STRENGTH IN NUMBERS

BUILDING THE CASE FOR FULL-COST FUNDING FROM STATE AND LOCAL GOVERNMENT

AMBASSADOR INSIGHTS

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LEAP OF REASON
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Executive Summary

The nonprofit sector has long suffered under funders' insufficient reimbursement of indirect costs. The OMB Federal Guidance in 2014 improved this situation by requiring that federal grants and contracts—whether direct or passed through states or other entities—offer three options for indirect cost reimbursement: 1) nonprofits keep a federally negotiated indirect cost rate (NICRA); 2) nonprofits negotiate a rate directly with the state or local government; or 3) those without a NICRA or desire to negotiate get 10% de minimis.

In the case of pass-through funding, OMB Federal Guidance is often not followed. Nonprofits need the law to be followed in pass-through funding, just like in direct federal funding. Nonprofits also need improvements in the reimbursement of indirect costs in state and local grants and contracts.

Insufficient reimbursement of indirect costs undermines nonprofits' financial stability and restricts their effectiveness. The fair solution is to provide full-cost funding (i.e., reimbursement of the full costs of services). Coalitions of nonprofits in Illinois, Maryland, New York City, and Washington, DC, have successfully advocated for state and local government agencies to follow the OMB guidance in pass-through federal funding and apply the same guidance to their direct grants and contracts.

Based on the experiences of **Jeremy Kohomban** in New York City and **Lori Kaplan** in Washington, DC, and with the input of other Leap Ambassadors, this document offers tips for leaders on making the case for advocacy to board and staff, convincing fellow CEOs to join the advocacy effort, recruiting philanthropic allies, and explaining the problem—and what to do about it—to government officials. Appendices include links to calculating full costs, advocacy resources, and passed legislation, as well as examples of testimonies, and a fact sheet from Washington, DC.

Introduction

Years ago, **Lori Kaplan**, then-CEO of the Latin American Youth Center, calculated that she had to raise $500,000 annually to cover indirect costs incurred—but not covered—by government contracts. The organization had about 25 government contracts, all allowing different—and insufficient—indirect-cost rates. With government funds making up approximately 65% of the organization's ~$18 million budget, the amount of money Kaplan had to raise to cover the deficit was threatening the organization's financial stability to the point that the board wanted to stop taking government grants that didn't cover the full costs of services.

The idea that all funding should go directly to programs—and that paying for "overhead" is wasteful—is deeply ingrained in public attitudes. While the nonprofit world has tried for years to change the paradigm, most funders still refuse to pay the full cost of services delivered by the nonprofit sector. In recent years—including during the COVID-19 pandemic—there have been positive signs in the foundation world. Foundation grants, however, account for only 2.9% of nonprofit funding. For the sake of survival and sustainability, nonprofits need changes in government grants and contracts, which account for 31.8% of their funding.

One positive development in government came in 2014, when the federal government issued uniform—and fairer—guidance for indirect-cost reimbursement. However, many states and localities have refused to follow the federal guidance and continue to starve the nonprofit sector of required, and often legally mandated, indirect rates. Below, ambassadors provide suggestions, based on experiences in New York City and Washington, DC, for advocacy efforts that could lead to full reimbursement of indirect costs from state and local governments. We believe successful advocacy for indirect reimbursement could be key to survival for many nonprofits in these hard times.

A Jumping-Off Point: OMB Uniform Guidance

In recent years, Illinois, Maryland, New York City, and Washington, DC, have taken steps to follow Office of Management and Budget (OMB) Guidance on indirect-cost reimbursement. Each modeled their advocacy efforts on the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, known as OMB Uniform Guidance, introduced in 2014 and updated in 2020.

The guidance allows for a fairer allocation of required expenses toward direct costs (e.g. support staff dedicated to a specific program) and offers three options for indirect-cost reimbursement: 1) nonprofits keep a federally negotiated indirect cost rate (NICRA); 2) nonprofits negotiate a rate directly with the state or local government; or 3) those without a NICRA or desire to negotiate get 10% de minimis. While 10% is rarely sufficient, the de minimis option helps small nonprofits, in particular, who previously received 0% indirect cost reimbursements and don't have the resources to go through negotiation.

The OMB Uniform Guidance applies to all federal funds, whether direct or passed through states or other entities. Many states, cities, and counties, however, refuse to pass along the legally mandated percentage of indirect costs to nonprofit partners.

As for funding from state and local government, indirect cost reimbursement rates vary widely. One study found that 2016 human services contracts in New York City allowed indirect rates between 0 and 17%—with an average of 8.6%.

The OMB Uniform Guidance created a jumping-off point for nonprofits to advocate for two things at the state and local levels: 1) adherence to the reimbursement rates required for pass-through federal funding; and 2) similar guidelines for state and local governments' contracts with nonprofits.

State and Local Successes and Set-Backs

Insufficient reimbursement rates is a question of more than fairness. "Especially now, when funding is hard to raise, reasonable reimbursement with government contracts would help nonprofits survive and sustain services," wrote **Dave Coplan**, executive director of the Human Services Center in the Pittsburgh area.

By the time the COVID-19 pandemic hit, Illinois, Maryland, and New York City had introduced changes to nonprofit contracts that aligned with the OMB Uniform Guidance (Illinois in 2014, Maryland in 2018, New York City in 2019). In New York City, the funding was only allocated for fiscal year 2020's budget after a long fight led by the Human Services Council (HSC). Then, "due to the pandemic," funding was reduced to 60% of what had been promised. Children's Village CEO **Jeremy Kohomban** has been involved in these multi-year advocacy efforts in his role as chair of the New York Human Services Council. He said, "To take away indirect costs fundamentally changes the trajectory of many nonprofits who have thin margins and are counting on indirect costs being funded. Our sector will keep fighting."

