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OMB Issues Its Early Views on Potential Areas for Grant Administration Reform

By Michael J. Vernick

On Feb. 28, 2012, the Office of Management and Budget (OMB) published the long-awaited Advance Notice of Proposed Guidance (ANPG) titled *Reform of Federal Policies Relating to Grants and Cooperative Agreements; Cost Principles and Administrative Requirements (Including Single Audit Act)* (77 Fed. Reg. 11,778). The ANPG reflects input from a number of different working groups, including the A-21 Task Force,[1] focused on streamlining the regulatory requirements applicable to the performance of Federal grants and cooperative agreements. The grantee community had high hopes that the ANPG would yield significant reductions in the regulatory burdens associated with the performance of Federal awards, particularly in areas such as effort reporting.[2] As discussed below, however, the ANPG's areas of focus appear at this stage of the administrative process to be largely at the margins, and it remains uncertain whether some of the more significant changes, particularly those sought by large research universities and independent research institutions, will come to pass.

The ANPG begins by linking the government's efforts in the area of grant administration reform to Executive Order 13520, ''Reducing Improper Payments'' (Nov. 23, 2009), and a Feb. 28, 2011, Presidential Memorandum titled ''Administrative Flexibility, Lower Costs, and Better Results for State, Local, and Tribal Governments.'' The ANPG explains that these two documents reflect the Administration's desire that OMB work with the appropriate stakeholders—both in and outside of the government—to develop ways to increase the effectiveness and efficiency of Federal assistance programs, while also enhancing the government's oversight capabilities.

To that end, the ANPG is the first step toward actual changes to the OMB Circulars that govern the performance of Federal grants. It is limited to introducing broad areas of potential reform, requesting feedback on those issues, and stating that the grantee community's responses will be factored into a subsequent *Federal Register* notice to be published later this year. The forthcoming notice apparently will make specific proposed revisions to the various OMB Circulars and other

[1] The National Science and Technology Council Interagency Working Group on Research Business Models established the A-21 Task Force for the purpose of considering revisions to OMB Circular A-21. The Task Force included representatives from the Departments of Agriculture, Defense, Energy, Education, and Health and Human Services; the National Aeronautics and Space Administration; the National Science Foundation; and the National Institutes of Health.

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[2] Effort reporting is the process used by grantees to document compensation costs charged to Federal awards.

regulations governing the performance, administration, and auditing of Federal grants. The principal focus areas of the ANPG are discussed below.

A. Changes to the Cost Principles

There are currently four separate sets of cost principles:[3] OMB Circular A-21 (Colleges and Universities), A-87 (State and Local governments), A-122 (Non-Profit Organizations), and 45 C.F.R. Part 74, App. E (Hospitals). The ANPG discuses 17 potential areas for cost principle reform. Some of the more significant proposals are discussed in the remainder of this section.

1. Effort reporting

Of all of the areas considered by the A-21 Task Force and other similar bodies, effort reporting reform was probably the most highly charged. Compensation costs are typically the largest single component of cost charged to Federal research grants, and (as noted previously) effort reports are used to document those charges. Moreover, because compensation costs are such a significant portion of the costs charged to Federal grants, effort reporting is a frequent focus of Federal audit and enforcement activity. Complicating matters is that the rules governing effort reporting are complex, and sometimes counterintuitive. Not surprisingly, faculty and other researchers often find effort reporting difficult to understand and burdensome. For all of these reasons, grantees generally view effort reporting as both the single most onerous Federal administrative requirement, as well as the one fraught with the most compliance risk.

The grantee community, therefore, has been advocating for significant reform. Ideas floated have ranged from doing away with effort reporting altogether and relying on scientific progress reports to moving toward simplified payroll attestations covering entire grants. On the other side of the issue is the Inspector General and audit community, which views effort reporting as a key tool to ensure that Federal funds are spent appropriately.

The ANPG did not provide much insight into the important issue of effort reporting reform. Instead, it largely ''kicked the can down the road'' by suggesting that the Inspector General and grantee communities should work together to try to develop alternatives to the current effort reporting requirements. To that end, the ANPG specifically refers to existing pilot projects that are exploring alternative approaches to documenting compensation costs charged to Federal awards.[4] Although the lack of any concrete effort reporting reform proposal is disappointing, the reference to the pilot programs suggests that the door remains open—at least to some extent—as the administrative process continues.

