not acknowledge federal funding or comply with NIH's policies on financial conflicts of interest or research misconduct.

Circular A-133 Audit Requirements: OMB Circular A-133 implements the Single Audit Act and requires that not-for-profit entities that expend $500,000 or more of federal funds in a given year must undergo an audit.[5] However, federal funds received as payment for goods or services when acting in the capacity of a vendor (i.e., contractor) are not subject to audit. Therefore, determining whether an agreement is a subaward, which does count toward the A-133 threshold, or a contract, which does not, can have significant repercussions inasmuch as an A-133 audit can have financial and other consequences for the auditee.

Compliance Summary: As reflected in the discussion set forth above, there are several compliance issues that stem from the decision to treat an agreement as a subaward or a contract. For example, mischaracterizing an agreement as a subaward when it is actually a contract can result in an unnecessary and burdensome audit (*i.e.*, under OMB Circular A-133). Likewise, failing to designate a subawardee as such can result in a grantee not fulfilling its Circular A-110 monitoring obligations. In short, both primary grantees and lower-tier organizations can be adversely affected by a mischaracterization of an agreement. The next section of this article provides some guidance intended to assist institutions with making a reasonable subaward/contract determination.

II. Relevant Definitions and Concepts

Familiarizing oneself with a handful of definitions can be helpful when it comes to distinguishing between subawards and contracts. The following definitions are taken primarily from the definitions section of OMB Circular A-110:[6]

- **Award**: ''*financial assistance* that provides support or stimulation to accomplish a public purpose.''
- **Contract**: ''a *procurement* contract under an award or subaward, and a *procurement* subcontract under a recipient's or subrecipient's contract.'' Circular A-110 and agency regulations indicate that ''procurement instruments'' include fixed-price contracts, cost reimbursable contracts, and purchase orders.[7] Likewise, the NIH Grants Policy Statement defines ''contract under a grant'' as ''a written agreement between a grantee and a third party to acquire routine goods or services.'' The HHS Grants Policy Statement defines ''contract under a grant'' as ''A written agreement between a recipient and a third party to acquire commercial goods or services.''[8]
- **Recipient**: ''an organization receiving *financial assistance* directly from Federal awarding agencies to carry out a project or program.''
- **Subaward**: ''means an award of *financial assistance* in the form of money, or property in lieu of money, made under an award by a recipient to an eligible subrecipient or by a subrecipient to a lower tier subrecipient. The term includes *financial assistance* when provided by any legal agreement, even if the agreement is called a contract, but does not include *procurement* of goods and services nor does it include any form of assistance which is excluded from the definition of 'award.' ''
- **Subrecipient**: ''the legal entity to which a subaward is made and which is accountable to the recipient for the use of the funds provided.''

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[3] 2 C.F.R. § 215.5 (OMB Circular A-110 § __.5).
[4] 2 C.F.R. § 215.51 (OMB Circular A-110 § __.51).
[5] OMB Circular A-133 § __.200
[6] 2 C.F.R. § 215.2 (OMB Circular A-110 § __.2).
[7] 2 C.F.R. § 215.44(c) (OMB Circular A-110 § __.44(c)); 45 C.F.R. § 74.44(c).
[8] HHS Grants Policy Statement (Jan. 1, 2007) Appendix B-4.

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The terms "financial assistance" and "procurement" are key elements of the definitions set forth above. Unfortunately, Circular A-110 defines neither term. The Federal Grant and Cooperative Agreement Act[9] does, however, provide definitions of "grant" and "procurement contract" that shed some light on the differences between financial assistance, on one hand, and procurement, on the other. To paraphrase the act, grants are the legal instrument reflecting a relationship between the government and a recipient when the principal purpose of the instrument is to transfer a thing of value to the recipient to carry out a public purpose of support or stimulation.[10] The act attributes some substantive "public purpose" to relationships involving grants and cooperative agreements, and by extension, to agreements under federal grants for providing financial assistance (such as subawards).

In contrast, a procurement contract is the legal instrument reflecting a relationship between the government and a recipient when the principal purpose of the instrument is to acquire, by purchase, property or services for the direct benefit or use of the government.[11] Thus, contracts for procurement formalize the acquisition of goods and services for direct benefit to the acquirer, which is different from carrying out a public purpose of support or stimulation (which is more appropriate through financial assistance agreements). This distinction is consistent with A-110's definition of "subaward," which explicitly distinguishes procurements: subawards "*[do] not include procurement of goods and services*."[12]

At first glance, the distinction between a subaward and a contract under a federal award appears quite straightforward. The definitions indicate that a subaward formalizes the passing of financial assistance to a subrecipient. In contrast, a contract generally records the procurement of routine goods and services from a commercial entity. However, categorizing a particular transaction into one of these categories is not always a simple matter.

