NONPROFIT SECTOR

Treatment and Reimbursement of Indirect Costs Vary among Grants, and Depend Significantly on Federal, State, and Local Government Practices

Why GAO Did This Study

Nonprofits are key partners in delivering federal services yet reportedly often struggle to cover their indirect costs (costs not readily identifiable with particular programs or projects). This raises concerns about fiscal strain on the sector. To provide information on nonprofits’ indirect cost reimbursement, especially when funding flows through entities such as state and local governments, GAO was asked to review, for selected grants and nonprofits, (1) how indirect cost terminology and classification vary, (2) how indirect costs are reimbursed, and (3) if gaps occur between indirect costs incurred and reimbursed, steps taken to bridge gaps. GAO selected six Departments of Health and Human Services and Housing and Urban Development grants and 17 nonprofits in Louisiana, Maryland, and Wisconsin. GAO selected these agencies for their historical relationship with nonprofits. GAO reviewed policies and documents governing indirect costs and interviewed relevant officials. GAO also reviewed research on nonprofits’ indirect costs.

What GAO Found

Depending on the grant program, nonprofits may be reimbursed for indirect costs (generally costs such as rent or utilities), administrative costs (generally cost activities such as accounting or personnel), both, or neither. OMB officials said costs can be classified as either indirect or direct, and administrative cost activities are usually, but not always, classified as indirect costs. However, inconsistencies in the use and meaning of the terms indirect and administrative, and their relationship to each other, have made it difficult for state and local governments and nonprofits to classify costs consistently. This has resulted in varying interpretations of what activity costs are indirect versus administrative. As OMB guidance on cost principles for nonprofits recognizes (2 CFR Part 230), because nonprofit organizations have diverse characteristics and accounting practices, it is not possible to specify the types of costs that may be classified as indirect in all situations. This increases the challenges of administering federal grants and, in some cases, makes it difficult for recipients to determine those activities eligible for indirect cost reimbursement under a particular federal grant and those that are not.

GAO found differences in the rate in which state and local governments reimburse nonprofits for indirect costs. These differences, including whether nonprofits are reimbursed at all, largely depend on the policies and practices of the state and local governments that award federal funds to nonprofits. Federal grants often provide wide latitude in setting cost reimbursement policies and practices, and some state and local governments do not reimburse these costs at all. Those that do can often choose the reimbursement rate. As a result, GAO found that variations in indirect cost reimbursement exist not only among different grants, but also within the same grant across different states.

GAO found that nonprofits fund indirect costs with a variety of federal and nonfederal funding sources, and that when indirect cost reimbursement is less than the amount of indirect costs nonprofits determine they have incurred, most nonprofits GAO interviewed take steps to bridge the gap. They may reduce the population served or the scope of services offered, and may forgo or delay physical infrastructure and technology improvements and staffing needs. Because many nonprofits view cuts in clients served or services offered as unpalatable, they reported that they often compromise vital “back-office” functions, which over time can affect their ability to meet their missions. Further, nonprofits’ strained resources limit their ability to build a financial safety net, which can create a precarious financial situation for them. Absent a sufficient safety net, nonprofits that experience delays in receiving their federal funding may be inhibited in their ability to bridge funding gaps. When funding is delayed, some nonprofits said they either borrow funds on a line of credit or use cash reserves to provide services and pay bills until their grant awards are received. Collectively, these issues place stress on the nonprofit sector, diminishing its ability to continue to effectively partner with the federal government to provide services to vulnerable populations.