2. Indirect cost rates

The ANPG devotes substantial discussion to the idea of Facilities & Administrative (F&A)[5] rate reform. The proposals advanced are focused on modifying the current system of negotiated F&A rates, which the ANPG notes are burdensome for both the government and the grantee community. The first option discussed in the ANPG is to simply move to a mandatory flat rate that is discounted from an institution's existing negotiated rate. It is uncertain how OMB would propose to handle new recipients who have never had a negotiated rate. The second option would afford recipients the choice of accepting a flat rate or continuing to negotiate a rate with their cognizant agency.[6] Those recipients with existing negotiated rates would have the choice of accepting a flat rate discounted off of their current negotiated rate. The ANPG indicates that OMB would be amenable to having the discounted rates in effect for a period of four years.

Whether any of the aforementioned options are at all attractive to the grantee community will likely depend on the details of the proposed revisions to the Federal cost principles. The basic decision of whether to impose a mandatory flat rate or to allow institutions to choose a flat rate will, of course, be critical. Likewise, the amount of the flat rate will be significant, as will the discount percentage off of a currently existing rate. The move to a mandatory flat rate would be a truly drastic change for the grantee community, and unless the flat rate is surprisingly high, it would be unpalatable because, among other reasons, most large research institutions already are subsidizing federally sponsored research.

3. Consolidation

Although the Federal cost principles generally are similar, there are some meaningful differences across the Circulars when it comes down to the ''nuts and bolts'' of charging costs to Federal awards. The ANPG raises the possibility of consolidating the existing OMB Circulars into a single document with only limited variation for different types of recipients.

The nature and extent to which existing variances are ''smoothed over'' likely will advantage (or disadvantage) different types of recipients. Indirect cost recovery is a good example of this possibility. Universities currently are subject to limitations and allowances on their indirect cost rate recoveries that do not apply to nonprofit institutions or academic medical centers. If OMB creates a single circular governing all types of recipients, it will have to assess how, and if, it is going to address those variances. The implication of the statement that ''limited variation'' will remain suggests OMB is not contemplating putting all recipients on equal footing, but the extent to which it does so remains to be seen. Effort reporting is another area where there are some differences across the current Circulars, particularly in terms of timing and acceptable methods of documenting compensation costs charged to Federal awards.

In sum, there are some noteworthy variances across the current Circulars, and decisions about where to achieve consistency and where to allow ''limited variation'' for different types of recipients will be a critical

[3] The Federal cost principles set forth the rules governing what can and cannot be charged to Federal grants and also set out the parameters for establishing indirect cost rates.

[4] The three programs cited by the ANPG are operated by the Federal Demonstration Partnership, the Department of Labor's Workforce Innovation Fund, and the Department of Education's Request for Ideas Initiative.

[5] F&A rates are commonly referred to as indirect cost rates.

[6] A cognizant agency is the single Federal agency assigned, among other responsibilities, to negotiate F&A rates for grantees. The role is generally played by either the Department of Health and Human Services or the Office of Naval Research.

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element of the forthcoming proposed revisions to the cost principles.

4. Other proposed cost principle reforms

In addition to the three aforementioned areas of potential reform, the ANPG also addresses several other issues, including the following:

- Expanding application of the utility cost adjustment—currently 65 universities receive a 1.3 percent increase in their F&A rate to cover utility costs. The ANPG would invite other institutions to apply for the same adjustment.
- Clarifying the existing guidance on charging directly allocable administrative support to Federal awards. This is an area where the rules are open to varying interpretations and also one being reviewed across the country by the Department of Health and Human Services Office of Inspector General.
- Eliminating the requirement in Circular A-21 that certain universities apply a portion of their F&A recovery associated with depreciation and use allowances to research infrastructure.

B. Reforms to Administrative Requirements Implemented by Circulars A-102, A-110, and A-89

Just as there are four sets of cost principles, there are also two primary sources of administrative guidance for Federal grantees: Circular A-102 (Grants and Cooperative Agreements with State and Local governments) and Circular A-110 (Uniform Administrative Requirements for Grants and Other Agreements With Institutions of Higher Education, Hospitals and Other Non-Profit Organizations). As is the case with the cost principles, the ANPG is contemplating the possibility of combining Circulars A-102 and A-110 with only ''limited exceptions'' by type of recipient.

Another area of potential reform in the administrative area is the ANPG's discussion regarding pre-award consideration not only of programmatic merit but also of financial risk. Although considering programmatic merit is commonplace, adding a compulsory financial risk assessment would be a potentially significant change. According to the ANPG, factors to be considered would include financial stability, quality of management and internal control systems, history of performance, and A-133 audit report findings. The ANPG also states that the assessment *should* affect award decisions and *may* affect terms and conditions. If this reform is implemented, agencies apparently will have significant discretion in terms of how they conduct the financial risk review. Open questions include (a) the level of transparency into the financial assessment, (b) how the financial risk assessment actually will affect award decisions and terms and conditions, (c) whether applicants will be burdened by having to supply information to facilitate the financial review, and (d) whether there would be an appeal process in the event of an adverse determination.