In Washington, DC, legislation was with the City Council when the pandemic hit. In July 2020, the council dedicated $200,000 to conduct a cost-implication study, and in December 2020, the legislation was passed. Kaplan, a leader of the DC advocacy effort, said, "As FY '21 begins, we'll proceed with advocacy efforts to implement the legislation. The cost implication study will inform our work."

Indirect Costs Defined

Simply put, indirect costs are the expenses not attributed to a specific program. Fiscal Management Associates explains it like this: "They are costs associated with running the non-constituent-facing operations of an organization. This includes such indispensable organizational activities as fundraising; executive management; human resources; data collection, analysis and dissemination; and information technology."

The Problem: Restricting Nonprofit Effectiveness

Aside from the obvious unfairness of government contracts not fully covering what it costs nonprofits to deliver the services (What for-profit is expected to take a contract that doesn't pay its costs?), this system has implications that constrain organizations' potential to meet their missions.

Time and effort. Filling the gap is extremely time-consuming. Some CEOs spend up to 40% of their time "dealing with indirect-cost reimbursement issues, between negotiations and fundraising to cover the gaps." Many foundations still put caps on indirect-cost spending, and the availability of general operating support is limited, making it difficult to find foundation funding to fill the gap.

Finances. Nonprofits typically conform with funders' unrealistic expectations for what it takes to run an organization by spending too little or underreporting true costs. Thanks to the nonprofit starvation cycle, coined by **Ann Goggins Gregory** and **Don Howard** in 2009, many nonprofits were already in a precarious financial position prior to COVID-19. When Bridgespan looked at 274 of the most highly co-funded nonprofits of the top 15 U.S. foundations, they found that half (53%) suffered from frequent or chronic budget deficits, and 40% had fewer than three months of reserves. Government contracts that don't pay full costs only contribute to what consultant **David Hunter** refers to as the "hollowing out" of nonprofits.

Effectiveness. The Nonprofit Overhead Cost Project found that often organizations receiving the most restricted funding (with inadequate reimbursement of indirect costs) were hampered by poor infrastructure, including computers and facilities; poorly paid, inexperienced, and poorly trained staff; unfilled positions; and more. Those receiving more unrestricted funding did better. As the Nonprofit Finance Fund's **Claire Knowlton** points out, an outcome-based approach requires investment in an organization's capacity to deliver high-quality services, systems to track progress over time, and flexibility to pivot as needed.

The Solution: Full-Cost Funding

All contracts and grants should cover the full costs of delivering high-quality services that lead to desired results. Knowlton argues that "Full costs include day-to-day operating expenses (both program and overhead expenses) plus a range of balance sheet costs for short-term and long-term needs." She proposes this formula for full costs:

Day-to-day operating expenses + working capital + reserves + fixed asset additions + debt principal repayment = full costs

Could a Pizza Shop Stay in Business If It Were Funded Like a Nonprofit?

The Human Services Council of New York used humor to convey the absurdity of the starvation cycle in this video: Everyone Deserves a Fair Slice: What if pizza shops were funded like human services nonprofits?

Unfortunately, too many nonprofit leaders don't understand their full costs, so their funders don't either. Others avoid raising the issue for fear of retaliation. According to Kaplan and Kohomban (who were both met with disbelief when they brought it up), your local government officials likely don't even know there's a problem. Since government is always fully funded with very high indirect costs, they may assume that nonprofits are treated the same.

In the following sections, we share tips for how to make the case to your board and staff, your fellow nonprofit leaders, potential philanthropic allies, and government officials. Appendix A provides general resources for advocacy, as well as the legislative language used in Illinois, Maryland, New York, and Washington, DC.

Making the Case for Advocacy to Your Board and Staff

If you want to advocate for full-cost funding with your state or local government, figure out what your full costs are (refer to appendix A for resources) and get internal support.

What If Your Paycheck Were a Restricted Grant?

Step into a nonprofit leader's shoes to understand why covering full costs is important: Why Funding Overhead Is Not the Real Issue: The Case to Cover Full Costs.

Kaplan and Kohomban found these talking points effective for board and staff:

- **The law:** Federal pass-through funding must comply with the OMB Uniform Guidance. If our state or local government isn't giving us what we're entitled to, the law is on our side.
- **Fairness:** It's only fair that state and local government also pays for the full costs of the services they contract with us to provide. No private-sector company would be expected to subsidize government services as nonprofits are forced to.
- **Finances:** If the government paid the full cost of services, it would save time and effort, prevent erosion of our financial condition (especially in hard economic times, when it's challenging to raise unrestricted funds from foundations and individuals), and allow us to focus on other important things, such as fair pay for workers, investments in technology and outcome measurement, and continuous improvement in program quality leading to better outcomes for our clients.
- **Important to small organizations:** This issue is especially important for smaller nonprofits without a negotiated federal rate. Pass-through federal funding would increase from 0 to 10%. If the state/local government aligns its direct funding with the OMB Uniform Guidance, the same would be the case in those grants and contracts.
- **Stewardship:** We're obligated to do what's best for our clients, communities, staff, and organization. Our organization's survival and its ability to provide effective services are vital to the people and communities we serve.
- **Great starting point:** Others have successfully advocated for state/local legislation based on the OMB Uniform Guidelines. We can do it, too.

Convincing Your Fellow CEOs to Join the Advocacy Effort

No one or two organizations are likely to succeed independently, as **Dominique Bernardo**, CEO of Variety the Children's Charity of the Delaware Valley, experienced in Philadelphia. In the words of Philadelphia Deputy Mayor **Cynthia Figueroa**, Office of Children and Families, "Government guidelines are often capped for really no solid reason. The greatest challenge is getting enough like-minded nonprofits together to submit a meaningful position." In New York City, 176 organizational members of the Human Services Council participated. In Washington, DC, Kaplan brought together about 40 nonprofit leaders—including CFOs and experts in policy and advocacy—to create the Coalition for Nonprofit Equity. One member of the coalition assigned her legislative and policy director, a lawyer, to work with Kaplan: "This was incredibly helpful as we studied other legislation, OMB documents and continuously tweaked the legislation as needed."

