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“Subawards or Contracts – More Than Just A Name”

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Shakespeare wrote that “a rose by any other name would smell as sweet.” Call yourself a petunia when you are really a rose, and though you would smell sweet either way, you nonetheless continue to have thorns.

The same principle holds true for subrecipients and contractors under Federal financial assistance awards. Call yourself a contractor when you are really a subrecipient, and you may be subject to disallowed costs at audit. Call yourself a subrecipient when you are really a contractor, and you may subject yourself to an unnecessary financial audit. Either way, the audit will undoubtedly produce a thorn in your side.

Federal financial assistance recipients frequently turn to subrecipients and contractors (often mistakenly called “subcontractors”) to help fulfill their statements of work. Regrettably, recipients often impose the wrong legal requirements – a contract when a subaward is appropriate, or vice versa. Grant program and administrative officials often allow the wrong terminology to be used in award documents, leading to further confusion.

At times this confusion results in undesirable consequences. When auditors review such projects, disallowed costs that may result can be devastating to a recipient. Sometimes auditors are confused as well, resulting in convoluted appeals.

Thus, it is important for financial assistance professionals to understand: What is the difference between a contractor and a subrecipient? What requirements apply to subrecipients, and what requirements apply to contractors?

What is the difference between a subrecipient and a contractor?

In short, a subrecipient is involved in financial assistance activities, and a contractor is involved in procurement.

Through the recipient, a subrecipient performs work to accomplish a public purpose authorized by law. *Compare to* 31 USC §6303-04; *see also* 15 CFR §14.25(c) (8). In other words, a subrecipient performs substantive work on an award project.

A contractor, in contrast, does not seek to accomplish a public benefit, and does not perform substantive work on the

project. It is merely a vendor providing goods or services to directly benefit the recipient. *Id.*

Regulatory Parameters

The Federal common rule on financial assistance administration, Office of Management and Budget Circular A-110 (Nov. 1993), codified by the Department of Commerce at 15 CFR Part 14, and similar regulations applicable only to state and local governments, 15 CFR Part 24, establish the difference between subawards and contracts. The Departmental regulations define “subrecipient” as “the legal entity to which a subaward is made and which is accountable to the recipient for the use of the funds provided...” 15 CFR §14.2(jj); *see also* 15 CFR §24.3, *Subgrantee*.

- The regulations define a “subaward” as “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...” 15 CFR §14.2(ii). *See also* 15 CFR §24.3, *Subgrant*. An “award is financial assistance that provides support or stimulation to accomplish a public purpose. 15 CFR §14.2(f); *See also* 15 CFR §24.3, *Grant*.
- The regulations define a “contract” as “a procurement contract under an award or subaward, and a procurement subcontract under a recipient or subrecipient’s contract.” 15 CFR

§14.2(i). *See also* 15 CFR §24.3 *Contract*.

What You Call It Is Not Determinative

Are you mistakenly calling subrecipients “contractors”? An agency should hold a recipient accountable based not on the title of the instrument selected but on the true function of work undertaken by the agreement.

This principle is supported by 15 CFR §14.2(ii), which states that the term “subaward” “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...” (*emphasis added*). *See also* 15 CFR §24.3, *Subgrant*.

Furthermore, Office of Management and Budget Circular A-133 (1997), which establishes common Federal guidelines relating to the audit of state and local governments and non-profit organizations, states in §__.210(d), “In making determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement.”

Speaking of semantics, the phrase “subcontractor” is often used instead of “contractor” when referencing contracts under financial assistance awards. Perhaps using the “sub-“ prefix helps staff remember that a contract is not the instrument being used by the agency to fund the recipient. Using the phrase “subcontract” helps to identify the activity as a lower tier transaction.

A “subcontractor” however, is a party that provides a good or service to a contractor, such as the eraser supplier for the pencil manufacturer that sells pencils to an agency or an agency’s financial assistance recipient. Probably ‘tis better to call the situation what it is really is – a contract under a financial assistance award, not a subcontract. Accuracy helps avoid confusion.

How Do You Tell?

Regulations seek to clarify the issue, but as a practical matter, sometimes it is difficult to tell whether an activity involves work on the project or provision of a service for the project. This is especially true in research awards. For example, software development or laboratory analysis might be procurement or a subaward, depending on the purpose of the original project.

For borderline cases, how do we decide whether a contract or subaward is appropriate? We must evaluate each situation on a case-by-case basis.

OMB Circular A-133 offers insight to help determine whether a subaward or a contract is appropriate. See <http://www.whitehouse.gov/OMB/circulars/a133.html>

Section __.210(b) of the Circular states that characteristics indicative of a Federal award received by a subrecipient are when the organization (1) determines who is eligible to receive what Federal financial assistance; (2) has its performance measured against whether the objective of the Federal program are met; (3) has responsibility for programmatic decision making; (4) has responsibility for adherence to applicable Federal program compliance

requirements; and (5) uses Federal funds to carry out a program of the organization as compared to providing goods or services for a program of the pass-through entity.

In contrast, §__.210(c) of the Circular states that characteristics indicative of a payment for goods and services received by a vendor are when the organization (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.

§__.210(d) notes that it is not expected that all of the characteristics described above will be present and judgement should be used in determining whether an entity is a subrecipient or a vendor.

Program statutes may complicate the matter. For example, the statute authorizing the Advanced Technology Program in the Department’s national Institute of Standards and Technology establishes financial assistance for industry-led “joint ventures” comprised of several parties performing a research project. *See* 15 USC §278n.

Under such a law, should a party performing research be a recipient, a subrecipient, or a contractor? The Department has concluded that ATP joint venture members are co-equal recipients, with one recipient designated the administrator for efficiency.

