Government of the District of Columbia
Office of the Chief Financial Officer

Jeffrey S. DeWitt
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MEMORANDUM

TO:	**The Honorable Phil Mendelson** **Chairman, Council of the District of Columbia**
FROM:	**Jeffrey S. DeWitt** **Chief Financial Officer**
DATE:	**November 9, 2020**
SUBJECT:	**Fiscal Impact Statement – Nonprofit Fair Compensation Act of 2020**
REFERENCE:	**Bill 23-107, Committee Print provided to the Office of Revenue Analysis on October 29, 2020**

Conclusion

Funds are sufficient in the fiscal year 2021 through fiscal year 2024 budget and financial plan to implement the bill. While there is no expected budget impact, the bill may increase the reimbursement rate on indirect costs for some District contracts and grants, and, depending on the specifics of a given service and provider, could reduce the level of service that is currently received. Current law[1] requires the Office of Contracting and Procurement to issue a report by April 2021 analyzing indirect costs of nonprofits contracting with the District. If data contained in the report warrants, ORA will re-estimate the cost of the bill at that time.

Background

Contracts and grants between nonprofit service providers and the District operate under a variety of contracting vehicles, funding sources, and policies specific to the contracting agency. Some contracts are federally funded "pass-through" contracts, others are locally funded, and others are hybrids. Some contracts and grants have sub-contracts to non-profits which do not necessarily follow the same reimbursement rates as the prime contract. The number of District contracts with nonprofit service providers is estimated to involve thousands of individual agreements and hundreds of millions of dollars in local funding.[2]

When engaging in a contract to provide a service to the District, a nonprofit entity negotiates an indirect reimbursement cost rate to help pay for its overhead costs that are not directly related to the

[1] See Subtitle (I)(I), Non-profit Reimbursement Fairness Analysis Amendment Act of 2020, of the Fiscal Year 2021 Budget Support Act of 2020, projected law date December 7, 2020 (D.C. Act 23-107; 67 DCR 10493).
[2] The is an estimate and not the result of an exhaustive review of all District contracts and grants.

specific service being provided.[3] Overhead costs may include, for example, the entity's rent and salaries of management or administrative staff. The reimbursement rates currently provided by the District vary. For federally funded contracts, rates are governed by federal requirements for pass-through entities.[4] For locally funded contracts, rates are governed by District agency policies and practices, as well as the specific overhead needs of the service provider. Some grants must be awarded with overhead caps or requirements specified in District law.[5] Some per-unit provider contracts have indirect cost rates built into the per-unit rate.[6]

If the contract or grant will provide a lower reimbursement rate than what is required for the entity to cover overhead costs, nonprofits must decide whether to seek the contract or grant and make up the cost difference using its other funding sources, such as fundraising and donations. This decision point is affected by the mission of the nonprofit, the ability to absorb the cost difference, and the size and flexibility of the contract. A nonprofit may be willing to absorb some overhead cost on a small after-school services contract serving 50 students but is more likely to require a higher rate from the District for a contract to manage a large homeless shelter. Nonprofits are less likely to accept insufficient reimbursement on a large, complicated contract because of the risk to the nonprofit's operations and the service being provided.

The federal government allows entities that receive federal grants to be reimbursed for indirect costs in accordance with cost principles specified in regulations.[7] Because of the vast differences across service providers, the federal government authorizes a single granting federal agency, known as the cognizant agency, to negotiate a reimbursement rate that is made on behalf of all federal agencies. This rate is known as the Negotiated Indirect Cost Rate Agreement ("NICRA").

Like the federal process, the bill would minimize the variation in rates a nonprofit may receive across District agencies. The bill requires all District contracts and grants with non-profits, as well as all subcontractors and subgrantees, excluding non-profits which are hospitals, foundations, colleges or universities, to be reimbursed at its federally negotiated rate as documented in an unexpired NICRA.

[3] Indirect cost reimbursement rates do not typically apply to contracts with for profit entities, although it does occur. Generally, these contractors simply build overhead costs into their total contract price.
[4] If grant funding comes from a federal entity, indirect costs must be calculated consistent with requirements for pass-through entities found at 2 C.F.R. 200.331.
[5] For example, the District of Columbia Poverty Lawyer Loan Repayment Assistance Program (D.C. Official Code § 4–1704.01(c-3)) sets a rate of 15 percent. This is an example and not a result of an exhaustive review of the legal requirements for grants.
[6] A Unit Price Contract is a type of contract based on estimated quantities of items and unit prices (rates: hourly rates, rate per unit work volume, etc.). In general, the contractor's overhead and profit is included in the rate. The final price of the project is depending on the total quantities needed to carry out and complete the work. A hypothetical example of per-unit provider contract might include an after school program that serves 50 students at a cost of $20,000 per student per year. The nonprofit's overhead is built into the $20,000 unit rate.
[7] The Office of Management and Budget Uniform Guidance on Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, last updated in 2013, can be found here: (https://www.federalregister.gov/documents/2013/12/26/2013-30465/uniform-administrative-requirements-cost-principles-and-audit-requirements-for-federal-awards). Office of Management and Budget proposed revisions to this guidance in January 2020: (https://www.regulations.gov/document?D=OMB_FRDOC_0001-0262).

