

BDO GOVERNMENT CONTRACTING PRACTICE

OFFICE OF MANAGEMENT AND BUDGET ISSUES THE “SUPERCIRCULAR”: UNIFORM GUIDANCE ON COST PRINCIPLES, AUDIT, AND ADMINISTRATIVE REQUIREMENTS FOR FEDERAL AWARDS

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The Federal government places many requirements on the entities that seek to receive government funding, whether through grants or by contract. For grant recipients, the landscape of regulatory requirements has historically been disparate and complex, with different rules propagated to govern the accounting and administrative functions for different categories of grant recipient. Now, change has come: On December 26, 2013, OMB issued an omnibus OMB circular – colloquially referred to as the “Supercircular” – which consolidates this constellation of regulations and seeks to provide consistent guidance for both the recipients and issuers of Federal grants.¹ With the advent of the Supercircular, grant recipients and administrators must carefully re-evaluate their grant practices in light of the new omnibus system to determine what has remained the same, and what has not.

The Supercircular contains multiple changes and consolidations, including:

- makes explicit in a single resource what requirements apply to all recipients, and which are uniquely needed to address specific needs, eliminating the requirement for grants professionals to cross-reference between multiple resources;
- includes new measures designed to ensure merit-based grant awards and identify problems early in the process;
- introduces new requirements for formal certification of grant submission;
- attempts to streamline and standardize the cost principles in many ways, including new options for the recovery of indirect costs.

In the long run, consistency, predictability and focus on quality are positive characteristics of any regulatory scheme. In the short term, however, the grants community is on the cusp of significant change.

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¹ Available at <http://www.gpo.gov/fdsys/pkg/FR-2013-12-26/pdf/2013-30465.pdf>.

I. Development of the Supercircular

The historical system of grant regulations was challenging for grant recipients and administrators alike. Hospitals were governed by a different set of cost principles than universities, and state and local agencies were subject to a third. The marketplace adapted by necessity to this balkanized, inconsistent training and compliance regime, as grant recipients trained their compliance professionals and other staff to their own particular stovepipe of rules and practices. Entities that met multiple definitions and government offices that administered multiple types of grants gained expertise over time in determining what requirements applied to which category. But when one requirement changed within one category, the process had to be reassessed, over and over again.

In 2009, President Obama issued Executive Order 13520, declaring a focus on reducing improper payments government-wide and eliminating waste and fraud in all government programs through better tracking of government spending and more transparency in the administration of government dollars.² As part of this effort, on January 18, 2011, the President issued Executive Order 13563, which directed all executive agencies to review their regulations, and determine if they were “tailor[ed] . . . to impose the least burden on society.”³ In an accompanying memorandum, the White House stated that “Executive Order 13563...requires retrospective analysis of existing significant rules and greater coordination across agencies to simplify and harmonize redundant, inconsistent, or overlapping requirements, thus reducing costs.”⁴

This policy led to many regulatory changes across the government, and OMB took action to reform several significant regulatory systems, including the mélange of approaches governing grants administration. On February 28, 2012, OMB took an initial step in this effort, publishing an Advance Notice of Proposed Guidance (ANPG) in the Federal Register. This ANPG first proposed the consolidation of cost accounting principles, but did not propose to consolidate the various administrative requirements unique to each category of recipient.

After a round of over 350 comments on this initial proposal, OMB issued the draft text of the Supercircular, currently designated as OMB-2013-0001-0002, on February 1, 2013.⁵ OMB also published a 15-page summary and discussion document in the Federal Register setting forth a history of the consolidation effort and discussing some of the critical changes proposed by OMB.⁶ Over 300 individuals and institutions submitted comments by the June 2, 2013 deadline.

The rule became effective December 26, 2013 and will be fully implemented by December 26, 2014. OMB will integrate the new rule into Title 2 of the Code of Federal Regulations.

II. Significant Features of the Supercircular

The Supercircular imposes common requirements for both administrative and accounting functions while consolidating and superseding two primary categories of documents.

First, three circulars previously defined the **administrative requirements** for grant applicants, recipients and administrators. Circular A-89 required all agencies administering “[F]ederally financed domestic assistance programs” to collect and submit information regarding these programs to the OMB. Circular A-102 offered grants management guidance for grants made to state and local entities, while Circular A-110 provided rules for grants with all non-governmental entities. The Supercircular supersedes all three of these documents and provides across-the-board deadlines and thresholds for notice requirements, small purchase limits and the like, as well as requiring new quality control and efficiency measures.

