

# BNA Insights

## Grant Administration

### Effort Reporting Under the Long-Awaited OMB 'Super Circular'



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**O**n Dec. 26, 2012, the Office of Management and Budget (OMB) published the long-awaited "Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards" (78 Fed. Reg. 78,590). The so-called Super Circular is intended to streamline the regulatory requirements applicable to the performance of federal grants and cooperative agreements. To that end, the Super Circular supersedes eight existing OMB Circulars that, among other issues, address cost allowability, Single Audits and the administrative requirements governing federal awards.<sup>1</sup> The Super Circular's effective date was Dec. 26, 2013, but grantees are not expected to become subject to the new rules until Dec. 26, 2014.<sup>2</sup>

The Super Circular is the culmination of more than two years of work by the government and the grantee community and has included numerous formal and informal information collection efforts, including a 2012 Advance Notice of Proposed Guidance<sup>3</sup> and a February 2013 Proposed Rule.<sup>4</sup> The impetus for this effort can be

traced back 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," which collectively articulated the Obama administration's desire to make federal assistance programs more efficient and effective, while also strengthening the government's oversight capabilities.

Throughout the dialogue between the government and the grantee community, the issue of how to document compensation charges to federal grants, referred to as "effort reporting," has been a critical issue. In general, compensation costs are the single most significant direct charge to federally sponsored projects.<sup>5</sup> As a result, federal audits and investigations in the sponsored projects area often focus, at least in part, on the grantee's compliance with effort reporting rules, which were set forth in Circular A-21 (colleges and universities), A-122 (nonprofit organizations), and A-87 (state and local governments). From the perspective of the grantee community, those rules were viewed as being, in some respects, counterintuitive, overly prescriptive and unduly burdensome. Thus, there was a strong desire for significant effort reporting reform that would simplify the rules and perhaps move toward more of a results-achieved/performance-based system of documenting compensation charges.

Overall, the Super Circular contains some potentially helpful changes and appears to introduce additional flexibility into the procedures used to document compensation charges. As discussed in detail below, one significant change is a move away from prescriptive effort reporting procedures and toward an approach that relies more heavily on a grantee's system of internal controls to document compensation costs. What remains uncertain, however, is how regulators will view the internal controls of those grantees that decide to take advantage of the Super Circular's increased flexibility. This article addresses some of the principal ways in which the Super Circular changes the effort reporting rules and identifies certain areas where the new rules leave open potentially significant questions.<sup>6</sup>

<sup>1</sup> Specifically, the Super Circular supersedes Circulars A-21, A-50, A-87, A-89, A-102, A-110, A-122 and A-133. Notably, OASC-3, which provides the cost principles for hospitals, is not included in the Super Circular.

<sup>2</sup> 2 C.F.R. § 200.110.

<sup>3</sup> 77 Fed. Reg. 11,778 (Feb. 28, 2012).

<sup>4</sup> 78 Fed. Reg. 7,282 (Feb. 1, 2013).

<sup>5</sup> Generally speaking, compensation costs can easily account for two-thirds to three-fourths of the direct costs on a sponsored research project.

<sup>6</sup> Because this article focuses on the effort reporting process, it will not discuss the Super Circular's treatment of issues closely related to effort reporting, including supplemental compensation, incidental work, extra service pay or intra-

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## A. Effort Reporting Overview

Recipients of federal grants and cooperative agreements are subject to numerous financial accounting and reporting obligations, including the obligation to ensure that they charge only reasonable, allowable and allocable costs to their sponsored projects. Historically, grantees have used the effort reporting process to reasonably allocate compensation costs to their federal awards. Although the rules vary depending on the type of recipient (e.g., college/university, nonprofit institution or hospital), the basic concept is that a grantee would generate activity reports reflecting the distribution of an employee's salary to individual sponsored projects and non-sponsored activities. The employee, or another person with a suitable means of verification, or first-hand knowledge (again depending on the type of recipient), would review the report and confirm that it was reasonably accurate. The reports must reflect an after-the-fact confirmation of actual effort; reliance on budgets is not appropriate.

Although seemingly simple, effort reporting has long posed a significant compliance challenge for many grantees. Common issues have included not having an effort reporting system, not completing the effort reports, having someone complete the reports who lacked the requisite level of knowledge, inaccurately completing the reports and/or completing the reports based on budgeted as opposed to actual effort.

Given the numerous audit findings and settlements under the civil False Claims Act involving various effort reporting issues, the sponsored projects community viewed the grant reform process as an opportunity to significantly streamline and simplify this area. In contrast, the audit and Inspector General communities seemed to be focused on maintaining what has been a key tool in their enforcement/oversight efforts.