If the nonprofit does not have a NICRA, the bill specifies that an entity may elect instead to use one of four rates:

1) a "de minimus" rate of 10 percent;
2) a new negotiated rate with the awarding agency;
3) the same rate used by the entity with any District agency in the past two years; or
4) a Certified Public Accountant certified calculated rate based on Office of Management and Budget Uniform Guidance.

The bill requires that indirect costs for federal grants are consistent with the federal requirements for pass-through entities.[8] Grant programs and contracts for which reimbursement rates are already specified in District law are also excluded from the reimbursement requirements of the bill.

The bill's applicability is to occur in stages. Upon approval, the bill would require federally-funded grants to apply the federally mandated indirect cost rates. The law would apply to locally-funded grants and contracts of certain sizes in a phased-in manner. Assuming the bill becomes law in fiscal year 2021, then beginning in fiscal year 2022 locally-funded grants and contracts valued at or below $1 million would be subject to the new requirements. In fiscal year 2023, grants and contracts at or below $5 million would become subject to the requirements. In fiscal year 2024, these thresholds increase to $10 million. In fiscal year 2025 contracts $25 million and under would become subject, and in fiscal year 2026, all grants and contracts over $25 million would become subject to the requirements.

Financial Plan Impact

Funds are sufficient in the fiscal year 2021 through fiscal year 2024 budget and financial plan to implement the bill. While there is no expected budget impact, the bill may increase the reimbursement rate on indirect costs for some District contracts and grants, and, depending on the specifics of a given service and provider, could reduce the level of service that is currently received.

To provide a more complete and precise assessment of the impact this bill will have on services, we would need several datasets that are not available. First, we would require a report on the universe of contracts and grants executed with nonprofit organizations that would be subject to the bill. The Office of Contracting and Procurement provided ORA with a report of grant agreements (over 1,500 and totaling more than $300 million in value) most of which we can assume are being provided by nonprofits. This is useful to help assess the universe of grants, but we do not currently have a comprehensive list of non-grant contracts that are executed with nonprofits. Second, we would need to know the current indirect cost rates provided to nonprofit grantees and contractors for every agreement. While the individual datapoints are available in contract documentation, they are not easily accessible and would involve considerable research and compilation to obtain. Third, we would need to know the NICRA or alternative allowed measure for each District nonprofit contractor. Some entities provide their NICRA to the District as part of contract negotiations, but that information is not broadly required, not available in accessible District databases, and not available for nonprofits who do not receive federal contracts. For those entities that do not have a NICRA, the bill allows several different methods for nonprofits to calculate an alternate rate and we would need to make assumptions about the method they would elect to apply as well as their financial information.

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[8] A pass-through entity means a non-Federal entity (in this case a District agency) that provides a subaward to a subrecipient to carry out part of a Federal program. 2 CFR § 200.19.

Even if all this data were readily available, it still may not be possible to assess how and where service levels will be impacted. There are myriad factors that go into a nonprofit response to a request for proposals (RFP) and into the selection of a contractor. There are several possible outcomes across the thousands of District contracts. However, a strong argument exists that most nonprofits will continue to submit approximately the same total dollar value bids as they do today to remain competitive in the RFP process. They may choose to supplement direct services with other funding sources, such as fundraising, to remain competitive. Discussions with managers in several agencies as well as with nonprofit representatives suggest this is a possibility in many circumstances. If a nonprofit entity is providing a service under a $1 million grant, then one would expect it to be able to continue to provide the same level of service for $1 million, without requiring any additional funding for overhead. In a very different scenario, service providers competing for a grant or contract could have a wide range of NICRAs, and the one with the lowest NICRA might win an award, perhaps even increasing the services that can be provided. There is no way to know for sure until the RFP process is played out.

There is a small risk that a particular service provided in the District cannot be reduced or absorbed because of a legal mandate or a significant public interest, and in this case the District could experience a spending pressure. One example of a service that is unlikely to be reduced regardless of indirect cost rate rules is the 24-hour per day management of family shelters. However, discussions with nonprofit leaders indicate that nonprofits are less likely to accept indirect rate gaps on these types of complex contracts. One shelter provider shared that they receive their full reimbursement rate on that contract from the District, suggesting that future contract bids would not be affected by this bill. (This is just one provider and one shelter so it does not represent a comprehensive assessment of how all shelter services providers might be impacted.) ORA has requested major agencies provide examples of services provided by nonprofits that cannot not be reduced or absorbed, and to date has not identified any clear problematic contract examples. To the extent there are required service contracts currently awarded to nonprofits with overhead payments affected by the bill, it seems likely that cost increases would be limited by the competitive RFP process already discussed.

The Office of Contracting and Procurement has $200,000 in fiscal year 2021 to produce a comprehensive report on the indirect cost rates of District contractors, and it is expected that this study will provide some clarity on the range of indirect cost rate across District agencies and contractors. Additionally, the staged implementation of this bill, beginning with small dollar value contracts and grants and moving to large contracts over four years, will allow time for problematic contracts to surface before the requirements are fully implemented. As has been noted, however, even with more detail on existing rates, the larger unknown is how District contractors will respond to rule changes in future applications for grants and future proposals for contracts. To the extent that there are impacts, we expect the impacts to be felt as reduced service levels and not in direct immediate budget impacts.