



**NATIONAL COUNCIL OF  
NONPROFITS**

National voice. State focus. Local impact.

December 5, 2013

## **A Dozen Common Sense Solutions to Government-Nonprofit Contracting Problems**

**W**hy the sense of urgency to solve problems in government contracts and grants *right now*?

Because we – individually and collectively – cannot afford the *status quo*.

“We” includes ...

- The troubled teen who must wait another day, or week, or month for an appointment with an overworked therapist or caseworker because fewer frontline program staff are available due to excessive administrative demands for contract compliance reporting.
- The businesses that lose the economic benefit of a better educated workforce, a vibrant arts scene that attracts innovators and other businesses, or a reliable child care and health care system for their employees, because senseless bureaucratic dictates drive community-based nonprofits out of business.
- The members of the community who will not experience the inspiration of a live performance, enjoy a cleaner environment, or engage in a development project that improves a neighborhood because private donations for these activities get diverted to fill government gaps.
- The charitable nonprofits that never take to scale their innovative solutions to intractable problems due to erratic and late payments from governments for services rendered on behalf of the governments.
- Individual donors, corporations, and foundations that are called on time and time again to subsidize governments by paying to keep nonprofit contractors and grantees afloat so that those nonprofits can continue performing under unfair and unworkable contracts with governments.
- State and local government employees dedicated to ensuring high quality services for people of the state and locality who have unworkable workloads due to excessive statutory mandates and so many government layoffs.
- Government officials who must look taxpayers in the eyes and say their money is not being spent as wisely, efficiently, and effectively as it could be if only the contracting and grantmaking systems could be updated, streamlined, right-sized, and rationalized.

For all of these and other reasons, government-nonprofit contract and grant reform is desperately needed *right now*.

## Introduction

In 2010, the Urban Institute issued the results of the nation's first in-depth survey documenting that nationwide **more than half** of all nonprofit human service providers under contract with governments at the local, state, and federal levels reported problems in the following government practices:

1. Governments not paying the full costs that nonprofits incurred in delivering contracted services;
2. Governments failing to pay on time;
3. Governments changing contract terms mid-stream after agreements were signed;
4. Governments imposing costly and burdensome contract application requirements; and
5. Governments imposing costly and burdensome contract reporting requirements.<sup>1</sup>

Each of these and other problems with governments not meeting their contractual obligations adds unnecessary costs to nonprofits, governments, and taxpayers alike. The Urban Institute's latest nationwide survey reveals that those five core problems remain firmly entrenched.<sup>2</sup>

Because governments at all levels depend heavily on charitable nonprofits to provide constituents with efficient and effective services, meaningful solutions to these problems must be collaboratively identified and implemented. Otherwise, the habitual problems will continue to wastefully increase costs as well as reduce the quality and quantity of services to individuals most in need.

Since 2010, the National Council of Nonprofits and its network of state associations of nonprofits have focused on identifying solutions to these and other recurring, systemic problems with the goal of promoting solutions that can be replicated in communities across the country. Where possible, we have worked with governments to begin the journey of implementing various solutions.

This white paper shares a sampling of common sense contracting and grantmaking solutions. The paper identifies replicable solutions that can overcome specific dysfunctional problems that prevent governments and their nonprofit partners from being as successful and efficient as possible. But first, we relate the benefits of "collaborative problem solving" that governments and nonprofits have jointly put to use in productive ways in recent years.

## Collaborative Problem Solving

### **1. Government-Nonprofit Task Forces**

**Policymakers who want to reduce the cost of government, improve services provided to constituents, and return greater value to taxpayers should consider creating a joint government-nonprofit task force to develop and implement recommendations to reform contracting practices and procedures.**

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<sup>1</sup> Human Service Nonprofits and Government Collaboration: Findings from the 2010 National Survey of Nonprofit Government Contracting and Grants ("Urban Institute 2010 Study").

<sup>2</sup> Nonprofit-Government Contracts and Grants: Findings from the 2013 National Survey ("Urban Institute 2013 Study").

During the period since the initial nationwide study in 2010 highlighted the serious problems surrounding government-nonprofit contracting, nine state governments have created joint government-nonprofit contracting reform task forces. A recent report, ***Partnering for Impact: Government-Nonprofit Contracting Reform Task Forces Produce Results for Taxpayers***,<sup>3</sup> reviews the creation, recommendations, and implementation activities of those task forces and identifies trends and insights that can be applied to jumpstart efforts elsewhere. As participants in those nine task forces, the network of the National Council of Nonprofits has developed considerable experience in helping task forces identify state-specific problems and opportunities, develop solutions, and assist with implementation of cost-saving policies, practices, and procedures. In our experience, government-nonprofit contracting task forces consistently produce pragmatic recommendations that can save taxpayers' dollars and reduce burdens on nonprofit contractors and the people served.

Some might presume that task forces made of "opposite sides" would be contentious. But that has not been the case. Governments and nonprofits are natural partners serving the same communities and same constituents. They see the same problems that prevent everyone from accomplishing their missions efficiently. They share common goals of fixing broken systems that hurt everyone. Thus, coming together to solve shared problems makes sense.

Government-nonprofit contracting reform task forces have been created under many different scenarios and can produce positive, meaningful results when the participants share a common commitment to address shared problems.<sup>4</sup> Just as the best solutions will vary from jurisdiction to jurisdiction, no single approach exists. Here we present four forms that task forces have taken.