Second, the Supercircular consolidates the various documents setting forth the **cost principles** governing the use of Federal grant funds. Circular A-87 defined such requirements for state and local public agencies, including educational agencies, Circular A-21 applied to colleges, universities and other institutions of higher education, and Circular A-122 applied to nonprofit organizations not covered by the other circulars. In addition to these, hospitals receiving grant money were subject to cost principles issued by the Department of Health and Human Services (HHS). All of these entities must now refer to the consolidated terms of the Supercircular.

A. Reforms to Administrative Requirements (Circulars A-102, A-110, and A-89)

The overarching purpose of the administrative changes is simple. Much like the effort to eliminate the multiple competing agency fiefdoms that led to the development of the omnibus Federal Acquisition Regulations (FAR), the goal of the Supercircular is to complete the task of cross-referencing and simplifying the relevant regulations in order to present a complete system to the grants community. The general rules and the per-entity

2 Executive Order 13520, available at <http://www.whitehouse.gov/the-press-office/executive-order-reducing-improper-payments>.

3 Executive Order 13563, available at http://www.whitehouse.gov/sites/default/files/omb/inforeg/EO12866/EO13563_01182011.pdf.

4 February 28, 2011 Presidential Memorandum on Administrative Flexibility, Lower Costs, and Better Results for State, Local, and Tribal Governments.

5 Available at <http://www.regulations.gov/#!documentDetail;D=OMB-2013-0001-0002>.

6 78 FR 7282-7296.

exceptions are recited within a common framework of reference. Hundreds of pages of duplicative guidance across program areas have been boiled down and eliminated, and an administrator who wants to see how requirements differ between, say, states and universities, need only refer to the relevant topic section, without juggling four or five administrative and audit guidances to arrive at a guess.

The OMB specifically requested comments from the recipient community to identify areas where application of general regulations would be helpful or harmful and addressed these comments in issuing the final rule. In general, the commenters were in favor of distilling the existing disparate and confusing system, but each constituency had its own particular interest to protest, from small recipients arguing against onerous competition requirements for contract awards, to research institutions seeking flexibility for accounting for the costs of specialized equipment and facilities.

The Supercircular also standardizes various procedural aspects of grant application and solicitation. For example, the 2011 ANPG proposed to require agencies to provide 90 days' advance notice of grant opportunities. Various commenters observed that such notice was not always feasible in light of appropriations and acquisitions schedules.⁷ The Supercircular instead requires that all notices of funding opportunities be open for a minimum of 30 days, unless "exigent circumstances dictate otherwise, as determined by the head of the agency."⁸ This section also sets forth unified standards for funding information to be provided to GSA and included in funding opportunity announcements to help applicants prepare responsive submissions.⁹

Subpart C of the Supercircular includes sections not previously found in any of the OMB Administrative Requirements. Of note is Section §200.210, which requires all award notices to recipients to contain significant new details, including required terms and conditions,¹⁰ as well as "an indication of the timing and scope of expected performance by the non-Federal entity as related to the outcomes intended to be achieved by the program."¹¹ Additional requirements "may be" imposed against offerors or awardees with a history of failure to meet terms of grants or failure to meet grant objectives.¹² This, along with other more formal language regarding procurement standards, has led some in the grant community to be concerned that future assistance awards may be managed more like acquisition funding. Also of note is a new section of the guidance which makes explicit a non-Federal entity's responsibilities with regard to effective internal controls¹³.

Several specific issues relating to administration came under scrutiny by multiple commenters, and are worthy of particular note.

• Pre-Award Consideration of Merit and Financial Condition

The Supercircular introduces a new requirement for granting agencies to "design and execute a merit review process for applications" and disclose the criteria for that review.¹⁴ Prior to making an award, granting agencies "must have in place a framework for evaluating the risks posed by applicants before they receive Federal awards."¹⁵ The structure of the rule implies that the agency may wait to perform this evaluation until after it determines that an award is likely. In the draft rule, OMB explained this provision as an effort to ease administrative burden by requiring the merit/risk assessment only of "applications likely to be selected for funding."¹⁶ In effect, this creates a new category of grant applicants similar to the "competitive range" under FAR Part 15 procedures, whereby only a select group of offerors undergo additional, more time-consuming scrutiny.

Commenters were generally, and predictably, in favor of award to meritorious applicants. Some argued that the requirement for grantees to assess these factors for subgrantees represented an unworkable administrative burden, given the nature of their subgrantee population.¹⁷ Conversely, some commenters insisted that the new standard does not go far enough and offers the granting agency the discretion to ignore significant past failures to meet stated performance goals.¹⁸ Notably, these latter comments were not implemented, as §200.207 makes the imposition of special conditions upon previous poor performers optional.