Compliance With Requirements

Who is responsible for determining whether a subaward or contract is appropriate? Ordinarily, agencies hold recipients accountable for any requirements that flow down to subrecipients or contractors. Recipients are therefore interested in using the appropriate instrument.

Recipients rely on agencies, however, to make requirements clear to them. And agencies seek to implement their programs effectively. Thus, to ensure the fair and efficient administration of financial assistance requirements, agencies should ensure that the appropriate terms are used in award documents. This should result in fewer problems when recipients are audited.

This is particularly important regarding subawards. A Grants Office should approve a recipient's use of subawards in the original award, or, consistent with 15 CFR §14.25(c)(8), require prior approval when subawards are used.

What requirements apply to subrecipients, and what requirements apply to contractors?

The distinctions between a subaward and a contract necessitate that different requirements apply.

Subrecipients

Because a subaward is financial assistance, the terms that apply to financial assistance recipients generally apply to subrecipients as well. For example, subrecipients must comply with programmatic requirements, administrative requirements in 15 CFR

Part 14 or Part 24 (as applicable), cost principles, and audit requirements.

Departmental regulations make this clear. "Unless sections of this part specifically exclude subrecipients from coverage, the provisions of this part shall be applied to subrecipients performing work under awards..." 15 CFR §14.5. *See also* 15 CFR Part 24, which often directly applies administrative requirements on both recipients and subrecipients, and which also specifies "flow down" requirements for subrecipients in §37.

The Department's Financial Assistance Standard Terms and Conditions (Oct. 1998) reiterate this point. Section J.01 specifies that recipients shall require all subrecipients to comply with the provisions of the award, including cost principles, administrative, and audit requirements. The Standard Terms further specify in §J.02 that recipients are required to encourage competition and impose standards of conduct on subrecipients.

Thus, the laws that apply to the recipient generally apply to a subrecipient. For example, if a program statute or regulation limits the term of the awards, the subrecipient's term is limited, too. If a program statute imposes unique intellectual property requirements on recipients, the limitation should flow down to the subrecipient.

In implementing subawards, recipients should be aware that cost principles applicable to subrecipients are based on the nature of the subrecipient, *e.g.*, nonprofit, university, or commercial organization. The same cost principles may not apply to the recipient. *See*

OMB Circular A-21, §A.3; OMB Circular A-122, §3.b, and OMB Circular A-87, §A.3.b.; <http://www.whitehouse.gov/OMB/grants/index.html>

For example, if a nonprofit recipient has a university for a subrecipient, A-122 applies to the nonprofit, and A-21 applies to the university. If, in contrast, the university is merely a contractor providing bookkeeping services for the nonprofit, the university should use nonprofit costs principles in conducting the bookkeeping. The university's actual costs would not be subject to cost principles, because its services are provided as a procurement, not as substantive work on the award.

Contractors

The requirements for contractors, in contrast, are minimal in comparison. They are merely vendors, and the prime requirement is that the recipient use a fair selection process. Administrative requirements, such as compliance with programmatic requirements, Federal cost principles, and the standards for financial management systems in 15 CFR Parts 14 and 24, are not applicable. The results are notably different. For example, employees ordinarily are not required to keep time sheets. Profit is allowable and indeed expected.

What requirements apply to contracting activities? The recipient is responsible for ensuring that it implements contracts fairly. Departmental regulations, 15 CFR §14.40-48 and 15 CFR §24.36, require recipients to settle issues arising out of contracts, to maintain codes of conduct government the award of contracts, to encourage free and open

competition for contracts, and to follow specified contracting procedures. Recipients must also document cost and price analysis, maintain procurement records, and implement a system for contract administration.

While all terms of an award generally “flow down” to subrecipients, the “flow down” to contractors is generally listed in the Department’s administrative regulations and Standard Terms. Departmental regulations require contracts under financial assistance awards to include a number of provisions listed at 15 CFR §14.48 and 15 CFR §24.36(i) (this includes, for example, provisions on small purchases, termination, bonds, and access to records).

Furthermore, 15 CFR Parts 14 and 24, Appendix A, include another list of provisions that must be included in all of a recipient’s contracts. These provisions relate to equal employment opportunity, “anti-kickback” activities in construction projects, certain construction labor laws, intellectual property, certain environmental laws, anti-lobbying requirements, and debarment and suspension requirements.

In addition, other laws may “flow down” when a recipient’s contracting activities fall under an applicable law. For example, human subjects research regulations, 15 CFR Part 27, apply to all human subjects research “supported” by Departmental funding, which has been interpreted to include procurements under financial assistance awards.

At audit, in most cases a recipient’s compliance responsibility for contractors is only to ensure that the procurement,

receipt, and payment for goods and services comply with laws, regulations, and the provisions of contracts or grant agreements. *See* OMB Circular A-133, §__.210(f). Program compliance requirements normally do not pass through to vendors. *Id.* The auditee is responsible for ensuring compliance for vendor transactions which are structured such that the vendor is responsible for program compliance or the vendor's records must be reviewed to determine program compliance. *Id.*

Subrecipients and Contractors

Some requirements flow down to both recipients and contractors. Section J.03 of the Department's Standard Terms specifies provisions that flow down to both (relating to suspension and debarment, anti-lobbying restrictions, minority and women-owned businesses, and involvement with other Federal agencies).

Conclusion

Careful review of the distinction between subrecipients and contractors, and the requirements applicable to each, will help your recipients pass this aspect of their audits smelling like a rose. Or a petunia. Either way, without thorns.

We hope you find the information presented in this edition of "It's the Law" useful. Please contact a Federal Assistance Law Division attorney assigned to your agency for further information or guidance. Call our main office at (202) 482-8035, or see FALD attorney assignments and contact information posted on our World Wide web site:

<http://www.ogc.doc.gov/ogc/fl/fedasst.html>