#### a. Legislative Task Forces

State legislatures create government-nonprofit contracting reform task forces for many different reasons and typically mandate bi-partisan representation and nonprofit participation. State statutes have required task forces to address the dual goals of rooting out waste while maintaining and even enhancing public accountability. For example:

- The Connecticut Legislature created a task force, recognizing that "quality and effectiveness of services are predicated upon a viable and sustainable nonprofit sector," and that "the pursuit of efficiency and streamlining processes is a mutual goal of both purchasers and service providers."<sup>5</sup>

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<sup>3</sup> National Council of Nonprofits, *Partnering for Impact: Government-Nonprofit Contracting Reform Task Forces Produce Results for Taxpayers*, (April 2013) ("***Partnering for Impact***").

<http://www.councilofnonprofits.org/files/streamlining-report-partnering-for-impact.pdf>

<sup>4</sup> See ***Partnering for Impact***, "Lessons Learned from the Government-Nonprofit Task Forces," pages 2-3.

<sup>5</sup> Connecticut Commission on Health and Human Services, *State of Connecticut Commission on Health and Human Services Final Report* (March 2011).

[http://www.ct.gov/opm/lib/opm/finance/hhs\\_commission/final\\_report\\_commission\\_on\\_nonprofit\\_health\\_and\\_human\\_services.pdf](http://www.ct.gov/opm/lib/opm/finance/hhs_commission/final_report_commission_on_nonprofit_health_and_human_services.pdf)

- The Texas Legislature established a task force to develop “recommendations for strengthening the capacity of faith- and community-based organizations (FCBOs) for managing human resources and funds and providing services to Texans in need.”<sup>6</sup>
- The Illinois General Assembly, recognizing “the State’s budget crisis,” called on a bi-partisan panel “to recognize and address the redundant monitoring and reporting requirements, which divert time and resources away from client service delivery.”<sup>7</sup>

These collaborative efforts identified many of the solutions discussed later in this report: improving audit quality, with a reduction in duplication of efforts by multiple taxpayer-funded audit teams; creating electronic information repositories (also known as document vaults) that cut down on repeated paper filings that consume government resources of staff time and storage space; reducing duplication; standardizing contracts; and even the simple act of soliciting nonprofit contractor input at the beginning of the process when it can save money and time, rather than at the end when it often is too late.

#### **b. Executive/Administrative Task Forces**

Governors, Attorneys General, and other officials also have formed government-nonprofit task forces and identified workable solutions for their states. Like their legislative counterparts, executive-created task forces seek to reduce waste, improve efficiency, and maintain and even enhance accountability:

- The Governor of Connecticut created a high-level Cabinet on Nonprofit Health and Human Service – including significant nonprofit participation – to analyze and make recommendations to enhance client outcomes and the cost-effectiveness, accountability, and sustainability of the partnerships between the state and nonprofit health and human service providers.<sup>8</sup>
- Through an Executive Order, New Jersey’s Governor established a permanent, bi-partisan Red Tape Review Commission to review government interaction with for-profit and nonprofit organizations and make detailed findings and recommendations, including an analysis of existing rules, regulations, and legislation that are burdensome to the state’s economy.<sup>9</sup>
- In New York, the Attorney General appointed a Leadership Committee for Nonprofit Revitalization, which found that state laws “and regulatory practices have placed unnecessary and costly burdens on the nonprofit sector. Redundancies throughout the

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<sup>6</sup> 81st Texas Legislature, Regular Session, House Bill 492, Chapter 295, Legislative Document (May 30, 2009). <http://texashistory.unt.edu/ark:/67531/metaph148949/>

<sup>7</sup> Streamlined Auditing and Monitoring of Community Based Services: First Steps Toward a More Efficient System for Providers, State Government, and the Community Report to the Illinois General Assembly as required by PA 96-1141 (January 2011). <http://www.dhs.state.il.us/OneNetLibrary/27896/documents/StreamlinedAuditing/HB5124ReportFINALDraft122210.pdf>

<sup>8</sup> Connecticut Governor’s Cabinet on Health and Human Services website. <http://www.ct.gov/opm/cwp/view.asp?a=2998&Q=490946>

<sup>9</sup> New Jersey Governor’s Office, *Executive Order 41* (2010). <http://nj.gov/infobank/circular/eocc41.pdf>

system waste scarce taxpayer and nonprofit dollars, and bury nonprofits in duplicative paperwork and audits.”<sup>10</sup>

- The Secretary of the North Carolina Department of Health and Human Services formed a task force of Department officials and nonprofits to develop solutions to ten specifically identified inefficiencies that nonprofits were experiencing in their DHHS contracts. The Department-level collaboration made several recommendations for reform, including prompt payment and reimbursement of full costs of performing contracted services, crafting clearer definitions to avoid confusion and delays, standardization of contracts and of monitoring processes, and shared training.<sup>11</sup>

### c. Permanent Contract/Grant Streamlining Councils

Governments and nonprofits recognize the value of resolving problems together. Eight of the government-nonprofit task forces analyzed in *Partnering for Impact* found the joint efforts so beneficial that their recommendations specifically included a call for the establishment of a formalized group of government and nonprofit officials to continue working together on contracting as well as other common issues.<sup>12</sup>

In 2012, the Maryland Legislature created the Council for the Procurement of Health, Educational and Social Services to monitor and engage state agencies in implementing reform recommendations from the Task Force that studied procurement issues. The Council, which includes four representatives of nonprofit service providers, is also charged with providing ongoing oversight of the procurement process for human services and reporting to the Governor and Legislature.<sup>13</sup>

