

## Time and Effort Reporting: Overview and Risk Assessment

Robert J. Kenney, Jr., Director, Grants & Contracts Practice,  
Hogan & Hartson LLP, Washington, D.C.

*This article is the first of a three-part series addressing the research compliance risk areas highlighted by the Office of Inspector General of the Department of Health and Human Services in its recent proposed guidance on compliance programs in the federal research area. The articles are intended to provide an overview of the applicable federal rules in each risk area and to identify the issues in each area that present the greatest problems for grantees.*

Late last year, the Office of Inspector General (OIG) of the Department of Health and Human Services (HHS) published a proposed set of guidelines on setting up compliance programs in the federal research area. 70 Fed. Reg. 71312 (Nov. 28, 2005). The draft guidance relates primarily to compliance with legal and program requirements affecting the reimbursement of costs charged to federal projects. By way of introduction to its proposed guidance, the HHS OIG highlighted three examples of research compliance "risk areas" that had come to its attention: (1) time and effort reporting; (2) proper allocation of charges to federal awards; and (3) reporting of financial support from other sources. Although the HHS OIG did not say so explicitly, it is clear that it considers the highlighted risk areas to be significant potential areas of fraud and abuse by grantees.

### The Federal Time and Effort Reporting Rules

The principles that govern how colleges and universities must document time and effort on federal grants and contracts appear primarily in OMB Circular A-21, "Cost Principles for Educational Institutions." The circular requires each grantee to maintain a system of distributing salary charges to federal grants that results in a reasonable allocation of salary charges to each grant. The salary distribution system also must include a periodic review to confirm the reasonableness of salary charges to federal projects. In the case of faculty and other professional employees, that confirmation may be provided as infrequently as every six months or even once a year (depending on the type of effort reporting system). These confirmations are usually in the form of an effort or activity report or a salary distribution report and must be signed either by the employees whose salary charges are being confirmed, or by "responsible persons with suitable means of verification that the work was performed." These signatures confirm that "the distribution of activity represents a reasonable estimate of the work performed," or that the salary distribution is "reasonable in relation to the work performed."

The effort reporting rules in OMB Circular A-21, particularly those applicable to faculty and other professionals, were deliberately designed to free researchers as much as possible from the trouble and aggravation of

traditional timekeeping, while at the same time giving federal sponsors reasonable assurance that they are receiving the grant effort they were promised and for which they are being charged.

### The Six Payroll Distribution System Standards

Section J.10.b(1)(c) of OMB Circular A-21 expressly acknowledges that the process of allocating salary based on effort is inherently inexact and must depend on estimates. It makes it clear in section J.10.b(1)(d) that "[t]here is no single best method for documenting the distribution of charges for personal services." Section J.10.b(2) of the circular, however, does identify six fundamental "Criteria for Acceptable Methods," and states that "[f]or systems which meet these standards, the institution will not be required to provide additional support or documentation for the effort actually performed." The six fundamental payroll distribution standards that appear in Section J.10.b(2) of A-21 provide a reasonably clear outline of a compliant time and effort reporting system. The key points in the six standards are as follows:

◆ **The system for allocation of salaries based on effort must be "incorporated into the official records of the institution."** Allocations supported only by unofficial records, such as personal calendars or informal, ad hoc departmental spreadsheets, are not compliant with A-21. However, A-21 does indicate that effort systems "may include the use of subsidiary records"—so the mere fact that informal records are used in connection with an effort reporting system does not make the system noncompliant.

◆ **The system must "reasonably reflect the activity for which the employee is compensated by the institution."** This is, of course, the ultimate requirement of any compliant effort reporting system. The system must be able to capture the employee's "total institutional effort" and spread the employee's institutional base salary proportionally over the entirety of total effort. For example, if a faculty member's institutional duties include teaching and proposal writing as well as federal research, allocating 100 percent of the employee's institutional base salary to federal research would violate this prin-

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ciple of A-21, because it would not result in an allocation of salary that reasonably reflects the faculty member's nonresearch activities.

