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Consider adding a federally negotiated indirect cost rate to your revenue portfolio

By: Rob Hoshaw

The nonprofit sector collectively earns about one-third of its revenue by delivering services through government grants and contracts. Many nonprofits earn federal funds through grants directly with federal agencies or indirectly with state and local governments that initially received those funds. Whether your organization either currently has or might seek such grants in the future, then you may want to consider adding a federally negotiated indirect cost rate agreement (NICRA) to your revenue portfolio, because it can add more resources.

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If the mere thought of navigating another federal bureaucratic process makes you shudder, I get it. I've spent more than a decade completing NICRA applications at my former organization. This article aims to demystify some of the process for you.

Indirect costs are "essential infrastructure"

Indirect costs are as essential to your nonprofit's mission as its programs. "Indirect costs" are simply the expenses of operating a functioning organization that aren't directly attributable to a specific project or program. For nonprofits, indirect costs typically include expenses associated with the health and functionality of the entire organization; for example, fiscal management, human resources, annual audits, and information technology systems. These costs benefit all programs and overall operations, not just one project.

For decades, a pernicious myth suggested that the "best" nonprofits had zero to very little indirect costs (often loosely called "overhead" and "administrative costs"). This misguided notion discouraged nonprofits from investing in their core support. However, in the last decade or so, attitudes toward indirect costs have steadily improved among grant funders, boards of directors, and donors of charitable nonprofits.

Years ago, I attended a training where a nonprofit professional advocated the sector shift its lens to view indirect costs as *essential infrastructure*. I found that simple statement profound and started to think of my former organization's budget like a house. The prominently visible kitchen, bedrooms, and living spaces are like program areas and projects, but indirect costs act as the *foundation*. While few of us think much about our foundation, any cracks or instability in it can create major issues. For a nonprofit, those issues often look like struggling to pay competitive salaries and benefits, limited investment in staff training, making do without necessary or functional equipment, and straining their capacity to deliver essential services in the community.

Indirect cost rates and NICRA

Continuing with the house analogy, each room has its own **direct costs**: the kitchen needs food, a stove, cookware, and utensils; the living room needs furniture, a TV, and power cable; the bedroom, a bed, blankets, pillows; and so on. Each room benefits from what the house's foundation provides-- everything from electricity, water, heating and cooling to insurance, pest control, and internet access. Each room also spends its fair share of those **indirect costs**. The **indirect cost rate** is the ratio of total indirect cost expenses divided by your direct costs. The rate determines the proportion of indirect costs each "room" in the house should bear.

In the nonprofit context, state and local governments spending their own funds impose different rules to determine what counts as reimbursable indirect costs the nonprofit incurred on behalf of that government and how to calculate the indirect cost rates. However, whenever any government is spending federal dollars, the starting point is it must pay the nonprofit the rate established in the nonprofit's **federally negotiated indirect cost rate agreement** (NICRA). A NICRA is a legal document between the federal government and the applicant nonprofit that formalizes the indirect cost rate the applicant can use on grant budgets. NICRAs are designed to streamline the grant process for the government and nonprofits alike, because once the parties negotiate an indirect cost rate covering indirect costs and fringe benefits, that rate will apply in all subsequent federal grants to the nonprofit until it is renewed.

NICRA vs. *de minimis*

A significant watershed moment came a decade ago when the Office of Management and Budget's (OMB) Uniform Guidance established that any local, state, or federal government using federal funds to hire nonprofits to deliver services must reimburse the nonprofit for the indirect costs it incurred using the rate established in the nonprofit's NICRA, or if the nonprofit does not have a NICRA, then that government must pay at least a *de minimis* rate of 10%. That rate may increase soon, as OMB is considering proposed updates that would raise the minimum indirect cost rate from 10% to 15%.

However, even a 15% indirect rate may not always ensure full recovery of essential infrastructure expenses. Case in point, the Ford Foundation increased its minimum grantee indirect cost rate to 25% in 2023, with the belief that achieving successful project and program outcomes requires an investment of at least 25% toward indirect costs. It's possible that you could still be leaving money on the table by claiming the *de minimis* on your grant budgets.