• Subrecipient Monitoring and Management

In a similar vein, the Guidance places increased emphasis on assessing and monitoring subrecipients. While much of the language included here is not new, it is now collected and consolidated in a single place for the first time, with greater emphasis given. A number of larger recipient organizations had been hoping that the OMB would take this opportunity to clarify the distinction between a Federal agency approving the ability of a Prime Recipient to subgrant or contract out a portion of the award versus reviewing and approving the selection of an individual subrecipient and the terms and conditions of an individual subaward.¹⁹

7 78 Fed. Reg. 7285-7286.

8 Supercircular at §200.202(a)(3).

9 *Id.* at §200.202(b); 203.

10 *Id.* at §200.210(b).

11 *Id.* at §200.210(d).

12 *Id.* at §200.207.

13 *Id.* at §200.303.

14 *Id.* at § 200.204.

15 *Id.* at § 200.205(a).

16 78 Fed. Reg. 7285.

17 Comments of The Wistar Institute at 10 (arguing that merit evaluation of a research subgrantee would need to be too large in scale to be efficient).

18 Comments of The Brennan Center for Justice at NYU, at 2-3 (objecting to discretionary provisions in section § 200.205).

19 See for example comments of InsideNGO at 5.

• Procurement Standards

The Supercircular proposes to apply consistent procurement standards across all grant recipients. In essence, OMB has eliminated the less formal requirements previously set forth in A-110 governing non-state recipients and has applied the more stringent standards set forth in A-102 across the board. For some recipients, especially nonprofits or educational institutions, this may represent a significant increase in the administrative burden of awarding contracts to vendors essential for their grant operations. The Supercircular requires a formal, almost FAR-like process for ensuring competition, presumably to ensure the most efficient use of grant dollars.²⁰ However, numerous commenters pointed out that many recipients operate on shoestring budgets, and requiring new administrative procedures before permitting award of contracts would hamper their ability to spend grant funds on grant objectives.²¹ The draft Supercircular required new protest procedures for disappointed offerors for grant-funded contracts (i.e. subrecipients), but commenters objected to the significant administrative burden this represented for small recipients.²² In fact the draft rule required that grant recipients report *any* procurement dispute with subrecipients or contractors to the OMB. These procedures were eliminated in the final rule in response to feedback from commenters.²³

The Supercircular allows for what appears to be less stringent procurement methods for contracts under the Federal simplified acquisition threshold of \$150,000. The text states that “relatively simple and informal procurement methods” may be used in these small purchase procedures, but it still requires proof of competition by obtaining quotes from an “adequate” number of qualified sources.²⁶ One commenter specifically requested that the procurement provisions be clarified to only apply to grants over \$150,000, but the final rule did not add clarity to the draft language.²⁴

Also omitted from the final rule is the language currently found in 2 CFR 215.40, which states that “[n]o additional procurement standards or requirements shall be imposed by the Federal awarding agencies upon recipients, unless specifically required by Federal statute or executive order or approved by OMB.” A number of comments – especially from the NGO community – requested that this language be retained.

• Certification Requirements For Applicants

The issue of formal certification of grant submissions presents an interesting instance of the OMB’s reaction to commenters. The draft Supercircular required requestors and recipients to certify that their submissions to the government are for “appropriate purposes” within the scope of the grant.²⁵ The draft did not, however, require certification that all contents of a submission are “true and correct.” Several commenters from within the Federal government advocated for stronger certification requirements consistent with government anti-fraud statutes.²⁶ The DOJ’s Financial Fraud Enforcement Task Force stated plainly that “[c]ertification language is often the bedrock of successful Civil False Claims Act litigation and criminal fraud prosecutions.”²⁷ It appears that the views of these influential enforcement constituencies carried significant weight, as the OMB agreed with their comments and imposed a new explicit certification requirement upon all grant submissions.²⁸ Grant recipients have always been subject to the False Claims Act (FCA), but recipients must be aware that enforcement agencies are focused upon the grant community, and will interpret any intentional or reckless falsehood in a formally certified document to be a violation of the FCA.

