

## **New OMB Uniform Guidance on Indirect Costs: What It Does and Why It Matters**

Charitable nonprofits and foundations will benefit significantly from the comprehensive “once-in-a-generation” overhaul of federal grants policies and procedures that the White House Office of Management and Budget (OMB) issued on December 26.<sup>i</sup> Most notably, OMB’s Uniform Guidance makes clear that a nonprofit’s indirect costs (sometimes called overhead or administrative costs) are legitimate expenses that need to be reimbursed for the organization to be sustainable and effective.

The OMB Uniform Guidance explicitly requires pass-through entities (typically states and local governments receiving federal funding) and all federal agencies to reimburse a nonprofit’s indirect costs by applying the nonprofit’s federally negotiated indirect cost rate, if one already exists. If a negotiated rate does not yet exist, then nonprofits are empowered to request negotiating a rate or elect the default rate of 10 percent of their modified total direct costs (MTDC).

The National Council of Nonprofits summarized the importance of the new Uniform Guidance as follows:

“The new guidance means that nonprofits should be able to focus more on their missions and should be under less pressure to raise additional funds to essentially subsidize governments. In turn, charities with no government contracts or grants could see less competition for scarce philanthropic dollars. This is a major win for the entire charitable nonprofit community.”<sup>ii</sup>

At separate gatherings in Georgia and Maryland on January 6, 2014, nonprofit leaders spontaneously erupted in enthusiastic applause upon hearing about the new federal Guidance. Their emotional response reveals the widespread hope that this long-sought recognition – that reimbursement of indirect costs is as vital to the sustainability of charitable nonprofits as it is to for-profits and governments – will lead to greater fiscal stability and broader change. The changes sought? That foundations and more governments will begin paying indirect costs and everyone will stop using the metric of lower overhead as a false proxy for effectiveness. The OMB Guidance accelerates the trend of repudiating “*The Overhead Myth*” that arbitrarily sets artificial limits on indirect and other costs that “starve charities of the freedom they need to best serve the people and communities they are trying to serve.”<sup>iii</sup>

### **1. Importance to Nonprofit Contractors/Grantees**

A nationwide study published December 5, 2013 by the Urban Institute found that governments arbitrarily limit indirect costs for necessary program and organizational expenses; among those experiencing arbitrary caps, one in four nonprofits (24 percent) said that governments refuse to pay *any* indirect costs of the organization, and *half* (49 percent) responded that they were limited to 7 percent or less.<sup>iv</sup> This will no longer be tolerated when federal funds are involved.

### **2. Importance to Foundations**

When governments don’t pay the full costs for services provided by nonprofits pursuant to contracts and grants, nonprofits turn to private philanthropy to fill the gaps. Foundations essentially are called on to

subsidize government and redirect their planned donations away from arts, civil rights, conservation, education, research, and other important priorities.

### **3. Importance to Nonprofits Without Government Contracts/Grants**

Every dollar raised from private philanthropy to pay the costs incurred on behalf of governments, but not reimbursed by them, is a dollar denied to charitable nonprofits that perform no services on behalf of governments.

#### **Next Steps**

OMB's new Guidance provides much-needed clarity and direction, but it does not guarantee increased revenues to cover full costs or, by itself, change long-standing attitudes about nonprofit overhead. To secure the benefits of the new rules, nonprofits and foundations must do much, immediately. For instance, the Guidance says only that, when it becomes effective, federally funded contracts and grants must pay for indirect costs; it does not appropriate additional funds to do that, so nonprofits will need to become more adept at advocacy on appropriation and tax matters. Moreover, governments have incentives to try to avoid compliance. Nonprofits and foundations must be primed to guard against such attempts, whether by actively negotiating fair contract terms or blowing the whistle when the Guidance is being evaded. Federal agencies have up to a year to revise their regulations and train staff to implement the changes. During this time, nonprofits in the field need to learn how to maintain their financial records to properly allocate costs so they can negotiate for the full indirect costs rather than settle for the default rate of 10 percent of MTDC. Nonprofits must also secure training on how to negotiate for their own indirect cost rates at the federal as well as state and local levels. In short, immediate action is needed to create capacity for nonprofits to ensure that the recognition gained through the OMB Guidance is turned into the reality of reimbursement.

#### **About the Government-Nonprofit Contracting Reform Project**

The National Council of Nonprofits works through its network of state associations of nonprofits to proactively promote reforms to government contracting and grants such as these being implemented by the federal government. Readers are encouraged to [contact their state association of nonprofits](#) to learn more about efforts to streamline and improve contracting and grants in your state. Learn more about ongoing government-nonprofit contracting reform efforts across the country and find practical resources at [www.govtcontracting.org](http://www.govtcontracting.org).

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<sup>i</sup> Federal Register, December 26, 2013; <https://www.federalregister.gov/articles/2013/12/26/2013-30465/uniform-administrative-requirements-cost-principles-and-audit-requirements-for-federal-awards>.

<sup>ii</sup> Statement from National Council of Nonprofits on OMB Grant Reforms, December 19, 2013; <http://pages.invoc.us/archive/bWVzc2FnZV8yMjAwOTA5XzM0OF8xMDI2XzM0NDQ4>.

<sup>iii</sup> Open Letter to Donors of America, Better Business Bureau's Wise Giving Alliance, Charity Navigator, and GuideStar, June 2013; [http://overheadmythcom.b.presscdn.com/wp-content/uploads/2013/06/GS\\_OverheadMyth\\_Ltr\\_ONLINE.pdf](http://overheadmythcom.b.presscdn.com/wp-content/uploads/2013/06/GS_OverheadMyth_Ltr_ONLINE.pdf). See also [www.overheadmyth.org](http://www.overheadmyth.org).

<sup>iv</sup> Nonprofit-Government Contracts and Grants: Findings from the 2013 National Survey (Urban Institute; Dec. 2013).