Here are some reasons to join, in addition to the ones listed above:

- **Strength in numbers:** None of us can achieve this on our own, but together we can make it happen. Others have done it.
- **Minimizes risk of retribution:** If we join forces, no single organization will stand out and the risk of being punished for challenging government practice is reduced.

Kohomban recommends being prepared for internal opposition, which took the New York coalition by surprise. He said, "If you're lucky, you will know who is fighting against you. In most instances, you will not see or hear the opposition directly." They learned that a few fellow nonprofit leaders opposed the effort out of fear. Some were silent. They refused to be identified among those calling for action and, in doing so, hoped to benefit no matter what happened. If the coalition was successful, they would gain from the new indirect rates. If New York City and its powerful allies retaliated, they would claim that they were an ally of the city and therefore deserving of favors. There were also those who worked actively against them by being a conduit for New York City's position that the city could do no more, concurrently stoking fears of retaliation in the form of denied or delayed contracts. While that was unlikely, the actions were nevertheless intimidating and effectively sowed seeds of disunity.

Recruiting Philanthropic Allies

Strong philanthropic allies were important in New York City, but they weren't easy to recruit. "Among private leaders, not everyone who complains is willing to take the public risk, collaborate, and fight the battle," Kohomban said. **Doug Bauer,** Executive Director of the Clark Foundation, was an early exception: "To me, covering indirect costs is just plain common sense and an equity issue. I continue to be amazed that so many in the sector still cling to the overhead myth – especially in the midst of a pandemic." Find a sample letter of philanthropic support from **Nicky Goren** of the Meyer Foundation, a DC funder, in appendix D. These arguments persuaded the allies:

- **Stop subsidizing government:** When government doesn't pay what it costs, philanthropy has to fill the gap. Let's put an end to foundations having to subsidize government services. *(Note: Be careful when making this argument, to avoid implying that foundations should stop covering the gap to provoke government change. Their funding to cover the gap is critical until government funds the full costs of services.)*
- **Fund advocacy:** Advocacy with government takes time and effort. Organizing, strategizing, meeting, and advocating requires funding.
- **Lend your voice:** Foundation leaders' public support carries weight. We need you.

Explaining the Problem—and What to Do About It—to Government Officials

Kaplan and Kohomban found that most government officials were unaware and needed a good deal of help to understand the problem. In Washington, DC, advocates frequently used a fact sheet (appendix E). Whether in a fact sheet or in other communications, here are some points worth emphasizing:

- **The law:** State/local governments must follow OMB Uniform Guidance about federal pass-through funding; it's the law.
- **Fairness:** Nonprofits should be paid the full costs of the services they provide, just like any private contractor. We need direct funding from state and local governments to follow similar guidance to that at the federal level.
- **Mutual need:** When we're not paid the full costs of services, it's hard to find general operating support to fill the gap, and it threatens organizations' survival. This threat is particularly grave during hard times, as **Elizabeth Boris** and her Urban Institute colleagues found after the 2008 recession. It's in government's interest that the nonprofits with whom they contract are financially stable and able to provide uninterrupted, effective services to the people who need them. By paying the full cost of those services, governments remove a threat to their partners' ability to meet the government's need. Given the problems it causes, funding from other sources shouldn't be required to fill a gap in reimbursement, but can instead, to the extent available, support additional services.
- **Effectiveness:** It matters that nonprofits are able to produce results for the recipients of government-funded services. That requires a shift in focus from compliance to outcomes. In the current system, nonprofits are less effective than they could be.
- **Efficiency:** A uniform system for all nonprofit grants and contracts is more efficient than each agency having its own rules. Such uniformity would produce major savings for both nonprofits and governments.

Kaplan worked with her Washington, DC, ward city council representative to author the legislation, using the Maryland legislation as an example. "Then we all got additional city council members to sign on," Kaplan said. "In the first year the legislation had four council signatures, and when introduced again the following year, we had nine co-signers." Similarly, in New York City, one supportive council member was gradually joined by more than a dozen supporters.

Hearings are an important opportunity for influence. The CEOs, CFOs, and board members of nonprofits, as well as auditors and representatives from philanthropy are all great people to testify (see appendices B and C for testimonials). In Washington, DC, the opening panel included representatives from Maryland, Illinois, and the National Council of Nonprofits, who framed the issue as a national trend and growing movement for best practices. Substantiating facts and figures can be compelling, and **Lindsey Buss** at the World Bank pointed out that the Washington, DC, City Council seemed to find persuasive data the advocates had collected from nonprofits, showing how much indirect costs varied from contract to contract and agency to agency.

On the Right Path, But Not There Yet

While passing legislation is an important step forward, it doesn't mean the goal has been reached. The "full" cost, negotiated in New York City and Washington, DC, was to cover the costs nonprofits are currently incurring—a step on the way to what would be fair and equitable: funding the infrastructure required for an organization to become high performing as defined by the Leap Ambassadors Community's Performance Imperative.

Existing legislation, however, must be funded and implemented. In New York City, complying with a new cost manual was an intensive exercise for nonprofits during fiscal year 2020, involving reclassifying and documenting costs and getting auditor certifications. After the organizations had met these new demands and the fiscal year had ended, they were told they would receive only 60% of the indirect costs for which they had been approved. In some cases, that could be less than what they received prior to the indirect rate agreement, because some costs were reclassified from direct to indirect.