The Texas Legislature created the Texas Nonprofit Council this year following the recommendation of two legislative task forces.<sup>14</sup> The Council will work with the Interagency Coordinating Group of state agencies to strengthen collaboration between government agencies and the nonprofit sector. Specifically, it has the responsibility for making recommendations for improving contracting relationships between state agencies and nonprofits, developing best practices for cooperating and

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<sup>10</sup> Revitalizing Nonprofits: Renewing New York, Leadership Committee for Nonprofit Revitalization Report to Attorney General Eric T. Schneiderman (February 2012).  
<http://www.ag.ny.gov/sites/default/files/NP%20Leadership%20Committee%20Report%20%282-16-12%29.pdf>

<sup>11</sup> *Partnering for Impact*, pages 8-9.

<sup>12</sup> See, e.g., Connecticut Commission on Nonprofit Health and Human Services Final Report (March 31, 2011): “Recommendation #1: An ongoing body, similar to this Commission, should be created and charged with tackling the issues before us, working to add value to the process of implementing the specific recommendations, achieving specific results over specific timeframes, and as this Commission has been, should be comprised of a cross-section of representatives from State Agencies, Private Providers and their representative organizations, Labor, and persons who are recipients of benefits under health and human services programs.”  
[http://www.ct.gov/opm/lib/opm/finance/hhs\\_commission/final\\_report\\_commission\\_on\\_nonprofit\\_health\\_and\\_human\\_services.pdf](http://www.ct.gov/opm/lib/opm/finance/hhs_commission/final_report_commission_on_nonprofit_health_and_human_services.pdf)

<sup>13</sup> Maryland House Bill 217/Senate Bill 315 enacted May 2, 2012.  
<http://mlis.state.md.us/2012rs/billfile/hb0217.htm>

<sup>14</sup> Texas S.B. 993, enacted June 14, 2013.  
<http://www.legis.state.tx.us/tlodocs/83R/billtext/html/SB00993F.htm>

collaboration with them, and identifying and addressing duplication of existing services and of gaps in state services that nonprofits could fill.

Other states are considering other permanent structures to tap into the expertise of nonprofit contractors for improving contracting efficiencies.<sup>15</sup>

#### **d. Informal Government-Nonprofit Dialogue**

Nonprofits do not have to wait for government officials to invite them to discuss contracting and grant reforms. Often their work to develop solutions can be implemented without the need for legislation, chief executive action, or publicity.

Donors Forum, the state association of nonprofits in Illinois, pioneered an excellent model for collaboration and problem solving by the public and private sectors. Its efforts culminated in the highly-endorsed “Partnership Principles for a Sustainable Human Services System.”<sup>16</sup> Successful partnerships have also been established in Connecticut, Maine, and New York City.

Similarly, in 2013, the National Council of Nonprofits empaneled the National Task Force on Government-Nonprofit Contracting Reform. Task Force members are experts from government and nonprofit organizations who live in different regions of the country. They have come together to identify, exchange, and disseminate nonpartisan policies and practices that result in real systems improvements to best serve local communities.<sup>17</sup> They bring tremendous energy as they enthusiastically exchange information – in part because they have no other forums in which to work on vexing problems that they encounter daily. Their selfless devotion of time and sharing of their expertise is just the latest example of quiet collaboration between governments and nonprofits to better serve the public and save taxpayers money.

## **2. Nonprofit Liaison**

**Governors, Mayors, and other executive branch officials should appoint high-level Nonprofit Liaisons to oversee and promote efforts of the government and nonprofits to work together on policy issues that threaten the sustainability of charitable nonprofits on which governments rely to provide basic services to constituents.**

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<sup>15</sup> See, e.g., Massachusetts Senate Bill 1486, would create a permanent interagency coordinating group on the government-nonprofit partnership with the “goals of: (i) increasing the impact of state funds granted or contracted to nonprofits; (ii) improving efficiency in the grant and contracting systems and processes between state government and nonprofits; and (iii) strengthening accountability in the government-nonprofit partnership by improving the use of data and technology to inform decision-making and oversight. Further, the coordinating group shall: (i) identify and develop on-going opportunities to improve the impact, efficiency, and accountability of the government-nonprofit partnership; and (ii) make recommendations as to the need for legislation, ad hoc Commissions, or task forces.” <https://malegislature.gov/Bills/188/Senate/S1486>

<sup>16</sup> Donors Forum, *Fair and Accountable: Partnership Principles for a Sustainable Human Service System* (n.d.). Retrieved from [http://www.donorsforum.org/s\\_donorsforum/bin.asp?CID=19380&DID=33993&DOC=FILE.PDF](http://www.donorsforum.org/s_donorsforum/bin.asp?CID=19380&DID=33993&DOC=FILE.PDF)

<sup>17</sup> “National Task Force to Improve Government-Nonprofit Contracting Practices Begins Work,” National Council of Nonprofits news release (June 26, 2013). <http://pages.invoc.us/archive/bWVzc2FnZV8yMjAwOTA5XzE2MV8xMDI2XzM0NDQ4>

Across the United States, few government structures exist to tap the expertise, creativity, and local economic impact of the nonprofit community, despite the fact that charitable nonprofits employ more than 10 percent of the workforce (13.7 million workers), contributing \$587.6 billion in wages and salaries – or 9.2 percent of all wages and salaries paid in the United States in 2010.<sup>18</sup> However, a few inspired government officials have discovered – and implemented – ways to open and maintain communications, thereby creating opportunities for government and nonprofits to work together on policy issues that threaten the sustainability of charitable nonprofits on which governments rely to provide basic services to constituents.