Admittedly, it is not always easy to draw the line between "institutional effort" and "outside effort." For example, service on an NIH peer review panel or on an editorial board of a scientific publication, even though related to a faculty member's institutional activity, may well be considered outside the scope of his or her institutional duties. Outside consulting for which the faculty member is separately paid by a third party is clearly outside the scope of "total institutional effort."

◆ **"Incidental work" need not be included in total institutional effort.** One exception to the "total institutional effort" concept is that "incidental work" (that in excess of normal for the individual) for which an individual is separately compensated by the institution need not be included in the base of total institutional activity that is used to allocate institutional base salary. A-21, Section J.10.a. Of course, if the institutional compensation relating to the "incidental work" is included in the salary that is allocated out to federal grants and other activities, then the incidental work also must be included in "total effort."

◆ **The system must provide some form of "after-the-fact confirmation or determination" of the reasonableness of the salary allocations to federal grants.** This "after-the-fact" confirmation is usually what we mean when we refer to effort reporting, and clearly an effort reporting system that does not confirm salary allocations after the fact with reasonable accuracy would not be compliant with A-21. A-21 does not, however, prescribe the particular means by which such "confirmation" must be obtained, other than by way of a few examples of compliant systems.

◆ **Employee salary allocations must be confirmed by the employees themselves or by "responsible persons with suitable means of verification that the work was performed."** There is a wide variation of practices on this point among research institutions. Some insist that every employee must sign his or her own effort confirmation. Others require that any person signing an effort or salary confirmation on behalf of another employee must have "first-hand knowledge" of the employee's actual activities. Neither of these practices is mandated by A-21, but in some cases there may be good reasons for having a standard on this point that is stricter than A-21 requires.

◆ **The payroll distribution system "may reflect categories of activities expressed as a percentage distribution of total activities."** In practice, the overwhelming majority of institutions confirm distribution of salary or

effort on a percentage basis; that is, the effort spent on a particular federal grant is expressed as a percentage of total institutional effort. The same result could be achieved by collecting data on total hours and hours devoted to each activity, but these hours then would have to be converted to percentages to allocate salary among the various activities. Most institutions have concluded, therefore, that expressing effort allocations in percentage terms provides adequate estimates on which to base salary allocations.

◆ **"Significant changes in the corresponding work activity must be identified and entered into the payroll distribution system."** Effort reporting systems tend to focus primarily on the accuracy of effort reporting at the time of the report itself — under A-21, once every six months or once a year. It is true that if an employee's signed effort report is inconsistent with allocations of salary made during the report period, then the employee's salary allocations must be corrected at that time to conform to the reported effort. Institutions also are required, however, to correct salary allocations in response to "significant changes" in work activity that occur between effort reporting dates.

◆ **The system must provide for "independent internal evaluations" of its effectiveness.** This is a requirement of A-21 that many institutions overlook. A-21 does not prescribe the exact nature of the "independent internal evaluation," how "independent" it must be, or how often it must be done. Systematic spot checks of compliance, performed not less frequently than once every year or so by an institutional office not directly involved in the operation of the effort reporting system, in most cases would be sufficient to determine whether the system was working properly. Whether the HHS OIG or others in government would expect a more comprehensive, more frequent, or more independent form of evaluation is an open question.

### **Time and Effort Reporting Presents Major Compliance Challenge**

Inaccurate effort reporting in connection with federal research is an area of great potential danger for research institutions. As most in the research community are well aware, effort reporting has been a major issue, if not the only issue, in the majority of research-related False Claims Act settlements over the last several years. But knowing that effort reporting is a serious potential problem and knowing what to do about it are two different things.