At the time of writing, New York City is seven months into the 2021 fiscal year. Nonprofits have been on the COVID frontlines since March, 2020, but payments for fiscal year 2020 have not been made. The city has asked them to do more but not yet decided how much of the indirect rate it will pay for fiscal year 2021. This puts some nonprofits in a no-better—possibly, in even worse—position than before. Many feel their trust has been betrayed.

Final Words

Kaplan and Kohomban believe advocacy for full-cost funding from government needs to happen across the country. Their takeaway? Be courageous and know it takes time.

"It takes leaders and nonprofit boards willing to take a personal risk by expending their political capital and take the political risk of being ostracized or having their organizations 'punished' by public funders and those private nonprofit leaders who are beholden to elected leaders," Kohomban said. Both New York City and Washington, DC, have experienced setbacks, each adding time to the process. When Washington, DC, experienced a setback after two years of advocacy, Kaplan was encouraged that New York City had succeeded after four years. In the end, the DC legislation was passed in December, 2020, after three years of advocacy.

The work continues in both New York City and Washington, DC. Kaplan's and Kohomban's best advice? Don't give up.

Appendix A: Resources for Full Cost Calculation, Advocacy, and Legislative Language

How to Calculate Full Cost of Services

- Best Practices for Nonprofit Financial Health, Part 3: Understanding Full Costs, Nonprofit Finance Fund
- Nonprofit Cost Analysis Tool Kit: Six Steps to Finding the True Costs of Programs, Bridgespan Group

How to Advocate

- Yes, You Can—and Should! Nonprofit Advocacy as a Core Competency, Nonprofit Quarterly
- Everyday Advocacy, National Council of Nonprofits
- Everyday Advocacy Resources, including Advocacy Toolkits, National Council of Nonprofits

Understanding the Political System

The state legislative process is similar, though not identical, across the United States. Get an overview of the legislative process by state here. Local government legislative processes vary greatly, so if you're advocating at the city or county level, it's important to research the local system.

In addition to the legislative process, it's important to understand the procurement process, which according to **Robert Sainz**, .formerly assistant general manager with the Economic and Workforce Development Department in Los Angeles, tends to "encourage the government agency to underestimate costs and encourage agencies to provide understated cost proposals." Consider how this can be mitigated in the implementation of new rules.

Legislation and Related Resources That Can Be Used as Models

The OMB Uniform Guidance forms the basis for legislation in each of the states and cities below.

Illinois

- Grant Accountability and Transparency Act (30 ILCS 708/) (GATA) became law as Public Act 98-0706 effective July 16, 2014
- All Illinois grantees must enter the Centralized Indirect Cost Rate System to substantiate their selection of indirect cost reimbursement

Maryland

- State Government – Grants and Contracts – Reimbursement of Indirect Costs (SB 1045) took effect on October 1, 2018

New York City

- Indirect Implementation, New York City's webpage about implementation of the Cost Manual
- The City of New York Health and Human Services Cost Policies and Procedures Manual ("Cost Manual") took effect in November 2019, and provides uniform indirect-cost reimbursement guidance for all city agencies that contract with health and human services nonprofits

Washington, DC

- The Nonprofit Reimbursement Fairness Act of 2019 was passed on December 1, 2020

Appendix B: City Council Hearing Testimony, New York

The New York City Council Contracts Committee
CHAIR, HELEN ROSENTHAL
HEARING: Oversight - Challenges Facing Nonprofits in City Contracting

Chambers at City Hall
April 4, 2016, 1 PM

Testimony of
Jeremy C. Kohomban, PhD
President and CEO, The Children's Village
President, Harlem Dowling West Side Center

Good afternoon, I am Dr. Jeremy Kohomban, and I represent four organizations that employ over 1,500 New Yorkers. Together, The Children's Village, Harlem Dowling, Inwood House, and the Bridge Builders Community Partnership in Highbridge serve more than 20,000 New Yorkers each year.

We serve a broad range—from children considered to be at highest-risk for harm to children and families who simply need a meal or a safe and affordable place to call home.

The Children's Village has benefited from the leadership and support of New York City, which has historically been exemplary in helping us do this work. The Mayor's 2.5% COLA and the push for equity are examples of this leadership. In return, we, like the other nonprofits represented here today, have been there for New York City during the good times and in those difficult times. In fact, let me go even further by saying that charities like us created New York City's safety net. Today, during crises, we are the lifeline that New Yorker's depend on. We are embedded in communities, many of us are available around-the-clock and, in many cases, we are the visible representation of responsive government.

However, I believe that government has taken us for granted. We lack the support needed to continue to make our City the envy of the world. The current status quo of underfunding, delayed payments and competing and confusing regulatory demands is draining us of resources and driving many mission-critical organizations into survival mode.

Our entire sector provides services at rates far less costly than any government agency. Despite this reality, contract reimbursement often refuses to take into account the annual escalations that include healthcare, cost of living and a living wage for our staff. At The Children's Village, our Federally-approved indirect rate is 13%, but NYC caps indirect costs at 10%, forcing us to absorb the additional costs. In addition to this underfunding, we also deal with delayed reimbursement and the often hidden cost of unreimbursed interest payments that we are forced to make on extended credit lines.

While we are untiring in our fundraising, our donors are most interested in helping children and families and least interested in subsidizing what they are increasingly seeing as government shirking its responsibility. I would be remiss if I did not note that, without our generous donors, The Children's Village would not be in a position to serve New York as we do today, perhaps not at all.

Mandate overload and confusing and competing regulations are an additional burden, with real human and financial costs. There continues to be a trend of well-intended mandates and regulations that are imposed on us with no additional reimbursement. We have also seen the intentional shifting of liability from government to nonprofits. These translate into additional costs for the nonprofit and also for government. This also make our front-line work extremely difficult by creating a "gotcha" culture – basically, a culture of fear among those employees who we depend on to be on the front lines, often serving in very difficult circumstances.

