NONPROFITS: FINANCE

More About "Indirect Costs" of Nonprofits

11.21.22 | Linda J. Rosenthal, JD

In *Progress on Raising "Indirect Costs" Reimbursement* (November 18, 2022), we brought you good news in the battle against the dreaded "Overhead Myth."

"This destructive mindset arises … from a … widely held misconception … 'that low overheads in non-profits is a sign of efficiency.' So funders adopt project-restricted funding policies. Grantees don't ask for unrestricted funds or specifically for indirect costs 'in fear of being seen as inefficient. In the end, funders do not understand the needs of grantees and grantees do not have funding to support their infrastructure.'"

What happened recently is the announcement by the Ford Foundation of an increase in the "indirect cost ratio" it will pay in project grants beginning next year. It's the latest in a progression of reforms that was sparked by the secret coalition of five major U.S. foundations in 2016 aiming to pull grant making practices from the archaic chains of the Overhead Myth and the resulting "Nonprofit Starvation Cycle."

Coalition Research Projects

By the time this coalition went public in 2019, they had already commissioned important preliminary research and invited other major U.S. grantmakers to join in this movement. From 2019-2021, under the new name "Funders for Real Cost, Real Change," and assisted by the BDO FMA and BDO Nonprofit Advisory practices of BDO USA, the research collaboration continued in earnest.

In 2022, they published important guidance; we listed some of the material in last week's post. In addition, they created the Indirect Cost Rate Guide 2022, a 12-page PDF (downloadable) manual, along with a companion spreadsheet template, the Indirect Cost Rate Template 2022.

These are particularly welcome items, particularly because key terms – for example: “indirect costs,” “indirect costs ratio,” and “full and fair share” of administrative costs – have proven difficult even for the experts to pin down and define uniformly.

Helping Grantors and Grantees

In *New BDO Resources for Understanding Indirect Costs in Nonprofits* (May 12, 2022), *BDO Nonprofit Blog*, the firm’s John Summers and Robby Vanrijkel applaud that “… more donors and grantmakers are beginning to recognize—and pay for—the operating infrastructure that enables nonprofits to carry out their important programmatic work.”

They note, though, that “…even sympathetic funders don’t always know the appropriate amount to ensure that a grant is covering the intended share of an organization’s operating costs. Furthermore, nonprofit leaders often have a difficult time not only calculating an indirect rate, but also communicating with funders about it, since the rules for defining and categorizing cost types can be unclear.”

That’s why the Funders for Real Cost, Real Change coalition commissioned BDO “to help nonprofits and their funders formulate a common language and approach to understand the indirect costs of delivering programs and services.”

What emerged is “a set of straightforward guidelines to categorize and allocate costs, allowing nonprofits to establish an indirect cost rate—a percentage that donors can apply to grants to cover the essential infrastructure that supports key services.”

Mr. Summers and Mr. Vanrijkel also explain that the spreadsheet-format template helps organizations determine the “indirect cost rate in accordance with the guidelines, so organizations can offer full transparency to their funders into how they are interpreting and presenting their costs.”

BDO has made the tools publicly available to help grantors and grantees to collectively move towards a healthier future for individual nonprofits and the charitable sector as a whole. The prominent consulting firm hopes that both sides of the fundraising equation can use this information and these tools “to engage in conversations about the true costs of delivering on grant-supported projects.”

Conclusion

Of course, any current discussion of costs for nonprofit organizations – whether “direct” or “indirect” – is wholly inadequate without consideration of the raging inflation plaguing the global economy.

For more context about how this financial crisis is affecting the nonprofit sector, see our November 14, 2022 post: *Another Turbulent Year for Nonprofits*.

– Linda J. Rosenthal, J.D., FPLG Information & Research Director