- In his first week in office in 2011, Connecticut’s Governor became the first in the nation to appoint a cabinet-level official to serve as liaison with nonprofits providing services to the state’s residents on behalf of government.<sup>19</sup>
- The Governor of New York appointed an InterAgency Coordinator for Not-for-Profit Services who is responsible for tackling persistent problems that add costs and complicate otherwise effective government-nonprofit relations, including reforming contracting practices. The official is taking action on ways to streamline processes to help taxpayers and nonprofits.<sup>20</sup>
- Several years ago, the Mayor of Denver created the Denver Office of Strategic Partnerships (DOSP) to serve as a liaison between the City of Denver and the nonprofit sector. Beyond providing a way “for both nonprofit and City staff to develop an understanding of each other’s strengths and capacities” to strengthen Denver’s communities, DOSP has trained hundreds of nonprofit leaders on how to apply for federal grants, bringing outside dollars to the City.<sup>21</sup>

In these and other locations, elected officials have seen that the government and taxpayers benefit when ongoing dialogue is established – at the highest level – with solution-oriented charitable nonprofits. The core purpose of a nonprofit liaison is to establish a constructive way for government and charitable nonprofit leaders to interact and communicate directly to identify problems and create coordinated reform efforts. Through these arrangements government executives are able to make better informed decisions based on ideas and solutions tested in the real world by organizations dedicated to serving their communities.

### **Sampling of Solutions to Problems Documented by Urban Institute Research**

Since 2010 when the Urban Institute first documented the five widespread problems with government-nonprofit contracting practices, the National Council of Nonprofits and its network have been identifying and promoting solutions to those problems. The following sampling of solutions will help taxpayers, those needing services, and governments just as much as they help nonprofits.

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<sup>18</sup> Katie L. Roeger, Amy S. Blackwood, and Sarah L. Pettijohn, *The Nonprofit Almanac 2012*, The Urban Institute. See more at: <http://www.councilofnonprofits.org/public-policy/three-simple-things-state-local-elected-officials#sthash.C4qKCPOZ.dpuf>

<sup>19</sup> State of Connecticut Governor’s website (January 2011).  
<http://www.governor.ct.gov/malloycwp/view.asp?A=4010&Q=471320>

<sup>20</sup> “Coming Soon! A NYS Standard Contract,” NY Nonprofit Press (Oct. 6, 2012).  
<http://www.nynp.biz/October0912.html>

<sup>21</sup> 2011 Annual Report, Denver Office of Strategic Partnerships.  
<http://www.denvergov.org/Portals/691/documents/New/DOSP%20annual%20report%202011%20c.lr.pdf>

## **A. Failure to Pay the Full Costs of Services**

The Urban Institute's 2013 study reveals that greater than half of all nonprofits (54 percent) with government contracts or grants report problems with governments not paying the full costs of the contracted services. When this occurs nonprofits have to divert resources away from mission to raise funds elsewhere. This forces nonprofits to subsidize the work of government. While governments pay defense contractors, highway paving companies, and local accounting and law firms their costs – plus profits – for delivering goods and services, governments routinely and systematically do not to pay nonprofits their actual costs incurred. As even government studies reveal, this short-sighted practice threatens the sustainability of nonprofits on which governments rely.

### **3. Payment of Indirect Costs Incurred**

**Governments at all levels must reimburse nonprofit organizations for the full indirect costs that the nonprofits legitimately incur in delivering contracted services. Paying indirect costs will ensure that taxpayer dollars are invested to achieve the greatest impact, because research proves that the most efficient and effective charitable nonprofits are those that invest in accountability, technology, and other necessary infrastructure items that are considered “indirect costs.” Federal, state, and local governments should reimburse nonprofits for indirect costs, regardless of whether the nonprofit is a prime contractor/grantee or subrecipient, or from where funds originate.**

Until recently, the conventional view held that the best charitable nonprofits were those that spent the least on indirect costs – that is, costs for such things as accounting, information technology, human resources, training, governance, and management. The same thinking has rarely been applied to for-profit businesses, where such expenses are accepted as essential for creating more efficient and more effective organizations that produce better outcomes. Yet public policies and community attitudes have historically believed that if nonprofit organizations incurred any similar costs, then they were somehow inappropriately diverting resources from direct service delivery.