What's stunning about all of this is that some, and possibly most of these mandates and regulations can be streamlined. Is it really necessary or useful to anybody to have a hundred plus program and fiscal audits every year? We believe mandates and regulations can be streamlined to be supportive rather than repressive, if we work together.

In closing, I ask that you consider working on three problems that would make a significant difference in our ability to serve New Yorkers: fund nonprofits at fair rates; pay us on time; and work with us to streamline and reduce unfunded mandates.

Thank you for the opportunity to testify about these important issues.

Appendix C: City Council Hearing Testimony, Washington, DC

Testimony Presented by
Lori Kaplan, Special Projects Advisor, LAYC
Committee on Facilities and Procurement
Robert C. White, Jr., Chair

Public Hearing B23-0107, the "Non-Profit Reimbursement Fairness Act of 2019"
Tuesday, January 28, 2020, 10:00 a.m.

Good morning Committee Chairman White, Council members and members of your staff. My name is Lori Kaplan. Thank you for this opportunity to testify today.

As we have talked about today indirect costs are the expenses incurred tied to a specific set of outcomes but shared across multiple projects. Indirect costs are essential and inextricably tied to every nonprofit's ability to accomplish its goals. Indirect costs are more expansive than the word overhead although too often they are used interchangeably. An indirect cost rate is calculated based on a percentage of total direct cost. Every single service that a nonprofit provides, housing for the homeless, childcare, literacy instruction, school based mental health counseling, job training, has indirect costs tied to that specific delivery. Yet, as we now know too often district of government contracts do not pay their fair share of that cost. As a result non-profit Directors, staff and board of directors are forced to raise additional funds through galas, bake sales, rummage sales, donor and foundations fundraising to cover that budget deficit. If the deficit is not filled the nonprofit is not functioning at its highest potential.

Payments for indirect costs vary wildly an inconsistently between district government agencies grants and contracts. In all of my years as a nonprofit CEO at the LAYC I could never figure out how the indirect rate was established or why we were often told this is what we will give you for your indirect costs. If often seemed arbitrary. Each contract had a different rate – each district agency had different rates – different contracts in the same agency had different rates. But the end result was the same – the contract or grant was not paying its fair share of the costs for the requested services. That is why we are here today. That is what this legislation will fairly rectify.

Some in government will say, wait – how much will this cost and then they may decide it is too much! It is important to understand that there is a much larger price to pay in the nonprofit community when they are struggling to fund their budget gap due to lack of indirect costs payment. Professional development for staff suffers, turnover can be greater as salaries may not be competitive in the market, working conditions may not be safe which impacts staff morale, IT systems that support front-line staff in their daily work in real time may be out of date, funds to cover the cost for ongoing monitoring of key performance indicators may be lacking impacting quality and or effectiveness of work to name a few.

Too often nonprofits accept funding from the district government that requires them to shortchange these areas of need and others. As a result the nonprofit is not operating at its highest quality capacity in a reliable and sustainable way. Ultimately our clients may pay the price of this inequity.

Finally I would like to note that the OMB regulations require any federal funds passed to nonprofits through the local government agencies pay the required negotiated rate to the nonprofit agency. This is not consistently happening in the District of Columbia.

Passage of this legislation will make the District of Columbia government a leader in the country just as Maryland and Illinois are today. Times are changing. Philanthropy has begun to recognize and need to cover grantees indirect costs. And government jurisdictions all over the country are beginning to tackle this issue with their nonprofit partners.

Chairman White, you have believed in this issue since the first time I testified almost three years ago. And finally we are here today. You will be key, with your committee members, in making sure this legislation passes and is fully implemented. Only then will District of Columbia government be a leader in the field through valuing their nonprofit community and paying their fair share leading to the highest quality outcomes.

I would like to end by thanking Councilmember Nadeau for her leadership in bringing this legislation forward. In addition, I would like to thank you, and all of the Councilmember co-sponsors. Thank you too to Michelle Loggins, Deputy Committee Director, Shawn Hilgendorf, Committee Director and Kirti Suri, Legislative Counsel. And we would not be here today without our awesome nonprofit leaders who have been working on this issue to insure that their organizations can provide the outcomes that our community deserve. A special thanks to Melissa Millar, Policy and Advocacy Director from Community Hope who did an incredible job on this effort.

Thank you for this opportunity to testify today.

Appendix D: Philanthropic Letter of Support, Washington, DC

MEYER FOUNDATION

Rooted in Humanity

January 31, 2020

Councilmember Robert C. White, Chair
Committee on Facilities and Procurement
c/o Shawn Hilgendorf, Committee Director
1350 Pennsylvania Avenue, NW, Suite 121
Washington, DC 20004

Dear Committee Chairman White:

I am writing at your invitation on behalf of the Meyer Foundation in support of B23-0107, the Nonprofit Reimbursement Fairness Act of 2019. For the past 75 years, the Meyer Foundation has provided philanthropic support to thousands of nonprofit organizations in the District of Columbia and across the region, many of whom deliver critical services in our most under-resourced communities. Time and again, our nonprofit partners have experienced the challenges associated with receiving grants and contracts – whether via foundations or the government – that do not cover the full costs of operating an organization. The Nonprofit Reimbursement Fairness Act of 2019 would change that by increasing the coverage that District grants and contracts provide to nonprofits for their indirect costs. I offer the following four reasons for the council to adequately support covering the indirect costs of its nonprofit service providers.

