Program Income – An Interesting Topic in Grants Management

by Winifred A. Schumi

How do you determine if a project has generated program income? What procedures must the institution follow to insure that the sponsor regulations are followed? Is your policy up-to-date?

As grants management administrators, you should be aware of sponsored projects that have the potential for generating program income. Thinking that you do not have to be concerned with program income, probably means that you do. In any case, program income is an issue that is best to address up front, rather than to have sponsors or auditors find after the fact.

Program income is not a black and white topic. There are plenty of gray areas that present opportunities for interpretation. It is important to take the time to ask questions, to communicate with faculty, technology transfer professionals and sponsors and to include a section on program income in your grants management education program.

In the early1990s, the University of Minnesota (UMN) experienced a serious situation that heightened our awareness of program income-related issues and problems. This led us to revise our policies and procedures about program income. In doing so, we not only clearly defined the roles and responsibilities of principal investigators and other university administrators but we also communicated all of this information to everyone involved in grants management.

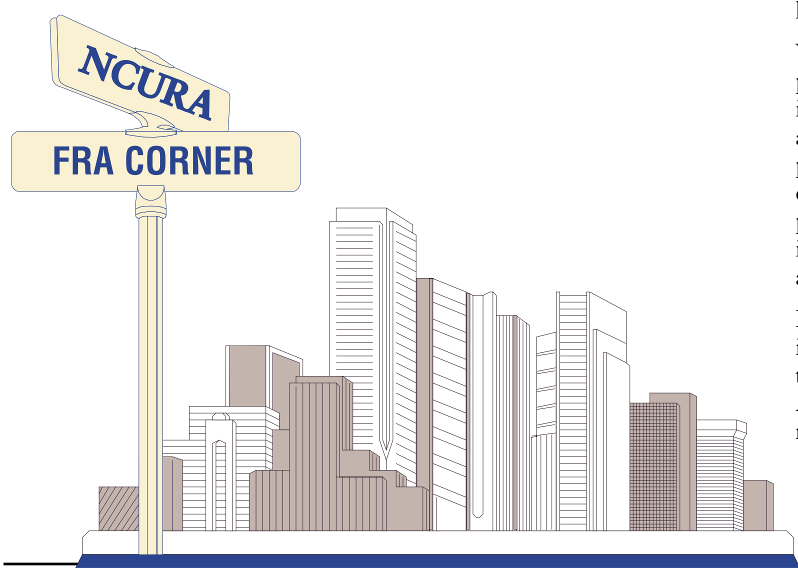
What is program income?

The definition of program income, according to OMB Circular A110 and 45 CFR, Part 74, is the following:

Gross income earned by the University that is directly generated by a sponsored activity or earned as a result of an award.

Examples of program income include:

- Fees for services performed, such as laboratory tests.
- Money from the use, sale, or rental of equipment purchased with project funds.
- Sale of supplies or equipment purchased or fabricated with project funds.
- Sale of software, tapes or publications.
- Sale of research materials, such as animal models or reagents.
- Fees from participants at conference or symposia.
- Royalties from patents and copyrights.



Exclusions from program income are the following:

- Patient care credits.
- Interest earned on advances of federal funds.
- Receipt of principal on loans, credits, discounts, etc. or interest earned on them.
- Taxes, special assessments, levies and fines raised by government recipients.

In sum, program income funds are those earned while a sponsored project is active. If a product or service is developed during the course of a sponsored project and the development of that product or service was funded by a sponsoring agency, then the net income received is considered program income.

Reportable versus Non-reportable Program Income

Program income comes in two flavors – reportable and non-reportable. This distinction is usually specified by the terms and conditions of the award agreement but can still present interpretation challenges. For example, royalties from patents and copyrights are considered program income, but most award agreements do not require them to be reported as program income to the sponsor. However, most institutions' technology transfer offices report royalties according to Bayh-Dole Act requirements. The basic message is that all program income should be reported to the institution's financial accounting office, but not all program income needs to be reported to the sponsor.

Policy and Procedures

Since UMN was reviewed by NIH, there were a number of important issues that were incorporated into the UMN program income policy. I would recommend that these issues be considered in the development of any institutional program income policy: 1) a clear definition of program income, including specific citations from the regulations; 2) a specific statement regarding the requirements to report program income, and 3) a clear statement regarding roles and responsibilities.