The difficulty of addressing the effort reporting problem is compounded by the many persistent myths that have grown up around the subject, some of which are used to rationalize effort reporting methods that are sim-

ply wrong. The pressures on researchers in many institutions to cover a high percentage of their compensation through outside funding sources sometimes causes faculty or administrators to overstate how much effort actually has been expended on a particular grant. In some cases, levels of effort are assigned by departmental administrators based on levels of effort proposed in grant applications, and faculty members may have, or feel that they have, little or no opportunity to correct what appears to be an incorrect effort report. Even with the leeway afforded by A-21, most research universities would acknowledge that obtaining reasonably accurate reports of effort represents a continuing compliance challenge.

The most important obstacles in effort reporting compliance are misunderstanding and denial, and sometimes one obstacle feeds on the other. A faculty member who does not understand the government's effort reporting requirements or the importance of accurate reporting is more likely to question the need for enhanced compliance measures, and faculty members who have an innate resistance to new effort reporting procedures are less motivated to understand what they are being asked to do.

The compliance problems created by such misunderstanding and resistance are often made worse by mechanical deficiencies in effort reporting systems, as well as poor training of departmental and central administrative support personnel who are responsible for implementing effort reporting procedures.

If one multiplies these problems across the hundreds or thousands of personnel and sponsored projects that an effort reporting system is expected to support, it becomes clear that the implementation and operation of a compliant system is a major challenge, fraught with difficulty and potential danger.

### **Specific Effort Reporting Compliance Problems**

◆ **Lack of any effort reporting system.** Institutions that are relatively new to research, or those whose research activity has increased rapidly in recent years, sometimes wake up to realize that the task of creating a compliant time and effort reporting system has been overlooked or deferred for too long. Obviously, these institutions are the ones that are most exposed to liability, in the form of cost disallowances and allegations of fraud or abuse. The only good news here is that an institution in this position has an opportunity to build its effort reporting system from scratch, avoiding some of the deficiencies of systems that were put in place decades ago.

◆ **Failure to distribute and collect effort forms.** Even the best thought-out time and effort system will be worthless if those who are required to complete time and effort reports do not do so, or if the information in the reports

does not get to the right place at the right time. This point may seem too obvious to mention, but the fact is that the task of collecting time and effort information on a timely basis is by no means a trivial one, and the effort systems of many institutions break down at this point in the process.

◆ **Effort reports signed by individuals with insufficient knowledge of the work performed.** The effort report form must be completed by the individual whose effort is being reported or by a responsible person with access to reliable information as to how the individual's effort has been expended. An institution that does not take this requirement seriously is exposed to potential risk. It is difficult to ensure that individuals signing on behalf of other employees have "suitable means of verification" of what they are affirming. Often, in practice, effort reports are signed by departmental administrators with little or no knowledge of the work actually performed by individual faculty members or other employees. Federal auditors and investigators are very much aware of this phenomenon, and a common audit practice is to interview such administrators to determine how much they really know about the effort to which they are certifying.

◆ **Failure to include all institutional effort in the effort percentage calculation.** Effort report forms must account for all effort for which the individual is compensated by the institution. This would normally include all effort expended on institution-compensated sponsored research, administration, instruction, and unsponsored scholarly activity, clinical activity, and other activity. Even where the number of hours of effort the individual expends each week substantially exceeds the "normal" work week of 40 hours, it is necessary to base effort percentages on total effort, not just "normal" effort. Common manifestations or variations of this problem include:

— Use of a "normal" 40-hour work week as the basis for the effort percentage calculation. As indicated above, this is not permissible if the employee actually averages more or less than 40 hours per week on institutional activities.

— Use of an overly expansive concept of employees' "own time." Each institution is permitted, within reasonable limits, to define the activities for which it does or does not compensate its employees. Once those activities are defined, normally it does not matter for effort reporting purposes when the activities are performed. For example, the fact that a faculty member does administrative work or proposal writing on his or her "own time" — weekends or vacation — does not mean that the work is not institutional activity and may be excluded from the denominator of total effort. If the nature of the work makes it institutional activity, normally it must be included in total effort.