First, by entering into one-sided agreements that do not provide sufficient support for the "costs of doing business," nonprofits risk dire financial consequences that directly and negatively affect the quality of the programs and services they offer. This makes it more difficult, for example, for nonprofits to hire and keep experienced, highly qualified staff, which in turn exasperates the issues experienced by the people in our community most in need of the service. This is ultimately a disservice to all Washingtonians. Government risks losing access to the best partners to provide those services. Nonprofits, many of which operate for pennies on the dollar in comparison to private companies, cannot afford to run programs or deliver services without covering those everyday business expenses that factor into indirect costs – expenses including rent, internet, health insurance premiums, and electricity. No business can operate without the resources to cover these basic and essential operating expenses, yet there appears to be an assumption that nonprofits should be able to find a way. As a former nonprofit CEO, I can attest to the fact that it quickly becomes unsustainable to be put in that position and in that role, I was forced to turn away grants that did not include sufficient overhead funding, as we could not afford to run the projects and programs without the support of the "indirect costs" funding.

Meyerfoundation.org | 1250 Connecticut Ave. NW, Suite 800 | Washington, DC 20036

Second, there appears to be an expectation that philanthropy will fill the gap that government leaves. This, too, is unsustainable. Each of these nonprofits is essentially competing for philanthropic dollars from a fairly shallow philanthropic community in D.C. Even if the foundation community were larger in the District, the fact remains that government dollars eclipse the total amount of funding available through private philanthropy. Many funders also, albeit misguidedly, only fund project support, so similarly won't pick up those costs. Government resources far exceed those of philanthropy and so it does not make sense for foundations to use their limited resources to cover costs of doing business that the government should be paying for.

Third, not covering indirect costs disadvantages smaller community organizations and advantages larger groups, deepening inequities among those groups. Smaller organizations, often led by people of color, frequently do not have the funding base or reserves to cover the difference between full project costs and under-funded government grants and contracts. Larger organizations may have other resources to draw on when they take on government contracts but may or may not have the deepest connections with the people in the communities in which they operate and serve.

Last, it is incumbent on all of us to reflect on the challenging power and financial dynamics we create vis-à-vis our nonprofit partners and the starvation cycle we put them in with the onerous, irresponsible strings we attach to the dollars we give them. In the philanthropic sector, general operating support that allows nonprofits to allocate funds they receive to any and all aspects of their work is widely viewed as a best practice. Even those who still provide project support are increasingly providing higher levels of overhead reimbursement in recognition of what it takes to deliver on the work.

We must stop assuming nonprofits should do more with less and cover the costs of running a robust business, and we must stop underestimating the value of the service that they provide to our community. If we don't, we risk losing some of our most critical partners, leaving many communities and neighbors without the programs and services needed to help them live stable, fruitful lives. We would also prevent the District from being a just city where everyone has the opportunity to thrive. For these reasons, the Meyer Foundation supports codifying a fair and rational way to cover the indirect costs of the nonprofits with whom the government does business.

Sincerely,

Nicky G

Nicky Goren
President and CEO
Meyer Foundation

Appendix E: Fact Sheet, Washington, DC

Frequently Asked Questions
B23-107, the Nonprofit Reimbursement Fairness Act of 2019

"Conventional wisdom on nonprofit indirect costs is beginning to reach alignment with what for-profit businesses have known all along: **continually spending less on indirect costs erodes efficiency and effectiveness, preventing organizations from producing better and lasting outcomes. Contracts and grants that fail to cover indirect costs actually reduce a charitable nonprofit's effectiveness and efficiency."**
– National Council of Nonprofits, Investing for Impact: Indirect Costs are Essential for Success, September 2013

1. **What are indirect costs and why should the District pay these costs for direct services providers?**

   Indirect costs are the costs associated with being in business (typically administration and overhead costs, such as staff salaries, benefits, and training; research; strategic planning; auditing; infrastructure replacement and maintenance; IT support; utilities; rent; etc) that pertain to the operation of the business as a whole and cannot practically be assigned directly to the production or sale of a particular product, or provision of a specific service. Uniform Guidance from the federal Office of Management and Budget (OMB) makes clear that a nonprofit's indirect costs are legitimate expenses that need to be reimbursed for the organization to be sustainable and effective.

   The District currently contracts out most of its direct health and human services work to nonprofit direct services providers, including for behavioral and physical health, shelter and housing support, and disabilities services. However, unless a provider has a federally negotiated indirect cost rate with the federal government and the contract is a federal pass-through, they are unlikely to receive sufficient reimbursement for their indirect costs to ensure continuity and provide the services for which the government contracts. Failure to adequately cover those costs by contract places each provider at a financial loss that must be covered by other means (fundraising, philanthropy) in order to continue to provide the contracted service.

2. **What are the average indirect costs of DC service provider nonprofits, and what rate, if any, is the District government providing as reimbursement?**

   A small section of District nonprofits was surveyed with respect to their indirect cost rates. Actual costs ranged from 8% to 25%. However, most reported that their contract-reimbursed indirect rates were either in the de minimus, 5%, 6%, 8%, or 10% cost reimbursement categories and some reported that 0% of costs were reimbursed.

3. **How do other jurisdictions approach the issue of indirect cost rate reimbursement?**

   More included below in response to question #4.

   The Federal government offers a federal Negotiated Indirect Cost Rate Agreement (NICRA) and must pay that rate on grants and contracts with the provider

   Maryland passed Senate Bill 1045 in 2018 that allows for at least a 10% indirect cost reimbursement, and if a nonprofit has a NICRA, the state will honor that rate

   New York City, in 2019, expanded its indirect cost rate reimbursement across its contracting, including to its health and human services providers, capping the administrative rate at 15%.

   Illinois requires registration into a database that provides nonprofits with grants and cooperative agreements with the state the opportunity to make an election whereby they can negotiate a rate with the state, elect to use the de minimus rate of 10%, provide a copy of the nonprofit's federally negotiated rate, or decline any indirect cost rate.