At UMN we also determined that it was necessary to lay out specific procedures for handling program income at all stages in the grants management process - at proposal time, during the course of a project, and at final termination or closeout. As a result, we developed specific procedures to follow, prepared a flow chart to describe the process, provided forms for staff to use when handling program income, and highlighted detailed specific responsibilities for principal investigators about processing program income. These procedures can be found at http://www.research.umn.edu/regulations/.

We found that asking about anticipated program income on internal proposal routing forms raised the awareness of both principal investigators and administrators to its potential. In fact, NIH requires applicants to indicate, on the PHS 398 application form, whether program income might result from their projects. However, the opportunity to accrue program income often arises in the middle of a project and is not readily apparent at the beginning. It is therefore important that you widely communicate your program income policy and procedures amongst institutional faculty and staff.

Funding agencies use several alternative methods to handle program income. Federal award notices usually specify which alternative applies to a particular program. The alternatives are: Addition, Deduction, Add/Deduct, and Matching. NIH programs generally use the Addition method, unless an award notice specifies an exception.

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The following example illustrates how these different alternative methods can be applied:

A sponsor awards $100,000 for a project. The project generates an income of $30,000.

- Addition: The total project cost could be $130,000. The additional funds should be kept in a separate account and would need to be reported to the sponsor.
- Deduction: The sponsor will now only fund $70,000 of the project's costs. The sponsor will deduct the amount of program income from the total amount reimbursed.
- Add/deduct: If the sponsor limit is $25,000, then $25,000 can be added to the total project cost, and $5,000 will be deducted from the sponsor's payment to reduce it to $95,000. The total amount available is $125,000.
- Matching: If the University were required to supply matching funds in the amount of $50,000, the University would now have to provide $20,000, using the $30,000 in program income as part of the match. Sponsor would still pay $100,000.

If this $30,000 is non-reportable program income, it should still be tracked in the financial system as program income, but should not be reported on any final financial report to the sponsoring agency. Also remain cognizant that program income funds should be spent before additional payments are requested from the sponsor.

Is it an external sale?

When a 'product or service' is developed using funds from the sponsor and the opportunity for a sale exists, consider when the sale will occur. Remember that if the sale occurs during the course of the project, the net income could be considered program income. However, since sales may extend beyond the life of the grant, a number of issues should be considered early in the process. Make sure that the product or service is priced to meet the actual cost of production. The sales agreement should address warranty/indemnity issues and the applicability of sales tax should be considered. And perhaps most important, communicate and coordinate your activities with the External Sales office in your institution.

Lessons learned to promote best practices

Remember to keep in mind the following to promote best practices:

- Recognizing and determining program income is not easy.
- Determining whether a project will generate program income depends on self-disclosure by the principal investigator, either at the time of the proposal submission or during the course of the project.
- Review sponsor regulations to understand the following: Which alternative method will they apply if program income occurs? What happens when the grant ends? Federal sponsors generally treat royalty income as non-reportable but be sure to check the terms and conditions of each award so you are clear on the requirements. Some sponsors may have reach forward rights.
- Clearly delineate in policy and procedures what steps to follow at each point in the grants management process.
- Consult the External Sales Office early in the process for advice on pricing and tax implications
- Consult the Technology Transfer Office to discuss and clarify whether it is program income or royalty income and how to proceed in either situation.
- Develop an institutional compliance plan for monitoring.
- Treat all program income consistently in your accounting system. Deposit program income directly to the central financial administration office, not departmental coffers.
- Be alert to sponsor regulations, both federal and non-federal. For example, if an agreement does not specify how to handle program income, UMN considers it non-reportable and handles it as an external sale. However, it is important to carefully review each agreement. We have noticed that some non-federal sponsors are incorporating specifications for handling program income into their agreements.
- Communicate your institutional policy and procedures widely.
- Educate principal investigators and administrators about the issues related to program income.

Conclusion

Program income is a complex topic. It is critical that your institution remains aware of the potential issues and risks associated with the generation of program income from sponsored projects. Having a well-defined program income policy and the process to effectively communicate and educate your principal investigators and institutional administrators to the policy is paramount. The University of Minnesota can bear witness that this is an area where you want to be ahead of the game. You do not want to find out that your institution had a major program income issue unbeknownst to you and now owes the federal government lots of money.

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