NICRA as a form of fundraising

This is because a NICRA typically yields a higher rate—sometimes significantly more—than the *de minimis* rate, which means a higher payout in support of your organization's fundamental costs of doing business. Nonetheless, I've encountered nonprofit leaders who have been reluctant to apply because a NICRA application can be time-consuming, seem complicated, and may feel like a process shrouded in mystery.

Speaking from personal experience, however, the NICRA we negotiated with the federal government created indispensable, consistent capacity funding for my former nonprofit. Our NICRA **became a vital part of our diversified revenue portfolio** that allowed us to grow our team of staff and expand our services to the community. I came to view the NICRA as another form of fundraising just like asking for community donations or writing grants—each with its own challenges and opportunities.

Tips on NICRA applications and deciding what's best for your organization

1. **First, don't let the term "negotiated" or other technical jargon scare you away.**
   The word "negotiated" can spark images of a contentious battle behind closed doors. From my experience, I'd focus more on the word "agreement" where the parties are coming to a shared understanding. The NICRA process protects nonprofits by giving grantors confidence in the validity of how the indirect cost rate was calculated.
2. **Understand where you can use NICRAs:** In most cases, local, state, and federal governments must and will honor NICRAs. In addition, a growing number of foundations also recognize NICRAs in their grant budgets.
3. **Contact the department that provides your organization with the most federal funding:** Referred to in federal jargon as the "cognizant agency," this is the organization that provides the majority of federal grant dollars to your organization. In most cases, you'll submit your NICRA proposal to this federal agency. If it's not readily clear, I recommend calling to clarify when proposals

are due, ask logistical questions, and request instructions and a sample proposal template. For example, the Department of Interior's Indirect Cost Services provides excellent resources and an FAQ. (Note this is just one example of a cognizant agency.)

4. **Understand the different NICRA applications**. A NICRA application will frequently include two parts submitted together. Most often, the application seeks both a *Final Rate*, calculated on your organization's Form 990 from the prior fiscal year, and a *Provisional Rate*, which is based on the estimated budget for the upcoming fiscal year. In other words, the application covers the year just before and just after your current budget year.
5. **Decide which type of rate is best for your organization.** All indirect cost rates are based on a calculation of direct (programmatic) costs: indirect costs divided by direct costs. However, there are important distinctions in how specific indirect rates are calculated. The three most common types of indirect cost rates vary in how the direct cost "base" is calculated (1) salary and wage expenses only; (2) salaries, wages, *and* benefits (total payroll costs); and (3) modified total direct costs (MTDC), where the rate is applied to most line items in your budget. Understand how these different rates are calculated before deciding which one is right for your organization, and perhaps test each rate out by applying them to past budgets.
6. **Develop a consistent timekeeping protocol.** For many organizations with paid staff, payroll costs are going to be a significant driver of the indirect cost rate. There can be some gray area between program, fundraising, or administration activities, so it's important to develop a consistent, justifiable, and documented protocol for coding activities. You should also be consistent with how you code your operating expenses. In both cases, seek guidance from your accountant, who's already coding expenses for your Form 990.
7. **Find your support network**. Before starting your first NICRA application, seek out others who can provide guidance. If you use an accountant, ask if they have other clients who've applied and if they are familiar with the general process. Also, reach out to your state association of nonprofits. They may have resources on applying for a NICRA, or perhaps can get you in touch with peer organizations that have gone through the process.
8. **Ask your negotiator questions.** After submitting your application, the federal agency will assign you a NICRA negotiator, often from a month to several months later. The "negotiator" title may sound intimidating, but in my experience, these individuals have all been happy to answer clarifying

questions. Learning from them is the number one way I became more efficient and confident with next year's application.

9. **Decide if a NICRA is right for your organization.** Consider your options both from a financial and organizational capacity perspective.
10. **Be kind to your future self**. Give yourself plenty of time to plan for and prepare that first application.

Many nonprofits earning federal grants successfully maintain an annual NICRA, adding flexible funding dollars that help cover essential organizational infrastructure costs. Completing a NICRA application is doable and doesn't need to be painful, especially if you create a plan and most importantly, find where to go for support.

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