C. Single Audit Reform

Currently, an institution that expends more than $500,000 of Federal awards in a fiscal year must undergo a Single Audit, also commonly known as an A-133 audit.[7] These audits are expensive and time-consuming activities. Furthermore, their effectiveness in terms of enhancing compliance is an open question in both the government and grantee communities. Because of the time and expense necessary to complete an A-133 audit, and to improve the ability of A-133 audits to enhance compliance, the ANPG suggests replacing the current $500,000 threshold with a tiered approach.

Entities expending fewer than $1 million of Federal awards in a year would not have to undergo an audit at all. OMB explains that raising the audit threshold will reduce the administrative burden on recipients of less significant amounts of Federal funding and concomitantly would allow sponsoring agencies to focus their oversight activities on larger recipients of Federal funds, for whom, the ANPG explains, the compliance risks are greater.

Entities expending between $1 million and $3 million would undergo a scaled-back version of an A-133 audit. Specifically, recipients in this category would be subject to audit in only two of the 14 current compliance areas.[8] One of those two always would be allowable/unallowable costs. The second would be left to the discretion of the sponsoring agency. The ANPG states that OMB would provide guidance to sponsors to assist them in selecting a second area that for their specific programs will best assess the risk of waste, fraud, or abuse. This scaled-back approach leaves open the question of what happens if an auditee has programs from five different sponsors and each of those sponsors selects a different second area of focus. Would that auditee actually be subject to audit in six areas—allowable/unallowable cost plus the five areas selected by its different sponsors? If so, that would reduce the intended burden reduction and in some cases perhaps eliminate it altogether.

Entities that expend more than $3 million would remain subject to a full A-133 audit, which would be made more ''efficient'' by additional ANPG proposals. The ANPG suggests streamlining the existing requirements in the annual A-133 Compliance Supplement to focus more on those that address improper payments, waste, fraud, and abuse. These would include allowable/unallowable costs, eligibility, and subrecipient monitoring. Testing in these areas would have larger sample sizes and/or lower materiality thresholds. Other compliance areas would be de-emphasized by smaller samples and/or higher materiality thresholds.

The ANPG also proposes to strengthen the A-133 process by placing increased emphasis on agencies' audit follow-up activities. Under the current regulatory regime, Federal responses to A-133 audit findings are somewhat ad hoc in terms of timeliness and approach. The ANPG would require agencies to designate a ''senior accountable agency official'' to oversee all audit resolution activity. The ANPG also focuses on having agencies take what it refers to as a more proactive and collaborative approach to resolving A-133 findings. The ANPG goes so far as to say that the suggested collaborative approach would be akin to ''mediation'' rather

[7] OMB Circular A-133 implements the Single Audit Act.

[8] The 14 areas are addressed in the Annual A-133 Compliance Supplement issued by OMB. The Compliance Supplement also provides detailed guidance to auditors carrying out Single Audits.

than the traditional more adversarial nature of audit resolution.

Other aspects of A-133 audit reform focus on reducing the burdens on pass-through entities and subrecipients.[9] The ANPG discusses increasing coordination across the government to reduce redundant audit activity. The notion is to ensure that the Federal government conducts any necessary follow-up audit activity regarding internal control issues for institutions that receive the majority of their funding as direct recipients. The goal is to avoid having pass-through entities engage in follow-up audit activity duplicative of Federal efforts. The second way the ANPG suggests reducing A-133 related burden on pass-through entities and subrecipients is by making the Federal government responsible for resolving audit findings related to subawards that do not specifically involve program delivery. Under the current regulatory regime, pass -through entities are responsible for resolving all audit findings related to subawards they make. Again, the notion here is to avoid having pass-through entities conduct follow-up audit activity duplicative of Federal efforts. Pass-through entities would, however, still be expected to conduct post resolution monitoring.

[9] A pass-through entity is an institution that receives Federal funds and subsequently awards a portion of those funds to another organization. A subrecipient is the organization that receives the awards from the pass-through entity.

Next Steps

The ANPG concludes by proposing a series of questions in each of the three areas covered in this article—(a) cost principles, (b) administrative requirements, and (c) A-133 audits. It also poses the following ''overarching'' questions:

- Which of these reform ideas would result in reduced or increased administrative burden to you or your organization?
- Which of these reform ideas would be the most or least valuable to you or your organization?
- Are any of these reform ideas ones that you would prefer that OMB not implement?
- Are there any reform ideas, beyond those included in this notice, that OMB should consider as a way to relieve administrative burden?

Although this is not the last chance to try to influence OMB's reforms, it does appear to be the final opportunity to do so before those reforms appear as actual proposed revisions to the OMB Circulars.

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