4. **What are the industry standards and/or national trends and best practices for reimbursement of indirect costs?**

   At the federal level
   OMB Uniform Guidance recognizes that governments at all levels must reimburse nonprofit organizations for the full indirect costs that the nonprofits legitimately incur in delivering contracted services for government.[1] This directive seeks to counter the narrative that nonprofits can and will indefinitely fill the gaps caused by governments outsourcing its work by funding their increased workload and costs through private sources.

   At the state and local level
   In May 2017, **New York City**'s Comptroller conducted a review of city spending at its six core human services agencies in Fiscal year 2016, totaling $4.7 billion via 8,214 contracts. The report noted that while nonprofits are "essential for the continued health and welfare of all city residents", many nonprofits struggle with solvency "due, in part, to the underfunding of government contracts." A targeted review of 105 NYC contracts with 76 nonprofits across six human services programs found indirect costs actually paid via contract ranged from 0% to 17% (in preventive services, supportive housing and shelters, senior services, and after-

1 https://www.federalregister.gov/documents/2013/12/26/2013-30465/uniform-administrative-requirements-cost-principles-and-audit-requirements-for-federal-awards; page 78600, Section 200.414

school programs), with an average reimbursement rate of 8.6% across all reviewed contracts. The report concludes stating:

> In the near-term, the City should align its indirect cost rate with the Federal government using each nonprofit's federal indirect rate, and if no such rate exists, the de minimus rate of 10% as prescribed in Federal OMB's Uniform Guidance. However, it should be noted that advocates from the sector have identified 15% as an appropriate indirect rate. This rate would be applied to the entire contract and should be the standard used for all human services contracts regardless of whether they are federally funded. Moving forward, the City can follow the lead of Illinois, which created a Grant Accountability and Transparency Unit to align their contracting with the Federal Uniform Guidance and to assist nonprofits in calculating their indirect cost rate.[2]

Beginning July 1, 2019, NYC's "City of New York Health and Human Services Cost Policies and Procedures Manual" provides uniform indirect cost rate guidance for all City agencies with contracts, applying to the City's health and human services contracts. Administrative costs are capped at 15%.[3,4]

Illinois passed the Grant Accountability and Transparency Act (GATA)[5] in 2014, whose stated purpose is to increase accountability and transparency in the use of grant funds and cooperative agreements while reducing administrative burden. The law encourages nonprofits without a federally negotiated rate to negotiate one rather than take the de minimus rate of 10%. All state grantees receiving awards from Illinois grant-making agencies must enter the State of Illinois Centralized Indirect Cost Rate System to substantiate its organization's election regarding indirect cost reimbursement. Each organization must choose one of the following elections:

- Negotiate an indirect cost rate with the state of Illinois
- Elect to use the de minimus rate of 10% for Modified Total Direct Costs
- Provide a copy of a current federally Negotiated Indirect Cost Rate Agreement (NICRA), or
- Elect to decline any indirect cost rate

Maryland Senate Bill 1045, enacted in 2018, streamlines and simplifies treatment of indirect costs, consistent with the OMB Guidance implemented in 2014. The Act

2 Scott M Stringer, New York City Comptroller, "Strengthening the Frontline: An Analysis of Human Services Contracts in NYC", Bureau of Policy and Research, May 2017, page 6

3 City of New York Health and Human Services Cost Policies and Procedures Manual, March 5, 2019

4 Jeri Eckhart-Queenan et al, The Bridgespan Group, "Pay What it Takes Philanthropy", May 15, 2016, notes that 15% is often still insufficient, quoting a Foundation Director that "the best organizations" do not seek grants from them due to their cap on indirect costs of 15%.

5 30 ILCS 708/1 et seq

allows nonprofit service providers to recover at least 10% of their modified total direct costs, and if the nonprofit has a federally negotiated rate, the state would reimburse at that level. The legislature took this action upon recognition that underfunding service providers threatens its service network, and that a potential majority of nonprofits have 30 days or less of operating reserves. This financial position could put nonprofits at risk for billing and payroll delays that could necessitate the need for short-term loans, furthering impacting finances through interests and fees.

At the philanthropic level

The Bridgespan Group, a global nonprofit whose mission is to build a better world by strengthening the ability of mission-driven organizations and philanthropists to achieve breakthrough results in addressing society's most important challenges and opportunities, released a paper, "Pay What it Takes Philanthropy" (May 2016)[6] that notes:

> It's time to break the "starvation cycle," a vexing pattern of underfunding and underinvesting that prevents countless nonprofits from maximizing their impact. Despite years of conversation around the topic of funding the real cost of programs, many grantmakers continue to pay flat—and too low—overhead rates regardless of a grantees' actual needs. "Pay what it takes" philanthropy looks to remedy the situation by providing a flexible approach to funding, grounded in real costs. By taking into account the true dollars needed, this new approach has the potential to shift funding from programs and services to what it actually takes to create impact.

This report speaks to the needs of philanthropic funders to not only fund the projects and programs they support, but the ancillary overhead or indirect costs of the funded organization. The lack of philanthropic funders currently reimbursing for indirect costs is a further illustration of the challenge for nonprofits to recover, primarily through philanthropy and fundraising, the indirect costs not provided through other contracts, including government contracts, as **there is a belief that providers will fundraise and simply use those funds to cover any and all gaps that government leaves in their budgets. This is not the case.** As noted by Bridgespan's report, philanthropy tends to put restrictions and stipulations on funding, including what it can and cannot be used for, and often indirect costs are specifically prohibited, under the "belief" or "desire" of the funder to have their work fund a particular project/program/outcome. **What this fails to recognize is that if a funded organization cannot keep covering its costs, there will be no project/program/outcome to tout.** Having donations into an "unrestricted fund" is something that donors decide, not the organization; having to specifically fundraise

6 https://www.bridgespan.org/insights/library/pay-what-it-takes/pay-what-it-takes-philanthropy

a type of funds that funders do not typically authorize is an extra challenge that requires significant time and effort for organizations that could be putting that effort towards its work and its community.

