



USAID
FROM THE AMERICAN PEOPLE

Profit Under USAID Assistance Instruments

An Additional Help Document for ADS Chapter 303

Full Revision Date: 07/22/2015
Responsible Office: M/OAA/P
File Name: 303sai_072215

I. PURPOSE

The purpose of this additional help document is to provide the Agreement Officer (AO) and the Agreement Officer's Representative (AOR) with guidance on the rules governing profit under Federal assistance. [2 CFR 200](#), Subpart E, Cost Principles, prohibits profit to recipients and subrecipients of assistance awards. While profit is not allowed for subawards, the prohibition does not apply when a recipient obtains goods and services for the recipient's own use and the award creates a procurement relationship with the contractor.

II. PROHIBITION AGAINST PROFIT

a. Regulatory Prohibition Against Profit. Profit is any amount over and above allowable direct and indirect costs. The Uniform Administrative Requirements, Cost Principles and Audit Requirements, states "The non-Federal entity may not earn or keep any profit resulting from Federal financial assistance, unless expressly authorized by the terms and conditions of the Federal award" ([2 CFR 200.400\(g\)](#)). USAID's Uniform Administrative Requirements, Cost Principles and Audit Requirements ([2 CFR 700](#)) specifically excludes profit under USAID assistance agreements for recipients and subrecipients that are commercial organizations ([2 CFR 700.13](#)).

b. Application of the Prohibition Against Profit to Subawards. The prohibition against profit in [2 CFR 200](#) applies to subawards. [2 CFR 200.101\(b\)\(1\)](#) states that the terms and conditions of Federal awards flow down to subawards to subrecipients unless a particular section of this part or the terms and conditions of the Federal award specifically indicate otherwise. This means that non-Federal entities must comply with requirements in this part regardless of whether the non-Federal entity is a recipient or subrecipient of a Federal award. For-profit (commercial) entities are also subject to this prohibition when performing under a subaward of USAID assistance ([2 CFR 700](#)).

c. Procurements are Excluded from the Prohibition Against Profit. The prohibition against profit does not apply to contracts (procurements) made under the assistance instrument when the recipient procures goods and services for the recipient's own use in carrying out its program and the award creates a procurement relationship with the contractor. Such contracts must follow the Procurement Standards found in [2 CFR 200.317 through 326](#). The recipient may pay a fair and reasonable profit to contractors providing it with goods or services ([2 CFR 200.323\(b\)](#)).

III. USE OF ACCURATE TERMINOLOGY

There are two types of awards that a recipient may make under an assistance agreement:

Text highlighted in yellow indicates that the material is new or substantively revised.

- A contract issued to a contractor, and
- A subaward issued to a subrecipient.

While the term “subaward” is sometimes used to apply to any award made by the recipient, in this context it is used specifically to refer to a subtier assistance award, not a procurement or an acquisition. The proper term for a procurement or acquisition under an assistance award is a contract. The term “subcontract” is sometimes used instead of “contract” and the term “subcontractor” is sometimes used instead of “contractor” when referring to contracts under assistance awards. A “subcontractor” is a party that provides goods or services to a contractor through a subcontract; a contractor provides supplies or services to a recipient. Since the terms and conditions of the prime Federal award flow down to subawards and subrecipients, the use of subcontract is ambiguous and obscures the relationship between the recipient and subrecipient. AOs and AORs must use the proper terminology to avoid confusion. AOs should also note that a subaward includes financial assistance provided by any legal agreement, even when that legal agreement is called a contract ([2 CFR 200.92](#)). This means that labeling an organization as a subrecipient or contractor in an agreement is not sufficient to meet the definition of one type of relationship or the other.