III. Distinguishing Between Subawards and Contracts

Suppose an institution secures a molecular biology grant to study the effects of a new growth hormone on cellular development. In order to conduct the research, the principal investigator proposed the use of computer software that tracks cellular augmentation. Assuming that the computer software is a readily available "off-the-shelf" item, the institution presumably would enter into a run-of-the-mill procurement contract with a vendor to purchase the software. However, the question becomes more complex if the necessary software does not yet exist. Put another way, where does one draw the line between a software acquisition and an undertaking that is really part and parcel of the research project?

OMB Circular A-133 is one of the primary sources used to assist institutions with differentiating between subawards and contracts. In distinguishing between the two relationships, A-133 cautions that "[i]n making the determination of whether a subrecipient or vendor [contractor] relationship exists, the substance of the relationship is more important than the form of the agreement."[13] Having provided that admonition, the circular presents characteristics indicative of each type of agreement.

The characteristics reflecting a subrecipient relationship include those where the lower-tier organization: (1) has its performance measured against the federal award's objectives; (2) can make, and has responsibility for, substantive programmatic decisions; (3) has responsibility for complying with applicable federal program compliance requirements; and (4) uses the federal funds to carry out its program's objectives as compared to providing goods or services for a grantee's program.[14]

In contrast, the characteristics indicative of a vendor (contractor) generally are that it (1) provides the goods and services within normal business operations, (2) provides similar goods or services to many different purchasers, (3) operates in a competitive environment, (4) provides goods or services that are ancillary to the operation of the federal program, and (5) is not subject to compliance requirements of the federal program.[15]

The Federal Demonstration Partnership ("FDP") Statement on Subawards (Sept. 18, 2000) provides additional guidance.[16] The FDP's interpretation of a subaward is an arrangement:

> in which two (or more) qualifying legal entities/institutions are working collaboratively on a sponsored project. Each institution has its own principal investigator/project director; however, one of the collaborating institutions takes on the role of prime awardee with the sponsoring federal agency.[17]

The FDP Statement also notes that:

> [a] collaborating institution is conducting its own scope of work and is not providing goods or services, such as simply executing lab tests or constructing experimental instrumentation. In a subaward situation, the principal investigator/project director of the subrecipient may be a co-author on publications or the subrecipient may seek patent protection for inventions and otherwise function in much the same manner as if the award came directly from a federal sponsor.[18]

Taken together, these sources of authority offer helpful guidance on subawards versus contracts and the principal purposes of each instrument. Generally speaking, a grantee enters into a subaward agreement with an organization that will receive financial assis-

[9] 31 U.S.C. § 6301 *et. seq*.

[10] 31 U.S.C. § 6304. The Act also defines "cooperative agreement." The relevant part of the definition is nearly identical to the definition given for "grant." *See* 31 U.S.C. § 6305.

[11] 31 U.S.C. § 6303.

[12] 2 C.F.R. § 215.2 (OMB Circular A-110 § __.2) (emphasis added). Also note that the HHS Grants Policy Statement describes "subawards" as the "transfer of substantive programmatic work." HHS GPS II-78.

[13] OMB Circular A-133 § __210(d).

[14] OMB Circular A-133 § __.210.

[15] *Id.*

[16] The FDP is a broad association of federal agencies, universities, and research organizations that work to streamline the administration of federally sponsored research. FDP members cooperate in identifying, testing, and implementing effective ways of managing federal research grants. Materials addressed in this section can be found at http://thefdp.org/.

[17] *Id.*

[18] *Id.*

tance in order to accomplish a public benefit such as directly furthering a project's scientific or other research objectives. In contrast, a grantee will enter into contract agreements with vendors (or contractors) in order to procure goods and services.

IV. Conclusion

In many instances it is relatively clear whether an agreement is a subaward or a contract. There are, however, times when the decision is not straightforward. In those cases, making a reasonable decision is important because there are compliance ramifications that can result from an unreasonable designation. Indeed, the mischaracterization of an agreement can lead to problems for either the grantee or the lower-tier organization. Although there are not many hard and fast rules that one can mechanically apply when considering whether an agreement is a subaward or a contract, it is important to bear in mind that the purpose and substance of the agreement carry more weight than the name it is assigned. At bottom, the decision requires an exercise of judgment. A reasoned application of the relevant guiding principles can inform your judgment and help support your decision in the event it is questioned at a later date.

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