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## Subaward vs. Contract—Why Does it Matter?

By Daniel Buchtel

Award recipients often rely on services provided by outside experts or other entities to accomplish tasks under their awards. A third party working under a contract is commonly known as a contractor, while a party performing under a subaward is a subrecipient. Although people often use the terms “contract” and “subaward” interchangeably, the purposes of these agreements are not the same. This article will highlight requirements associated with subawards and ways to avoid audit findings resulting from misclassifying subawards as contracts.

### What’s the Difference Between a Subaward and a Contract?

The key distinction between a subaward and a contract is its purpose. A subaward allows a subrecipient to carry out a portion of the work required by a federal award. Under a subaward, the award recipient transfers its responsibility to perform part of the project to another party. In contrast, a contract is designed to provide goods or services for the recipient’s own use. For example, an agreement to purchase research supplies for the award recipient’s use is a contract. However, if the recipient transfers those supplies to a third party to use in conducting award-funded research, the third party is a subrecipient. The Office of Management and Budget (OMB) provides direction to recipients for distinguishing between contracts and subawards in 2 CFR §200.331. The regulation includes characteristics to consider in making this determination, but also recognizes some judgment will be necessary.

### What Can Happen if a Subaward is Misclassified as a Contract?

Subawards have more restrictions and requirements for the federal award recipient than contracts. Misclassifying a third-party agreement can result in violations of award requirements and questioned costs for the recipient. The following three examples highlight requirements associated with subawards and show how improper classification can result in audit findings:

- 1. Subawards require prior NSF approval.** NSF must approve entities who will be performing portions of activities required under awards. NSF reviews these entities during the initial proposal review process or when a subrecipient is identified after a project has started. If auditors review a contract and conclude, based on the nature of work performed, that it met the parameters of a subaward rather than a contract, they will report finding an unapproved subaward and may question all or a portion of the costs claimed by the recipient for the agreement.
- 2. Subawards require monitoring.** Prime recipients have a responsibility to ensure subrecipients follow the terms and conditions of the subaward and other requirements of the federal award. According to 2 CFR §200.332(d), recipients must “[m]onitor the activities of the subrecipient as necessary to ensure that the subaward is used for authorized purposes, in compliance with Federal statutes, regulations, and the terms and conditions of the subaward; and that subaward

performance goals are achieved.” Neglecting to identify an agreement as a subaward and implement corresponding monitoring procedures can result in questioned costs and/or internal control findings for the award recipient.

- 3. Indirect cost recoveries on subawards are limited.** In general, federally negotiated indirect cost rates only allow recipients to recover indirect costs on the first \$25,000 of each subaward. There is no similar limitation on costs charged by contractors. If an agreement that exceeded \$25,000 was improperly classified as a contract and indirect costs were recovered on the full agreement amount, auditors will question the amount recovered on the portion of the agreement that exceeded \$25,000.

The funding agency official designated in your award agreement can help you with questions regarding proper classification of a planned agreement.

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