IV. RESPONSIBILITY FOR CLASSIFYING SUBTIER RELATIONSHIPS AS EITHER A CONTRACT OR A SUBAWARD.

a. Recipients are primarily responsible for determining whether subtier awards are contracts or subawards in accordance with the guidance in [2 CFR 2.330](#) states in part, “...a pass-through entity must make case-by-case determinations whether each agreement it makes for the disbursement of Federal program funds casts the party receiving the funds in the role of a subrecipient or a contractor. ...” While recipients should follow their own procedures, they must ensure that those procedures are consistent with [2 CFR 200](#). Agencies hold recipients accountable for flowing the appropriate requirements down to subrecipients or contractors. While all the terms of a financial assistance award generally apply to subrecipients, the flow down to contractors is more limited. However, some requirements such as USAID’s Source and Nationality requirements apply when a recipient or subrecipient makes a procurement, but not a subaward. Failure to properly distinguish between contracts and subawards could result in inappropriate flow down of requirements to subrecipients and contractors. This could subject the recipient to increased audit risk, particularly if they incorrectly classify a subaward as a contract and pay profit under the award.

b. Agreement Officer

Preaward stage: The AO and the merit review team should consider the nature of the subtier relationships being proposed and confirm that they are appropriately classified and are consistent with the technical and cost application. AOs should be particularly cautious when the recipient proposes a “partnering arrangement” with an organization that would receive profit under the assistance award. For the reasons discussed below, such a relationship is generally characteristic of a

Text highlighted in yellow indicates that the material is new or substantively revised.

subaward, not a procurement. AOs and the merit review team should also closely examine the nature of the relationship when a recipient proposes an award to a subtier organization that comprises a significant portion of the total award. If a recipient is proposing a subaward for which they propose to pay profit or misclassify a subaward as procurement, the AO should address this issue with the potential recipient prior to award.

The negotiator or AO should also review the proposed amount of subawards and contracts to determine how much of the program will be carried out by a third party and if the budget proposed reflects the programmatic approach. Implementation and administration should then follow the recipient's budget and programmatic approach.

The AO should also consider the amount of subawards and procurements in the applicant's budget. If the majority of the applicant's budget consists of procurements, this may indicate that assistance as USAID's original choice of instrument may not be appropriate.

Postaward: In accordance with [2 CFR 200.308\(c\)\(6\)](#), the AO is responsible for the prior approval of the subaward, transfer, or contracting out of any work under the award. Prior to giving such approval, the AO should consider the classification of the award as this has significant impact on the requirements that flow down and will determine whether profit is allowable. Additionally, the AO is responsible for making the management decision for any questioned costs, including any audit findings related to payment of profit under a subaward. The AO is not required to approve procurement contracts for the acquisition of supplies, material, equipment or general support services.

V. **DISTINGUISHING A CONTRACT FROM A SUBAWARD.**

a. **2 CFR 200 Guidance.**

[2 CFR 200](#) defines both contract and subaward:

A contract is “a legal instrument by which a non- Federal entity purchases property or services needed to carry out the project or program under a Federal award. The term as used in this part does not include a legal instrument, even if the non- Federal entity considers it a contract, when the substance of the transaction meets the definition of a Federal award or subaward.”

A subaward is “an award provided by a pass-through entity to a subrecipient for the subrecipient to carry out part of a Federal award received by the pass-through entity. It does not include payments to a contractor or payments to an individual that is a beneficiary of a Federal program. A subaward may be provided through any form of legal agreement, including an agreement that the pass-through entity considers a contract.”

Text highlighted in yellow indicates that the material is new or substantively revised.

[2 CFR 200](#) also defines the non-Federal entity making the subaward and the non-Federal entity receiving the subaward:

A pass-through entity is “a non-Federal entity that provides a subaward to a subrecipient to carry out part of a Federal program.”

A subrecipient is “a non-Federal entity that receives a subaward from a pass-through entity to carry out part of a Federal program; but does not include an individual that is a beneficiary of such program. A subrecipient may also be a recipient of other Federal awards directly from a Federal awarding agency.”

[2 CFR 200.330](#) provides guidance to recipients on distinguishing between a subrecipient and a contractor. As a practical matter, it is sometimes difficult to tell whether an activity involves work on the project or provision of a service for the project. Because the nature of the relationship between the parties is fact specific, each situation needs to be evaluated on a case-by-case basis.