Hospitals and Universities
Hospitals are not covered under the OMB Uniform Guidance and would not be covered for purposes of this legislation.

Universities are covered by a different portion of the OMB Guidance thus would not be covered for purposes of this legislation.

5. **What is the fiscal impact of increasing direct service providers' indirect contracting rates?**

While initially including indirect cost reimbursements on direct services contracts could add costs or result in fewer services in the short term, shoring up the financial viability of nonprofit service providers will support greater service provision in the longer-term and limit the likelihood of providers closing. The District chooses to engage a network of nonprofit direct service providers to meet many of the health and human services needs of District residents (versus the government directly providing those services itself). Ensuring proper reimbursement on District government contracts to those service providers by paying providers' true costs of delivering services on the government's behalf is a fair approach. Fundamentally the contracting system should result in a fair playing field where all providers are treated similarly. In the current system, the District overly compensates some services via contract while underfunding others. To the extent that leveling the playing field results in increased costs or reduced services, that is a conversation that the government and public should have. The public's need for direct services is equally as high as the public needs for physical assets such as schools, libraries, and parks and recreation facilities, which are often constructed with profit for the general contractor built into the overall construction contract.

In jurisdictions that have moved towards indirect cost rate reimbursements, including in New York City and Maryland, both jurisdictions note there would be financial impacts. In the fiscal and policy note for Maryland Senate Bill 1045[7], the state notes that there would be "no effect on the total value [sic] of State contracts and grants to nonprofit organizations. However, to the extent that indirect costs are not currently reimbursed, either [sic] fewer State funds are available for direct costs and services under grants and contracts or [sic] State expenditures (all funds) increase, potentially significantly, to maintain current levels of services. No effect

7 Department of Legislative Services, Maryland General Assembly, 2018 Session, Fiscal and Policy Note, Senate Bill 1045

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on revenues."[8]

New York City, in its Frequently Asked Questions on the reimbursement change, noted that "the City understands and expects that there will be modifications to Contract budgets based on the Cost Manual" and that the directives of the Cost Manual are applicable to all City agencies' contracts. However, the Manual also notes that a contracting officer may deny a requested increase in an organization's rate if the agency determines compensation at that rate would compromise the services delivered and/or would come at an additional expense to the City.

As the District considers B23-107 and its potential impacts, it may consider whether it would seek to restrict retroactive applicability to existing contracts, whether it would seek to apply new rates only to newly let contracts, whether to increase rates on option years for existing contracts or only for option years on contracts established after the Act's effective date, or other combinations of approaches, to ensure no anti-deficiency issues nor service disruptions arise impacting vulnerable populations.

6. **What are the equity impacts if contractual amounts for nonprofits are increased? How might residents be negatively impacted by changing the contracting process?**

The lack of appropriate contract terms allowing for the reimbursement of a nonprofit's indirect costs already results in an equity issue. Social services providers who mainly serve people of color, including several Core Service Agencies (CSAs), have closed over the last several years, and/or providers are shuttering valuable programs because they aren't fiscally viable. If providers are unable to afford to remain open or provide needed services because their true costs are not accounted for in District government contracts, inequity already exists and residents are not getting all of the services for which they may qualify or are entitled.

Additionally, the District government process for contracting with for-profit companies such as general contractors includes a built-in profit. The District's contracting system is itself inequitable as services provided by one set of agencies (nonprofits) are treated and paid for differently than services provided by another set of companies (for profits). As the District's nonprofit direct services providers are working with some of the District's most vulnerable residents, ensuring that costs of program implementation, including personnel and administrative costs are covered, is not only appropriate but an equitable solution that supports residents as well as District organizations.

7. **Will for-profit contractors with the District be able to receive their indirect costs, and how should that be minimized?**

The bill's language can be clarified prior to its passage to ensure that only nonprofit

8 Id., page 1

direct services providers are eligible for indirect cost reimbursement. The current long title of the bill can be amended to specifically address this by stating “To require that grants or contracts held by nonprofit service providers with the District allow for reimbursement of indirect costs at the same rate a nonprofit organization has negotiated to receive from a current federal contract or grant;”. Further, any concern that businesses currently designated as a Certified Business Enterprise (CBE) would unduly profit from the bill’s language should be allayed by the fact that in the District, an organization cannot be both a nonprofit and a CBE.

It should also be noted that current District contracting practices are structured such that some contractors receive more favorable terms on their contracts than others. Construction contacts offer a “cost plus” approach that provides for additional compensation beyond the costs of the project to the contractor, i.e. a profit. Escalation terms on typical five-year contracts (base year with four option years) can vary widely. For some multi-million dollar contracts, there may be a few million dollars differential between the base year compensation and payments in the fourth option year, while similar contracts may contain escalation of barely $100,000 each option year. The goal of Bill 23-107 is to help smooth the rougher edges of the contracting process for entities that are not seeking to profit from government contracts, but also want to stay in business to continue providing services on the government’s behalf.

8. **Why should the Council amend the District’s contracting Code versus the Mayor issuing a change to the contracting process via Mayoral Order?**

It is Council’s job to fix issues with the law. There is impermanence to both legislation and Mayoral Orders; however, in order to enact legislation, the process is lengthier and more transparent than an individual Mayor issuing a Mayoral Order and gives the public the opportunity to participate in a way that will never be available for Mayoral Orders. Council-approved legislation typically results in legislating activities within agencies under the Mayor’s authority by requiring an agency or agencies to either take or refrain from taking specific actions. A public discussion on the needs of nonprofits who contract with the District government provides a greater opportunity to understand and address the problem. Further, relying on a Mayoral Order in perpetuity is contraindicated by national trends and best practices for nonprofits.