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◆ **Faculty charged 100 percent to sponsored research.** It is certainly possible that a given faculty member could be 100 percent engaged in sponsored research. At some institutions, there are classes of faculty who have essentially no duties other than research. In general, however, most faculty have other duties and activities — teaching, administration, proposal writing, patient care, etc. — that are considered to be within the scope of their appointments and employment. For these faculty, an effort report showing 100 percent effort on sponsored research would be anomalous at best. Some institutions have begun to implement processes to identify such “highly charged” faculty to verify that the level of effort on sponsored research is reasonable in the circumstances.

◆ **Inaccurate statements of effort on federal projects.** There are many reasons why estimates of effort on federal sponsored projects may not be accurate. In universities, the estimates generally are made months after the effort has been expended, so limitations of memory may affect accuracy. Misunderstandings of effort reporting rules also may affect accuracy of effort reporting — the persistent myth that effort on a project may be reported in relation to a “normal” 40-hour work week is a good example. In some cases, although rare, it is possible that faculty members or administrators may deliberately overstate effort on federal projects, knowing that the estimates are factually incorrect.

◆ **Failure to account for unfunded effort.** Some effort reporting systems attempt to capture not only the effort that is charged to federal sponsored projects, but also effort for which no salary is charged (i.e., mandatory or voluntary cost sharing). Whether or not grantees are required to capture voluntary cost sharing through their effort reporting systems is a point on which grantees and the government sometimes disagree. However, if an institution’s system is intended to capture cost sharing, then it must do so accurately. Institutions, whose effort reporting systems are driven in the first instance by how much salary has been charged to a grant, often have difficulty capturing effort for which no salary has been charged.

◆ **Failure to reconcile effort report data with salary charges.** The mechanism for adjusting salary charges based on information contained in effort reports is usually a manual process, involving several steps. It sometimes happens that this mechanism breaks down in whole or in part, with the result that the effort reports fail to achieve their intended purpose. The proper functioning of this mechanism is obviously essential to a compliant salary allocation system

◆ **Failure to adjust for significant changes in effort levels between effort reports.** As noted above, OMB

Circular A-21 requires educational institutions to adjust salary allocations between effort reporting dates in response to “significant changes” in work activity. A failure to implement such a mechanism can result in errors in salary charges to grants, leading to over-recovery of salaries and distortions in interim reports of grant expenditures relative to budgets.

◆ **Misunderstandings of the effort report form.** Sometimes the effort reporting form itself may lead to inaccurate reporting. In some university systems, for example, the effort report form presented to the faculty for signature contains preprinted percentages, reflecting the estimated level of effort expended by the faculty member on sponsored research activities. These preprinted estimates, in turn, are typically based on the percentages of total salary actually charged to sponsored activities during the reporting period. For example, if 20 percent of a faculty member’s salary has been charged to a sponsored project during the period, the report form may propose an effort percentage of 20 percent, allowing the faculty member to confirm or correct it. If these preprinted percentages do not substantially correspond to the effort actually expended by the individual on those projects during the report period, the percentages must be manually corrected to reflect actual effort. This must be made clear to faculty members, who sometimes wrongly believe that they are not permitted to change the preprinted effort percentages.

### Conclusion

The HHS OIG had good reason to highlight time and effort reporting as a potentially serious compliance issue for federal research institutions. It is a complicated problem — far more so, perhaps, than most federal sponsors and enforcement authorities appreciate. From the perspective of the institutions themselves, the problem is exacerbated by the fact that some federal auditors and investigators, including some within the HHS OIG, seem to advocate a higher standard of effort reporting precision than OMB Circular A-21 actually requires. In light of the widely publicized recent False Claims Act settlements in this area, as well as the apparent tightening of government standards and expectations, most major federal research institutions today are taking a fresh look at their time and effort systems to ensure that they are compliant with the applicable cost principles and as consistent as possible with best practices in the research community.

Because there is no single reason for inaccuracies in effort reports, there is no single mechanism that will prevent them. Institutions must make their own assessments of the reasons for any inaccuracies they identify and develop measures to address each source of potential error. ♦