An organization, either for-profit or nonprofit, may be either a contractor or a subrecipient depending on the nature of the work they will perform under the award and the nature of the relationship with the recipient. Indications that an organization is a subrecipient include if it:

- Determines who is eligible to receive what Federal financial assistance;
- Has its performance measured against whether the objectives of the Federal program are met;
- Has responsibility for programmatic decision making;
- Has responsibility for adherence to applicable Federal program compliance requirements; and
- Uses the 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.

Indications that an organization is a contractor include if it:

- Provides the goods and services within normal business operations;
- Provides similar goods or services to many different purchasers;
- Operates in a competitive environment;
- Provides goods or services that are ancillary to the operation of the Federal program; and
- Is not subject to compliance requirements of the Federal program.

Text highlighted in yellow indicates that the material is new or substantively revised.

Each indicative characteristic may not be present in every action so individual judgment will be necessary in understanding whether an entity is a subrecipient or a contractor. A few of the key indicators are examined below, but many of the indicators interrelate and each situation must be viewed in its entirety.

b. Programmatic Decision Making. A key indicator in understanding the nature of the relationship is whether the subtier organization will be managing a portion of the program and making decisions related to it. For example, a recipient who receives a grant or cooperative agreement for an educational program may have building schools as an element of that program. If the recipient establishes a subtier relationship with another organization and arranges for them to build a number of schools in specific locations to a particular specification, the relationship would likely be characterized as one of procurement from a contractor. However, if the recipient establishes a relationship with a subtier organization that gives that organization responsibility for determining how many schools, in what locations and of what design to be built, this would be more characteristic of a subaward as they have essentially given the subtier organization the decision making responsibility for that portion of the program.

A subtier organization that provides key personnel, particularly the Chief of Party, would also be participating in the programmatic decision making and management. A subtier award of this nature would be characteristic of a subaward.

c. Carrying Out the Program vs. Providing Goods and Services. Another key indicator in determining whether a relationship is a procurement rather than a subaward, is whether the subtier organization is providing services to the program's operation rather than carrying out part of the program itself.

Determining whether the goods or services are involves consideration of the nature and extent of the activity being passed on to a subtier organization for performance.

Consider the example of a competitive RFA for a five year Education program with a total estimated value of \$10 million for award of a cooperative agreement. The RFA states that USAID desires to support higher education curriculum development activities. It is known that various universities as well as other organizations undertake such activities under their own programs. The RFA also noted that the quality of existing curriculum in higher education institutions in the country was unclear and might vary among the different local education institutions. The leading applicant clearly responded with a superior program as evidenced by merit review team. In their application, they also proposed a "subaward" with a for-profit small business for \$750,000 to undertake an initial baseline assessment, a mid-point review (2.5 years into the program), and a final assessment (last year of the program) of goals achieved compared to the initial baseline. The small business has specific expertise in conducting baseline assessments, and has awards on GSA schedules for similar services. You see in the applicant's cost proposal that the small business subcontractor also proposed a profit of 5% in their budget. Although labelled as a "subaward," the small business's relationship with the recipient is that of a contractor. The recipient

Text highlighted in yellow indicates that the material is new or substantively revised.

intends to acquire from the small business services for the recipient's own use and the award creates a procurement relationship with the contractor. As a contractor, the small business is entitled to a reasonable profit.

Other examples of services for the recipient's own use include janitorial or printing services, discrete data gathering, review and analysis of specific conditions, or providing specific training to "oversight" groups. In each case the recipient has stated segregable tasks that assist in performing the program that will result in a contract relationship.

Partitioning the program into smaller parts does not necessarily create a contractual relationship between the recipient and the subtier awardee. In each case the nature of the relationship and the responsibilities and role of both recipient and subtier awarded must be considered. In the same example, if the recipient for the program intends to make an award to a subtier organization for implementation of the program in one of the countries covered under the award, the subrecipient would be carrying out part of the program, not providing services. The subrecipient's activities and tasks retain their program that retains its programmatic nature, and the relationship is that of a pass through entity and subrecipient.