Landmark studies over the past ten years, as detailed in *Investing for Impact: Indirect Costs are Essential for Success*,<sup>22</sup> show that the most efficient and effective charitable nonprofits spend more on indirect costs than their less effective peers. In fact, the studies show that the old way of thinking about indirect costs has led to diminished capacity by nonprofits to perform vital services to the public. Notably, the studies identified in *Investing for Impact* show that **a range of between 20 percent and 40 percent is appropriate for indirect costs, with a range of 25 percent to 35 percent as being most realistic.**

In 2010, the National Council of Nonprofits recommended that the White House Office of Management and Budget “mandate that federal pass-through dollars actually pass through fully to the deliverer of services.”<sup>23</sup> The recommendation was based, in large part, on the in-depth analysis by the Government Accountability Office into the reimbursement practices of state and local

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<sup>22</sup> *Investing for Impact: Indirect Costs are Essential for Success*, National Council of Nonprofits (September 30, 2013) (“*Investing for Impact*”). <http://www.govtcontracting.org/sites/default/files/investing-for-impact.pdf>

<sup>23</sup> National Council of Nonprofits, *Costs, Complexification and Crisis: Government's Human Services Contracting “System” Hurts Everyone* (2010). <http://www.govtcontracting.org/sites/default/files/Costs%20Complexification%20and%20Crisis.pdf>



governments.<sup>24</sup> That GAO report found significant underpayment for the indirect costs of nonprofit contractors and grantees. As a result of these practices, GAO found that nonprofits, "to bridge the gap ... may reduce the population served or the scope of services offered, and may forgo or delay physical infrastructure and technology improvements and staffing needs," among many other actions that undermine organizational sustainability.<sup>25</sup>

To its credit, the federal Office of Management and Budget (OMB) has indicated that it recognizes governments' great interest in sustainable nonprofit contractors and grantees that can provide cost-effective services in their communities. OMB is currently evaluating proposed guidelines on how best to ensure that state and local governments pay adequate and legitimate indirect costs as a core cost of operations.<sup>26</sup>

The National Council of Nonprofits submitted comments in support of the OMB proposal, with recommended modifications, and the charitable nonprofit community is eagerly awaiting changes in federal reimbursement policy that will bring it more in line with the new informed thinking on indirect costs.<sup>27</sup> OMB is expected to publish "OMB Uniform Guidance: Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards" in December 2013.

Conventional wisdom on nonprofit indirect costs is beginning to reach alignment with what for-profit businesses have known all along, that 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. For government-nonprofit contracts and grants, a shift in thinking on indirect costs is long overdue and worthy of immediate attention by policymakers whose job is to ensure that taxpayer dollars are invested to deliver the greatest impact. Governments at all levels have the opportunity now to reverse outdated policies and practices regarding indirect costs and strengthen the service delivery system within their jurisdictions.

### **Additional Considerations on Indirect Costs**

In addition to reviewing recent research on indirect cost rates, *Investing for Impact* details how a combination of inconsistent terminology by governments, arbitrary application of those terms, and unrealistic expectations impair the ability of nonprofits to deliver services for which governments at all levels contract with them. Each of these issues requires further discussion and policy revisions.

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<sup>24</sup> Government Accountability Office, "Treatment and Reimbursement of Indirect Costs Vary among Grants, and Depend Significantly on Federal, State, and Local Government Practices," GAO-10-477 (May 2010).  
<http://www.gao.gov/new.items/d10477.pdf>

<sup>25</sup> *Id.* at page i.

<sup>26</sup> OMB Proposed Guidance, published on February 1, 2013, includes a provision that explicitly requires pass-through entities (typically states and local governments receiving federal funding) to either honor a nonprofit's negotiated indirect cost rate, negotiate a rate in accordance with federal guidelines, or pay a minimum rate of 10 percent for up to four years while a nonprofit works to obtain a negotiated rate.  
[http://www.whitehouse.gov/omb/grants\\_docs?utm\\_campaign=021113admat&utm\\_medium=email&utm\\_source=newsletter&utm\\_content=proposed%20guidance&#proposed](http://www.whitehouse.gov/omb/grants_docs?utm_campaign=021113admat&utm_medium=email&utm_source=newsletter&utm_content=proposed%20guidance&#proposed)

<sup>27</sup> <http://www.councilofnonprofits.org/files/National-Council-of-Nonprofits-Comments-on-OMB-Proposed-Guidance-6-2-2013.pdf>

#### **4. Clear and Consistent Definitions**

**Governments should provide and apply clear and consistent definitions of administrative costs, indirect costs, and overhead.**

People often presume that accounting is black and white and that accounting terms are defined distinctly and applied consistently. When it comes to the topic of indirect costs, however, that presumption is wrong. Several similar yet distinctly different terms – indirect costs, administrative costs, and overhead costs – are often unknowingly used interchangeably, causing great confusion and harm. The inconsistent understanding and usage of these and other terms in OMB Circular A-122 and IRS Form 990 have contributed to the systematic underfunding of the work of charitable nonprofits, eroding their sustainability – which, as noted by the GAO, threatens government and the public.<sup>28</sup>

Superimposed on top of competing federal categorization systems is the confusion caused when laypeople use the similar-sounding term of “overhead.” When charity watchdog groups refer to “overhead,” they generally define this as administrative (including facilities) and fundraising costs combined.<sup>29</sup> When governments use the terms indirect or administrative costs, however, they do not include any fundraising costs. Governments consider the costs associated with fundraising as being separate and distinct costs unrelated to programs and unallowable for reimbursement purposes.

Policymakers can significantly improve compliance and performance by clearly defining each term and codifying these definitions so they are consistent at the federal level and across states and localities.

#### **5. Repeal of Arbitrary Caps on Indirect Costs**

**Legislatures should repeal existing language in statutes that set arbitrary caps on legitimate indirect costs. Legislatures should also stop creating new caps, and instead provide clear guidance to government officials in support of sustainable reimbursement rates.**

Some reimbursement rates are the result of statutory dictates by legislatures that insert arbitrary caps or other restrictions when creating a new program or designating a funding stream. These arbitrary and artificial limits should be replaced by mandates to establish consistent and standardized contract and grant language and policies that fairly include full reimbursement of indirect costs. Legislatures should resist the urge to impose arbitrary caps on indirect cost reimbursements that override policies designed to promote long-term sustainability of nonprofit partners that can achieve better outcomes for the public.