B. Reforms to Cost and Audit Principles

The Supercircular aims to consolidate the cost principles in A-21, A-87 and A-122, with limited variations by entity type, as well as amend A-133 to incorporate changes to the audit provisions. For purposes of this article, we will focus on educational institutions and nonprofit organizations.²⁹ As it relates to selected items of cost, the final guidance provides recipients more opportunity for cost recovery. The guidance allows recipients to be reimbursed for the effort to collect improper payment recoveries or related activities. As such, the Federal recipient may consider these either indirect or direct costs. In addition, pass-through entities may charge Federal awards for the cost of agreed upon procedure engagements for sub recipient monitoring. The guidance does, however, provide allowability requirements for these types of costs.³⁰ The final guidance also includes the cost of certain computing devices as allowable direct cost supplies. This means entities can charge and treat computing devices not considered depreciable assets based on their capitalization policy as direct costs. Entities must follow practices for determining allocability of direct versus indirect costs to Federal awards for computing devices.

The new circular addresses cost principles in Subpart E. However, specific cost issues are addressed further in Appendix III for Educational Institutions and Appendix IV for Nonprofit Organizations. The primary result is that individual nuances remain intact and the substantial changes to drive consistency are more administrative in nature.

20 Supercircular at § 200.318, 319.

21 Comments of National Association of Community Health Centers, Inc. (“NACHC”) at 6.

22 See, e.g., Comments of Feldesman Tucker Leifer Fidell, LLP on behalf of the New Jersey Head Start Association (“NJHSA”) at 4 (“[T]he new bid protest provisions under (b)(12) should be deleted. Head Start programs simply cannot afford to devote staff time to conducting administrative appeals and the like as required by these provisions.”).

23 78 FR 78598.

24 Comments of NACHC at 6.

25 See, e.g., Draft Supercircular at 80, § 617(a).

26 Comments of Council of Inspectors General for Integrity and Efficiency at 13; Comments of DOJ OIG Financial Fraud Enforcement Task Force at 5-6.

27 *Id.*

28 Supercircular at § 200.415.

29 For purposes of our audience we have excluded A-87 cost principles.

30 Supercircular at § 200.425(c).

Of the changes to the cost principles, the most profound for both types of organizations will be the options available for calculating and negotiating indirect rates for non-Federal entities. Previously, organizations under the separate circulars were limited to calculating provisional and final rates similar to for-profit organizations. The Supercircular introduces several methods for streamlining the process and reduces the burden for the agency, as well. Recipients should be aware when selecting their method that award levels for Federal awards will not be adjusted throughout the "life" of the award due to changes in negotiated rates.³¹ Negotiated rates include final, fixed and predetermined rates. Outlined below are the aforementioned changes by entity type.

• **Negotiated Lump Sum for Indirect Costs**

Applicable to educational institutions only, this method may be used for self-contained, off-campus or primarily subcontracted activities where the benefits of the overall indirect activities cannot be determined. Any amounts included in grants or other agreements would be treated as an offset to the pool for the overall indirect rate calculation.³² This option may be especially useful for a university interested in expanding its research into new programs without necessarily implementing some of the administrative requirements related to indirect rate calculations. In lieu of detailed cost information, the educational institution can negotiate a fixed amount per agreement for indirect costs. The key to successful application of this option is being able to explain why the benefits from an institution's indirect services cannot be readily determined. This lump sum would apply to all grants issued by a Federal agency.

Based upon our experience with commercial contractors, the lump sum method may be a way to keep the financial benefits associated with increases in administrative efficiency under certain awards. Since the indirect costs allocated to these awards are fixed, any efficiency gained will be passed on to the institution. This method does not imply gamesmanship by the institution; rather, the fixed lump sum is assessed and negotiated as a reasonable quasi-price for the indirect services allocable to the grant, and the parties understand that the institution is entitled to the benefit of any efficiency. The converse is also true, however. If the actual and allocable indirect costs turn out to be higher than estimated and agreed, this difference cannot be considered for negotiating one of the options discussed hereafter or otherwise recovered. This option is a useful tool for new growth and can be successful pending accurate estimates and favorable negotiation.

• **Predetermined Rates for Indirect Costs**

Applicable to both educational and nonprofit organizations, the Supercircular now allows the use of multi-year agreements for predetermined rates for indirect costs. Notably, the guidance for Educational Institutions is much more specific, recommending that the agreement should be for a period of two to four years, and sufficient cost and budget experience should exist to allow for an informed decision. In Appendix IV for Nonprofit Organizations, the guidance is silent on specific timeframes and only states that reasonable information needs to exist to allow for a reliable projection.³³

Predetermined rates are a multi-year version of the process that exists for many organizations today and are different from fixed rates (discussed below). One advantage of the new guidance is the elimination of the need to calculate provisional rates. Instead, the rate would be predetermined for a set time period. When the actual rate is calculated, the over/underbilling will be reconciled as appropriate. This is a useful tool for well-established organizations that have static rates. However, it may be difficult for an organization experiencing rapid growth or entering new research fields to predict these changes going forward in a meaningful way.