While there is no specific dollar threshold that indicates whether a subtier relationship is a subaward or procurement, an award to a subtier organization that comprises a significant amount of the total assistance award should be closely examined. The large value of an award made by the recipient is a possible indicator that the recipient is acquiring goods or services for its own use but is acting as a pass through entity to a subrecipient. The large value of an award may also indicate that the original choice of instrument was incorrect.

Regardless, one indicator alone is not necessarily sufficient to determine whether the nature of the relationship is a procurement or subaward, and examining the indicators in 2 CFR 200 is necessary.

d. Procurement Standards and Competition. Another important distinction between procurement contracts and subawards under an assistance award is that the recipient is responsible for ensuring that it implements procurements fairly and conducts all procurement transactions in a manner that provides, to the maximum extent practical, open and free competition. [2 CFR 200.317 to 326](#) requires recipients to settle issues arising out of contracts, to maintain codes of conduct governing 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. If a subtier award is classified as procurement, the recipient should follow the procurement standards and use competition to the greatest extent possible in its award. Failure to do so is an indication to the AO that either the award to the subtier organization is not procurement or that there is a potential problem with the recipient's procurement procedures.

e. Small Business Considerations. When the recipient is awarding a contract for
Text highlighted in yellow indicates that the material is new or substantively revised.

goods or services, [2 CFR 200.321](#) requires that the Non-Federal entity take all necessary affirmative steps to assure that minority businesses, women's business enterprises, and labor surplus area firms are used when possible. Use of these affirmative steps is a positive indicator that the recipient intends a procurement relationship with a contractor.

These steps must include

- Placing qualified small and minority businesses and women's business enterprises on solicitation lists
- Assuring that small and minority businesses, and women's business enterprises are solicited whenever they are potential sources
- Dividing total requirements, when economically feasible, into smaller tasks or quantities to permit maximum participation by small and minority businesses, and women's business enterprises
- Establishing delivery schedules, where the requirement permits, which encourage participation by small and minority businesses, and women's business enterprises
- Using the services and assistance, as appropriate, of such organizations as the Small Business Administration and the Minority Business Development Agency of the Department of Commerce,
- Requiring the prime contractor, if subcontracts are to be let, to take the same affirmative steps as above,
- Making information on available and arranging time frames to encourage and facilitate participation by small businesses, minority-owned firms, and women's business enterprises ([2 CFR 700.11](#)), and
- Providing a description and quantity of the goods or services, the closing date and an address where the solicitation can be obtained to the Office of Small Disadvantaged Business Utilization (OSDBU), USAID Washington, DC 20523, at least 45 days prior to placing an order or contract exceeding the simplified acquisition threshold ([2 CFR 700.11](#)).

e. “Partnering” Arrangements. Recipients sometimes enter into what they describe as “partnering” arrangements with another organization. While there is no definition of “partnering” in [2 CFR 200](#), the term’s use suggests that the partner organization will share in the implementation and decision making for the program and that the “partner” was selected prior to the award through a non- competitive process. Regardless of the name used to describe such a relationship, under these circumstances, the relationship would be appropriately described, using the indicators in [2 CFR 200](#), as a subaward, not procurement.

Text highlighted in yellow indicates that the material is new or substantively revised.

Regardless of the use the term partner, recipients acting as pass-through entities must “ensure that every subaward is clearly identified to the subrecipient as a subaward.”

VI. SUMMARY

The determination of whether awards to a subtier organization are procurements or subawards has a significant impact on what requirements flow down and whether profit at the subtier level is allowable. In this determination, the substance of the relationship is more important than the form. “Substance” refers to the characteristics of the arrangement and whether those characteristics are more indicative of a subrecipient or contractor relationship as compared to “Form” which refers to the type of mechanism used. The recipient, not the AO, is primarily responsible for making this determination. AOs should be aware of the indicators of subrecipient and contractor relationships with the recipient, and that payment of profit under subawards is prohibited. While there is no profit allowed under subawards, when an award to a subtier organization is properly classified as procurement, the prohibition against profit does not apply.

303sai_072215