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<sup>28</sup> GAO-10-477, page 11. <http://www.gao.gov/new.items/d10477.pdf>

<sup>29</sup> See, e.g., Charity Navigator Financial Range Tables, which define “administrative expenses” as follows: “Percent of total functional expenses spent on management/general.” [http://www.charitynavigator.org/index.cfm?bay=content.view&cpid=48#.UjyAui3D\\_5p](http://www.charitynavigator.org/index.cfm?bay=content.view&cpid=48#.UjyAui3D_5p)

## **B. Late Payments**

The national data from the latest Urban Institute survey show that almost half (45 percent) of charitable nonprofits with government contracts and grants continue to experience problems with governments making late payments – as in later than the legal requirements in the written agreements that governments signed. As a result, many nonprofits are forced to divert efforts away from their missions as they scramble to meet normal cash-flow needs to pay their employees, rent and utilities, and other operating costs by raising funds from other sources such as private donations or bridge loans, or by taking extraordinary actions like curtailing operations and laying off employees. In all of these instances, nonprofits are essentially forced to subsidize government operations, at the expense of the people they serve and the nonprofits' own sustainability.

### **6. Prompt Payment Laws**

**Governors and legislatures should ensure that state and local governments pay their bills on time. State laws requiring prompt payment, backed by a statutory substantial late-payment interest penalty, must be enacted *and* must be enforced. Legislatures should extend state prompt payment laws to local governments to ensure that the state and its political subdivisions all honor their written commitments and treat nonprofit contractors and grantees fairly.**

Many states have prompt payment laws that require government agencies to pay interest penalties for payments made beyond a statutory deadline. To cite just one example, Illinois law provides that “if payment is not issued to the payee within [a] 60 day period, an interest penalty of 1.0% of any amount approved and unpaid shall be added for each month or fraction thereof after the end of this 60 day period, until final payment is made.”<sup>30</sup>

However, the statutory right can be illusory when governments will not or cannot meet their obligations. The Illinois Comptroller's Office admitted that the state ended the 2013 fiscal year with 73,184 unpaid bills totaling \$3.3 billion – on top of the state's total backlog that exceeded \$6 billion. The Comptroller expressed the frustration that many nonprofit and for-profit contractors are experiencing: “We continue to force businesses, hospitals, schools and service agencies to wait months on end for promised payment from the state. It is unconscionable and further highlights the importance of keeping spending flat and restoring our fiscal integrity.”<sup>31</sup> Apologetic words from elected officials, however, do not allow nonprofits to pay their employers, vendors, or others so they can achieve their missions of serving people in their communities.

### **7. Prompt Contracting Laws**

**Governors and legislatures should ensure that services provided on behalf of state and local governments are performed pursuant to written agreements that are signed prior to commencement of work. State laws requiring prompt contracting, backed by a statutory substantial late-contracting interest penalty, must be enacted *and* must be enforced.**

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<sup>30</sup> Illinois Prompt Payment Act, 50 ILCS 505/4.  
<http://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=725&ChapterID=11>

<sup>31</sup> “State Ends Fiscal Year \$6.1 Billion in the Red,” news release of Illinois Comptroller Judy Baar Topinka (July 1, 2013). <http://www.ioc.state.il.us/index.cfm/news-portal/712013-topinka-state-ends-fiscal-year-61-billion-in-red/>

Distinct from prompt payment, prompt contracting laws exist in a few states to ensure the provision of services is not disrupted or delayed. New programs often require hiring new staff and securing additional space, with no new revenue source yet in place to cover these costs until the contract is executed. Or, in the case of renewing contracts, nonprofits typically continue to provide existing services to avoid the costs of closing and reopening a program, as well as the disruptions to those they serve, with no assurance of being paid for the services until the contract is signed. Even when payments are made retroactive, this still means that nonprofits receive reimbursement long after providing the service, much like a late payment.

New York State has perhaps the toughest prompt contracting statute in the country. The law mandates that a state agency shall not take longer than 150 days following the latest date on which any of the appropriations covered by the program plan become law to execute contracts with nonprofit organizations pursuant to the program plan,<sup>32</sup> and even tighter timelines for contract renewals.<sup>33</sup> Yet New York's Comptroller recently found that state agencies failed to meet contracting timelines for approximately four out of every five contracts (78 percent), results that are virtually unchanged from 2011, when 80 percent of contracts were reported late. The report found further that state agencies reported that 1,953 contracts were eligible for interest penalties, but paid interest on just 735 (38 percent) of those totaling \$237,538.<sup>34</sup> In that report, the Comptroller points to promising developments to help alleviate future non-compliance, such as the standard contract documents and electronic applications, and contract management. While potentially promising, there is no real substitute for government agencies working directly with their nonprofit contracting partners to get the paperwork and administrative burdens out of the way early so that the focus can return to where it belongs, on the people and communities that the nonprofits serve.<sup>35</sup>

#### **8. Public Disclosure of Government Accountability**

**Governments at all levels should establish disclosure mechanisms that inform the public on the timeliness of payments by government agencies to contractors, whether the agencies are required to pay late penalties, and how much and when those payments are made.**

Each year, the New York State Comptroller publishes a report detailing the compliance by state agencies with New York's prompt contracting laws. Except for some bad press the state may get for a few days after the report is released at the end of May, the contracting and payment performance of state agencies receive little public scrutiny. Florida's Department of Children and Families, on the

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<sup>32</sup> [NY Code - Section 179-S](#).