## B. Significant Changes in the Super Circular

Section 200.430<sup>7</sup> sets forth the Super Circular's rules regarding the allowability of compensation costs to federal grants and cooperative agreements. The following section of this article compares and contrasts the new Section 200.430 with the superseded sections J.10 of OMB Circular A-21 and Circular A-122, Att. B, sec. 8.

### 1. Basic Principles

Under the Super Circular, salaries charged to federal awards will be allowable if the compensation meets the requirements of Section 200.430 and:

- is reasonable for the services rendered and conforms to the established written policy of the non-federal entity consistently applied to both Federal and non-Federal activities;
- follows an appointment made in accordance with a non-Federal entity's laws and/or rules or written policies and meets the requirements of federal statute, where applicable; and

university consulting. Those subjects will be addressed in a forthcoming article.

<sup>7</sup> 2 C.F.R. § 200.430.

- is determined and supported as provided in paragraph (i) of this section, Standards for Documentation of Personnel Expenses, when applicable.<sup>8</sup>

### a. New documentation standards

Section 200.430(i) provides the documentation standards for compensation costs. Throughout the regulatory process, this was among the most debated aspects of grant administration reform. At the most fundamental level, the final rule implements some meaningful changes. The Super Circular does not refer to activity reports or personnel action forms, sets forth no rules regarding the time period in which effort must be confirmed and offers no guidance on who may document compensation costs. In lieu of those former requirements, the new rule allows grantees increased flexibility to utilize their own systems of internal control to document compensation costs. Grantees must, however, maintain "records that accurately reflect the work performed." The question, therefore, becomes for those grantees that opt to move away from the traditional effort reporting process, what types of records will regulators accept?

The remainder of this section discusses some of the new documentation standards and highlights areas illustrative of the question raised directly above.

#### i. Who can document salary charges?

Under Circulars A-21 and A-122, effort reports had to be completed either by the employee whose salary was being supported or, for colleges and universities, someone with a "suitable means of verification that the work was performed," or, for nonprofits, a responsible supervisory official with "first hand knowledge of the activities performed by the employee." Over the past several years, there has been a relatively significant level of audit and enforcement activity addressing the question of whether effort reports were completed by an individual with the requisite level of knowledge. This has been prevalent particularly in the higher education area because even though Circular A-21 does not define the phrase "suitable means of verification," regulators have tended to adopt a rather strict view of who can reasonably complete an effort report. Thus, the decision to remove all requirements that records supporting salary charges be completed by someone with a "suitable means of verification" or "first hand knowledge" may be perceived as a step toward greater flexibility. Because, however, a grantee must still maintain "records that accurately reflect the work performed," it remains uncertain what level of documentation regulators will expect and accept.

#### ii. Continued focus on after-the-fact review

After-the-fact review is a bedrock principle of current effort reporting requirements. New Section 200.430(i) still refers to such a review. The Super Circular explains that:

[b]udget estimates (i.e., estimates determined before the services are performed) alone do not qualify as support for charges to Federal awards, but may be used for interim accounting purposes, provided that:

(A) The system for establishing the estimates produces reasonable approximations of the activity actually performed.

(B) Significant changes in the corresponding work activity (as defined by the non-Federal entity's written policies)

<sup>8</sup> 2 C.F.R. § 200.430(a).

are identified and entered into the records in a timely manner. Short term (such as one or two months) fluctuation between workload categories need not be considered as long as the distribution of salaries and wages is reasonable over the longer term.

(C) The non-Federal entity's system of internal controls includes processes to review after-the-fact interim charges made to a Federal awards based on budget estimates. All necessary adjustment [sic] must be made such that the final amount charged to the Federal award is accurate, allowable, and properly allocated.<sup>9</sup>

As reflected in the highlighted language, the Super Circular continues to require some sort of "after-the-fact" review to ensure that charges are "accurate, allowable, and properly allocated." Although perhaps less prescriptive, it is an open question whether that requirement is materially different than the current expectation for after-the-fact review.

Also noteworthy is that the Super Circular provides some rather specific guidance around the concept of internal controls:

The non-Federal entity must:

(a) Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award. These internal controls should be in compliance with guidance in "Standards for Internal Control in the Federal Government" issued by the Comptroller General of the United States and the "Internal Control Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

(b) Comply with Federal statutes, regulations, and the terms and conditions of the Federal awards.