• **Negotiated Fixed Rates and Carry-Forward Provisions**

Not to be confused with lump sum or predetermined rates, negotiated fixed rates allow an organization to calculate a fixed rate for one fiscal year or longer and apply an adjustment for over/underbilling to the next fixed price negotiation. This process must be agreed to by both parties, and any change to another method will need to be dealt with accordingly.³⁴ For example, any carry-forward amount would be included in the subsequent negotiated rate. This allows less administrative burden while reducing overrun risk to the organization. This method differs from lump sum accounting and predetermined rate methods in that, under those methods, any over- or underrun of the established sum or rate will accrue to the institution without subsequent adjustment.

• **Provisional and Final Indirect Rates**

A provisional rate is a temporary indirect rate applicable to a specified period pending the preparation of a final rate.³⁵ In a situation where the cognizant agency handling the indirect rate negotiation between the Federal government and the non-Federal entity cannot determine, based on cost experience, the use of a predetermined rate or fixed rate, a provisional indirect rate must be prepared. The guidance follows the method denoted in both A-21 and A-122 for negotiating rates between the non-Federal entity and the Federal agency.

³¹ Supercircular at Appendix III(c)(7).

³² Supercircular at Appendix III(c)(3).

³³ Supercircular at Appendix IV(c)(2)(d).

³⁴ Supercircular at Appendix III(c)(5).

³⁵ Supercircular at Appendix IV(c)(1)(e).

In addition to these different indirect rate recovery models, the final guidance now offers the possibility that any non-Federal entity that has never had a negotiated indirect cost rate may use a de minimis rate of 10 percent of modified total direct costs.³⁶

• Limitation on Reimbursement of Administrative Costs

Currently, and under the final guidance, *total* recovery of administrative costs from a full submission is capped at 26 percent.³⁷ Therefore, a non-Federal entity may not charge Federal awards in excess of 26 percent of Modified Total Direct Cost (MTDC) for general administration and general expenses, department administration, sponsored project administration and student administration.

• Alternative Method for Administrative Costs

Most organizations' chargeable administrative costs typically meet or exceed the cap detailed above. Educational institutions will be allowed to claim a 24 percent fixed administrative allowance MTDC or a portion equal to 95 percent of the most recently negotiated administrative cost pool.³⁸ This option may be very useful for many organizations, as it allows them to avoid the significant burden in staff and other costs of fully accounting for administrative indirect costs. Organizations will need to carefully assess the value of escaping this burden. Therefore, accepting the fixed rate of 24 percent means foregoing two percent of the recovery available for such costs via a full submission. Depending on the total volume of awards, organizations may find that the administrative burden of preparing a full submission exceeds the value of the two percent difference, making the fixed rate a winning proposition. The cost benefit analysis should be straightforward. If an organization's actual rate exceeds the current cap, two percent multiplied by the current volume of Federal awards will be the 'cost' of using the fixed rate. If this amount is less than the cost currently incurred in preparing a full submission, organizations should strongly consider taking advantage of the fixed rate.

• A-133 Audit Considerations

Generally, the A-133 requirements remain unchanged. The most favorable change is an increase to \$750,000 from \$500,000 in the dollar threshold for the A-133 audit.³⁹ However, organizations are still required to make records available for review or audit by appropriate officials of Federal agencies, pass-through entities and the Government Accountability Office. Organizations should also be aware of the level of oversight related to other provisions that would fall below the new threshold, including pre-award review of risks, standards for financial and program management, subrecipient monitoring and remedies for noncompliance.

C. Strategic Considerations

The final guidance provides flexibility and new options for the recovery of indirect costs. For recipients who strategically position themselves, these options may offer significant advantages. Higher education institutions and nonprofit organizations may now be able to use negotiated lump sums for indirect expenses, predetermined multiyear indirect rates, negotiated fixed rates with carry-forward provisions and even fixed rates by award.

For many recipients, the procurement standard changes represent an increase in the administrative burden of awarding contracts to fulfill grant program objectives. A robust and effective procurement process will be critical to address this challenge. Additionally, subrecipient monitoring and management will require increased staff oversight.

Federal agencies now have six months to prepare draft implementation regulations to OMB related to the final guidance. The final consolidated guidance will be effective for non-Federal entities in December 2014. Therefore, assessing which solutions work best for your organization now will help you to quickly incorporate this new approach into your estimating process.

36 Supercircular at §200.414 (f).

37 Supercircular at Appendix III(c)(8).

38 Supercircular at Appendix III(c)(9).

39 Supercircular at §200.501(a).