<sup>33</sup> [NY Code - Section 179-T](#).

<sup>34</sup> Prompt Contracting Annual Report for Calendar Year 2012, Office of the New York State Comptroller (May 31, 2013). [http://www.osc.state.ny.us/contracts/reports/2012/pcl\\_report.pdf](http://www.osc.state.ny.us/contracts/reports/2012/pcl_report.pdf)

<sup>35</sup> The Connecticut Office of Policy and Management maintains a policy that each state agency contracting with nonprofits must execute at least 95 percent of contracts no fewer than 15 days prior to the commencement of services: "The late execution of contracts imposes costs on nonprofit providers and is not an acceptable business practice for either the State or its providers." <http://www.ctnonprofits.org/ctnonprofits/sites/default/files/fckeditor/file/policy/private/PurchaseOfServiceContractingReforms.pdf>

other hand, publicly discloses a monthly “scorecard” of strategic indicators, including percentage of “payments presented & processed timely.”<sup>36</sup>

Government agencies should report the timeliness of their payments to contractors and the results should be posted monthly on a central website. The public and individual contractors have a right to know how their governments are operating, and which government agencies and departments are performing most efficiently and effectively. Timely data on contracting and payment performance will provide contractors with needed information to gauge their ability to withstand payment problems, while also providing incentive for government agencies to improve operations that benefit the public good.

### **C. Contracts/Grants Language and Interpretations**

The Urban Institute 2013 Study reveals that more than half (52 percent) of nonprofits with government contracts/grants reported that changes were made to the written agreements after they were signed. Such changes included governments increasing reporting requirements, decreasing payments for services, and increasing service requirements. Those types of changes increase operational, financial, and administrative strains on nonprofits. The following proposals would reduce the interruptions documented by the Urban Institute survey.

#### **9. Standardized Language for Contracts and Grants**

**State and municipal governments should standardize contract and grant language across multiple agencies to secure the savings attainable through reduced negotiating costs, standardized attachments and forms, as well as reporting requirements for consistency across government agencies, while also ensuring compliance with federal guidelines (where governing) and general accounting principles.**

The benefits of having standard language for a contract or grant cannot be overstated. In addition to creating consistency in the definitions that can be used when negotiating and enforcing contracts and grants, having uniform terms can eliminate some of the mid-stream changes that get made after agreements are signed. Even the process for developing common language for all written agreements can help reduce redundancy in forms and processes as government officials evaluate which legal provisions are required by law, which are essential for maintaining public accountability and fiscal oversight, and which are unnecessary. It is further essential that during the process of developing standard language, attention must also be devoted to standardizing what can and cannot be included within allowable costs across all agreements, rather than being established separately through each funding opportunity or agency. These actions will eliminate costs associated with preparing separate reports according to multiple sets of guidelines, enhance transparency, and promote greater compliance.

To this end, Illinois Public Act 0297-0210 calls for the creation of a common service taxonomy for human services providers to include, but not be limited to, a common list of terms to define services, processes, and client populations.<sup>37</sup>

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<sup>36</sup> See “Region Balanced Scorecard, Strategic Indicators November 2013 Report,” Florida Department of Children and Families.  
<http://www.dcf.state.fl.us/performance/regional/RegionBalancedScorecardReportNov2013.pdf>

## **10. Ongoing Provider Input**

**Governments should institutionalize methods to regularly obtain input from nonprofits about how contracting and grant processes, as well as program design and implementation, can be improved. Barriers to open and public exchanges of ideas and solutions should be eliminated.**

State ethics and contracting laws quite rightly prohibit individuals and organizations from improperly attempting to influence the drafting of Requests for Proposals (RFPs) and similar documents in ways that would provide them with unfair advantages. These restrictions, however, can have the unintended consequence of walling off government program and contracting officers from the work that will be performed on behalf of government and thus limiting their understanding of the real-world impact of the written agreements they are drafting.

The Maryland Legislature remedied the problem in 2012 by allowing state agencies to receive input and comments from provider groups on RFP's in their draft stage.<sup>38</sup> It is anticipated that the new approach will improve the quality of the RFPs and reduce the number of amendments that have bedeviled contractors in the state for years. If the government has a more informed view of delivery requirements and restraints in advance, there will be less need to try to change the terms of the agreements after they are signed, as well as reduce issues with prompt contracting.

## **D. Complexity of Application and Reporting Requirements**

The latest Urban Institute study documents (at page 24) that “more than 70 percent of nonprofits reported that complicated application and reporting requirements were problematic,” which hurts nonprofits, governments, and taxpayers – as well as those in the community who need services.

## **11. Document Vaults**

**States and municipalities should eliminate redundancy in the application and reporting processes by creating an electronic repository or “document vault” to house in a central location all documents relevant to bids for contracts and grants, and to which each contracting agency would have access.**

Virtually every time a nonprofit responds to a government Request for Proposal (RFP) or Request for Qualifications (RFQ), it must provide hard copies of its IRS Letter of Determination, its recent Form 990 informational tax returns, its list of board members, its most recent audit(s), its Articles of Incorporation, its bylaws, its licensing and credentialing document(s), its organizational charts, its personnel policies, etc. Since different state agencies require different items in different order, nonprofits are not able to create multiple packets of these documents in advance to have on hand to include with an application.