(c) Evaluate and monitor the non-Federal entity's compliance with statute, regulations, and the terms and conditions of Federal awards.<sup>10</sup>

It is uncertain how a grantee's existing system of internal controls will line up against the Comptroller General and Treadway Commission standards and whether achieving compliance with those standards will be administratively burdensome and costly. Furthermore, the concept of "reasonable assurance" is now likely to be a topic of debate between grantees and regulators.

iii. *Other changes that are particularly relevant to colleges and universities*

OMB Circular A-21, which set forth the cost principles for colleges and universities, included three examples of "acceptable" effort reporting systems: (a) Plan Confirmation, (b) After the fact Activity Records and (c) Multiple Confirmation Records. In general, colleges and universities have viewed the three "acceptable" methods as unduly prescriptive and have sought increased flexibility in terms of how they document payroll charges. To the extent the Super Circular has deleted those examples, that is a positive development from the perspective of the college and university sponsored projects community. However, as noted above, it remains unclear what the government will view as a suitable replacement.

<sup>9</sup> 2 C.F.R. § 200.430(i)(viii) (emphasis added).

<sup>10</sup> 2 C.F.R. § 200.303.

The Super Circular also formally defines institutional base salary<sup>11</sup> "as the annual compensation paid by an IHE [Institution of Higher Education] for an individual's appointment, whether that individual's time is spent on research, instruction, administration, or other activities. IBS excludes any income that an individual earns outside of duties performed for the IHE." In that sense, it formally memorializes what had been the general understanding of references in Circular A-21 to "base" salary.

## b. What constitutes a reasonable salary?

The Super Circular explains the concept of salary reasonableness as follows:

Compensation for employees engaged in work on Federal awards will be considered reasonable to the extent that it is consistent with that paid for similar work in other activities of the non-Federal entity. In cases where the kinds of employees required for Federal awards are not found in the other activities of the non-Federal entity, compensation will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor market in which the non-Federal entity competes for the kind of employees involved.

In general, the foregoing language may open the door to regulators adopting a more rigid view of what constitutes a reasonable salary. For example, the language addressing employees who are unique to the institution is potentially problematic because of its focus on using salaries paid to comparable employees in the relevant labor market. The proposed rule that issued in February 2013 was perhaps even more concerning because it contained language stating that compensation surveys from the representative labor market could be used to establish reasonableness. The grantee community expressed some concerns that such surveys would be *de facto* required. That language was removed but the continued reference to "similar work in the labor market in which the non-Federal entity competes" may provide a new lever with which regulators can challenge compensation costs charged to federal awards. For example, the language raises the possibility of disagreements over what constitutes the labor market in which the grantee competes. Likewise, questions may be raised concerning the documentation required to support salary reasonableness.

## 2. Use of performance-based systems

The Super Circular "encourages" cognizant agencies to consider and approve systems that support compensation costs through a focus on project "outcomes and milestones."<sup>12</sup> It is somewhat surprising that the Super Circular includes such an option given that the accompanying commentary explains that the government considered, but rejected, "performance oriented reporting" on the basis that it was not currently feasible.<sup>13</sup> Similarly, the Super Circular includes language that invites grantees to propose performance-based salary documentation plans in cases where multiple federal awards support related work. Under this option, a grantee must submit a waiver request from the stan-

<sup>11</sup> In practical terms, IBS is the salary that is used to seek and subsequently charge federal awards. It may, but need not always, be the employee's total compensation.

<sup>12</sup> 2 C.F.R. § 200.430(i)(6).

<sup>13</sup> 78 Fed. Reg. at 78,601.

dard documentation requirements, describe how it proposes to document salary costs, and establish "quantifiable measures of . . . activity in relation to time charged." The waiver request must be approved in advance by all involved sponsors.<sup>14</sup> In light of the unwillingness to move toward a performance-oriented system in general, it will be interesting to see how many of these alternative proposals are accepted.

### Conclusion

The Super Circular includes some changes that, at first glance, can be construed as liberalizing the rules governing the documentation of compensation costs. The commentary accompanying the Super Circular makes clear, however, that the government is still going to have high expectations when it comes to the allow-

ability of such costs. For example, the commentary accompanying the promulgation of the Super Circular explains that grantees must have a "strong system of internal controls" and that they are going to have to comply with a "stringent framework of internal control objectives." And, grantees still are expected to "ensure . . . that the final amount charged to federal awards is proper." Because of its focus on internal controls, the Super Circular acknowledges that "many" grantees may continue to find that their existing policies focused on personnel activity reports and other similar forms of documentation should remain in place, but also makes it clear that they are not required to do so. Ultimately, however, for those grantees that desire to move away from their current effort reporting systems, there is tremendous uncertainty about what regulators will consider an adequate alternative. Presumably, that question will be answered over the coming years through, among other means, enforcement activity.

<sup>14</sup> 2 C.F.R. § 200.430(i)(7).