Authority: 20 U.S.C. 1221e–3, 1234–1234i, 3474, unless otherwise noted.

2. Section 81.32 is amended by revising the heading and by adding new paragraphs (c), (d) and (e) to read as follows:

# §81.32 Proportionality; equitable offset.

(c) In determining the extent to which a violation that is not intentional or willful caused harm to an identifiable Federal interest, the Secretary or an authorized Department official, as appropriate, may take into account costs that could have been charged to the Federal grant or cooperative agreement but in fact were not (offset costs), only if the recipient has demonstrated that—

(1) The offset costs would have met all the requirements of the grant or cooperative agreement, including any applicable recordkeeping requirements;

(2) The offset costs could have been charged to the grant or cooperative agreement during the same Federal fiscal year as the original violation;

(3) The charging of offset costs to the grant or cooperative agreement would not result in other violations of applicable requirements, such as maintenance of effort, matching, or nonsupplanting;

(4) The practices and policies that resulted in the original violation have been corrected and are not likely to recur; and

(5) (i) If the recipient was apprised of the violation in a draft audit report or other written communication from the cognizant auditor that was issued prior to the final audit report—

(A) The offset costs were presented to the auditor within 60 days after the issuance of the draft audit report or other written communication; and

(B) The auditor verified that the costs met the conditions in paragraph (c) of this section;

(ii) If the recipient was first apprised in writing of the violation in the final audit report or the costs were timely presented to but not verified by the auditor, the offset costs were presented to the authorized Department official, in the form of facts demonstrating compliance with this paragraph and verified by an independent auditor, within 60 days of the issuance of the final audit report; or

(iii) If the recipient was first apprised of the violation in writing after the issuance of the final audit report, the offset costs were presented to the authorized Department official, in the form of facts demonstrating compliance with this paragraph and verified by an independent auditor, within 60 days of the first written notice of the violation; (d) In making a verification under paragraph (c)(5) of this section, the independent auditor may be the auditor that initially conducted the audit and may base the verification on the original audit as long as the offset costs were examined as part of that audit and were not disallowed.

(e) For the purposes of § 81.32(c)(1), in the case of a discretionary program under which awards are made by the Secretary, "grant" or "cooperative agreement" means the grant or cooperative agreement awarded to the recipient.

3. Section 81.40 is amended by redesignating paragraphs (d) and (e) as (e) and (f), respectively, and by adding a new paragraph (d) to read as follows:

### §81.40 Burden of proof.

(d) An offset cost should be taken into account in accordance with § 81.32 (c) and (d), except that the Secretary has the burden of initially establishing a prima facie case that a violation was willful or intentional so as to preclude an offset.

4. The Appendix to Part 81 is amended by adding new Examples 14, 15, 16, 17, and 18 to read as follows:

## Appendix to Part 81—Illustrations of Proportionality

\* \* \* \* \*

#### Equitable Offset Allowed

(14) Administrative costs of a State educational agency (SEA) are disallowed by the auditor under a program subject to a non-supplanting requirement because the SEA did not maintain adequate time distribution records for employees charged to the grant. The SEA demonstrates that other employees, whose salaries are paid for out of State funds, performed administrative functions allowable under the Federal grant during the relevant fiscal period. Adequate records, including any necessary time distribution records, were maintained for these employees. Charging these costs to the grant would not violate other requirements. The nonsupplanting requirement does not bar the offset because it is presumed that the State funds would not have been spent in the absence of the program. The SEA presents a corrective action plan to ensure that future recordkeeping violations will not arise. There is no evidence that the SEA intentionally failed to keep the required records. The Secretary recognizes the offset costs under the principles stated in §81.32 (c) and (d) and reduces the required

recovery by the amount of the offset costs.

Equitable Offset Not Allowed—Violation of Program Requirement

(15) Under the Title I program, a LEA provides remedial reading services to children residing in ineligible attendance areas. The LEA proposes to offset the disallowed costs with funds expended for eligible Title I children under a State compensatory education program similar to Title I but not excluded from the operation of the nonsupplanting requirement in Title I under section 1120A(b) of the Title I statute. Even though the costs of the State program would otherwise have been allowable under Title I, an offset is not allowed because the use of the State funds would violate the nonsupplanting requirement.

#### Equitable Offset Not Allowed

(16) Under a Federal vocational education program with a maintenance of effort requirement, the SEA fails to maintain required time distribution records for employees working on more than one program. The State proposes to use as offset costs the salaries of other employees, charged to State funds, who worked exclusively on the Federal program. If all those costs are not included as State expenditures, however, the SEA would not have sufficient State expenditures to satisfy the maintenance of effort requirement under the Federal program. An offset is not allowed, because the charging of the offset costs to the Federal grant would have resulted in another violation of an applicable program requirement (maintenance of effort).

#### Equitable Offset Partially Allowed

(17) In this example the State needs some but not all of its proposed offset costs to satisfy the matching requirement applicable to the program. The State may use the remaining offset costs (i.e., those not needed to meet the matching requirement) to reduce its liability. For example, under a program with a 1:1 matching requirement (\$1 of State funds must be spent for every \$1 of Federal funds), the State has spent \$100,000 of Federal funds and \$100,000 of State funds. However, the auditors have determined that \$20,000 of the Federal funds were not supported by required time distribution records. The State could not fully extinguish its liability through an offset, because the State would not meet the matching requirement. (If \$20,000 of State funds were used as an offset, the State would have left only \$80,000 of allowable matching costs which would not

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