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<sup>37</sup> Illinois PA 097-0210 (e) (July 2011). <http://www.ilga.gov/legislation/publicacts/fulltext.asp?Name=097-0210>

<sup>38</sup> [Maryland House Bill 1196](#), enacted May 22, 2012.

The government side of the RFP equation is even more paper intensive. Once the application from each nonprofit organization is received, multiple copies are printed and distributed to several state employees for review, each having his or her own files to maintain. Next, if the application is selected for funding, more copies are made to distribute to those who will be negotiating, reviewing, and ultimately approving an actual written agreement, in addition to those government employees who will be managing and monitoring it. And even the paperwork of those not selected must be maintained in file cabinets for a certain number of years in case there is a bid protest or to comply with public records laws. On top of all this paperwork is the human side: having enough state employees to receive, maintain, retrieve, archive, and then review documents when requested.

The money- and space-saving solution to this growing problem is a document vault – an online electronic repository where nonprofits can upload all of their required documents for any government employee to access as appropriate. Several governmental entities have already started the process of implementing document vaults as a way to save money for both government and nonprofits as well as to help streamline some of the contracting processes. Working with the charitable nonprofits in their states, each has developed a system that best meets its own needs. What is particularly impressive is that most have done so with little or no additional implementation costs.

For example, Illinois created the Management Improvement Initiative Committee (MIIC)<sup>39</sup> to improve government-nonprofit contracting practices and procedures. The state was able to utilize existing software and IT staff to develop a document vault, known as the Centralized Repository Vault (CRV), to house a standard list of documents from nonprofits contracting with the five different human services agencies in the State. The Illinois CRV, in its first three months of operation, saved the state \$40,000 in printing costs alone. Currently, more than 1,000 nonprofits have signed up and are using the system.

A Maryland state agency is testing an online document vault that is developed, managed, and maintained by a third-party vendor. Nonprofit providers pay for the system through an annual fee. Estimates are that the document vault in Maryland will produce average savings of \$12,176 per year for each nonprofit.<sup>40</sup>

## **12. Standardized Monitoring and Reporting**

**Governments should reduce redundant monitoring by standardizing and integrating procedures across multiple government agencies. In particular, governments should standardize administrative requirements, consolidate forms and reporting processes, and develop and use standardized language, and apply them consistently across services, with particular emphasis placed on fiscal and general administration documents.**

Monitoring generally refers to reviewing the program elements, requirements, and organizational process associated with a contract or grant exclusive of the financial components. Various government agencies may establish different requirements that at times conflict with those of others

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<sup>39</sup> <http://www.ilga.gov/legislation/publicacts/fulltext.asp?Name=097-0558>

<sup>40</sup> Estimate of savings provided to the National Council of Nonprofits by Chronos DocVault, [www.chronosdocvault.com](http://www.chronosdocvault.com).

or require nonprofits to keep the same information in multiple ways to comply with each agency's guidelines. Standardization and streamlining of monitoring and reporting is essential.

Identifying existing duplication is not the only way to find savings. The 2011 Illinois task force report found that "it is important to not only "fix" the existing problems, but develop processes for incorporating proposed requirements into the overall structure of monitoring procedures, in order to avoid creating new redundancies." Among many recommendations, that task force called for the creation and implementation of an inter-departmental process to cross check potential new requirements to avoid creating additional redundancies. The Illinois task force specifically urged the standardization of administrative requirements, consolidation of forms and reporting processes, and their application consistently across services, with particular emphasis placed on fiscal and general administration documents.<sup>41</sup>

### **Conclusion**

The National Council of Nonprofits salutes those government officials and employees who recognize that the current so-called "contracting system" is broken and are taking proactive steps to work with nonprofits to solve problems to help the communities and constituents that we jointly serve. The nonprofit community stands ready to assist government officials and employees in identifying places where processes create unnecessary and wasteful impediments, and offering solutions and engaging in training to improve efficiencies.

### **About the National Council of Nonprofits**

The National Council of Nonprofits is a trusted resource and advocate for America's charitable nonprofits. Through our powerful network of State Associations and 25,000-plus members – the nation's largest network of nonprofits – we serve as a central coordinator and mobilizer to build connections, leverage capacity, and amplify voices to achieve greater collective impact in local communities across the country. We identify emerging trends of concern to nonprofits, share proven practices, and develop solutions for the benefit of nonprofits and the communities they serve. Learn more at [www.CouncilofNonprofits.org](http://www.CouncilofNonprofits.org).

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<sup>41</sup> "Streamlined Auditing and Monitoring of Community Based Services: First Steps Toward a More Efficient System for Providers, State Government, and the Community," Report to the Illinois General Assembly as required by PA 96-1141 (January 1, 2011). [http://www.dhs.state.il.us/OneNetLibrary/27896/documents/StreamlinedAuditing/HB5124ReportFINALDraft122210.pdf?utm\\_source=Policy+Update&utm\\_campaign=896d8ee917-May\\_Policy\\_Update5\\_18\\_2011&utm\\_medium=email](http://www.dhs.state.il.us/OneNetLibrary/27896/documents/StreamlinedAuditing/HB5124ReportFINALDraft122210.pdf?utm_source=Policy+Update&utm_campaign=896d8ee917-May_Policy_Update5_18_2011&utm_medium=email)