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Nonprofits Win Key Victory in Overhead Battles With Government

By: Tim Delaney

Rather than focusing on what Congress will (or won't) do in the new year, foundations and other nonprofits would do well to take a close look at a little-noticed overhaul of federal grant-making rules—in the works for three years and that took effect the day after Christmas—that could provide meaningful traction for ending the so-called [nonprofit starvation cycle](#).

Last month, the federal Office of Management and Budget formally recognized in [new rules called the Uniform Guidance](#) that when governments hire nonprofits to provide services, those nonprofits legitimately need to incur and be paid for their "indirect costs"—which is government-speak for overhead and administrative expenses.

OMB, which is responsible for overseeing how federal funds are spent, is ordering governments at all levels—local, state, and federal—to reimburse nonprofits for more of their direct costs plus their indirect costs when their work is funded in whole or in part with federal money.

The new rules say that in general, nonprofits should receive at least 10 percent of the direct costs of their grant or contract to pay indirect costs. Organizations that

follow new cost-allocation rules in the Uniform Guidance can negotiate to receive even more than 10 percent.

This approach is so radically different from past practices that a [senior federal official](#) described them as a "historic reform [that] will transform the landscape ... for generations to come."

To many nonprofits, it's probably hard to imagine that the federal government is the source of meaningful traction to wipe away widespread perceptions that nonprofits can work miracles without the administrative and other costs that make service delivery possible.

But that is just one reason the rules are so exciting. They promise benefits for everyone: governments, nonprofits, grant makers, and the public. Nevertheless, the real work has only just begun. Nonprofits and foundations will play a critical role in determining whether the new rules are carried out in a way that meets their full promise—or if they end up doing little.

While the new rules are now the law of the land, the indirect-cost regulations must be interpreted and applied consistently by tens of thousands of individuals in fragmented departments, agencies, and offices at "pass through" entities (usually state and local governments and large nonprofits) that use federal funds to hire nonprofits to provide services in their communities.

The regulations are already in effect, but the multiple levels and layers of government have not learned about or communicated the existence of the new rules, let alone provided consistent training programs, to employees scattered across these pass-through entities.

Making matters worse, there has been no transition time for the thousands of jurisdictions to purge and modernize their outdated statutes and regulations to enable them to comply with the new federal requirements.

And that's just the government side. Nonprofits also face hurdles, because they need to learn about and advocate for their rights (individually to enforce their rights and collectively to change state and local laws) and need enhanced accounting skills and systems to manage the financial management and reporting requirements.

Unless we all take concerted action, it's quite possible that we will slide back to what had been the status quo: inconsistencies in our nation's archaic, patchwork government-nonprofit grants and contract "system" that have left nonprofits at the mercy of often contradictory policies and practices of disconnected federal, state, and local government departments, agencies, offices, and employees. Arbitrary, unjustifiable caps on indirect costs could remain routine.

Yet it's in our power to ensure that doesn't happen.

Although grant makers are not specifically mentioned in the federal rules, they stand to benefit as the new rules are fully adopted.

First and foremost, the rules can reduce the hidden subsidies that grant makers are effectively forced to pay when governments fail to reimburse nonprofits for the costs they incur working on government grants and contracts. The amount of those hidden subsidies is enormous, given the extent to which governments depend on and contract with nonprofits to deliver services (like providing food, shelter, and social services).

Consider this: The nonprofit sector as a whole [earns](#) about a third of its total revenue by providing services under written agreements with governments—compared with 9.3 percent from donations provided by individuals and 1.9 percent from foundations.

How much is being subsidized?

In a [nationwide survey](#), the Urban Institute found that more than half) of nonprofits with government grants and contracts (excluding hospitals and higher education) reported that governments imposed artificial limitations on reimbursement for indirect costs. Among those reporting such caps, the survey revealed that three out of four nonprofits were able to recover an indirect cost rate of only 10 percent or less; about half were paid 7 percent or less, and a quarter were paid zero.

Now consider the discrepancy between the meager rates that governments pay versus what nonprofit and for-profit groups that deliver services actually spend on overhead, which ranges from 25 percent to 35 percent.

To seize rather than squander this unique opportunity, nonprofit leadership groups must wage sustained campaigns in every state so organizations become aware of

their new responsibilities and rights and then advocate for systemwide changes so state and local laws comply with the federal requirements.

The National Council of Nonprofits, which I lead, and its network of state associations of nonprofits have been working with OMB and others involved in federal grant making to identify and troubleshoot anticipated barriers to putting the new rules in place.

To help nonprofits, we recently published [Know Your Rights ... and How to Protect Them](#) and posted a form on our website for nonprofits to share their experiences about what they are seeing under the Uniform Guidance—whether positive or negative—to identify trends quickly and build the evidence for approaches that work best and changes that need to be made.

Foundations can help build awareness by alerting their grantees to the promise of the new federal regulations and the need to protect their rights. And we hope that grant makers will help nonprofits pay for accounting practices and systems and other efforts to support advocacy activities in each state to ensure state and local government comply with the new rules.

Many foundation leaders are already providing valuable support for the needed sustained campaigns within their states. Among those providing early leadership: members of the Donors Forum in Illinois and a group of six foundations in California working with the state's regional associations of grant makers through leadership of the Weingart Foundation.

Each nonprofit organization that received government money must also learn the cost-allocation rules and revise its accounting procedures, honor its responsibilities under the new rules, and protect its new rights through advocacy.

Grant makers and nonprofits can do much working together to use the new federal grant-making rules to blunt the damage done for too long by people who expect charities to do great things with little or no overhead spending. It is up to all of us to act to turn the promise of these new regulations into reality.

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