Government Funding: Use It Well

by Jeanne Peters

For many organizations, the question is not whether to take money from the government but how best to do it. We all know nonprofit organizations that wear their lack of government funding like a badge of honor. “We have never received a single cent from the government,” or a similar proclamation typically implies the following: the nonprofit in question will never be influenced or controlled by the government; the nonprofit refuses to subject itself to the compliance and reporting demands of government funding; and/or the nonprofit can forego government funding because it is well-supported by its individual donors and other income streams. While these perceived advantages or comparative strengths may be true for a given organization, are there really inevitabilities that accompany taking money from the government? Are those nonprofits that see government funding as a necessary means to growing and innovating their services truly doomed to be complacent organizations, ever mired in reporting nightmares, with negligible financial support from nongovernmental sources?

First, let’s be real. Local, state, and federal governments are major buyers of social services in the United States. Activists have fought hard over the years for sufficient tax spending on issues ranging from early childhood development to HIV services. While an advocacy or policy group may decide that government funding isn’t desirable for the reasons mentioned above, many providers of direct services to people that cannot afford to pay for them could not make the same choice and remain financially viable. Lester Salamon reports in *The Resilient Sector*¹ that between the years 1977 and 1997 social service nonprofits in the United States experienced a 200 percent growth in government revenue; in 1997 government dollars made up 52 percent of total income among these nonprofits. So for many organizations, the question is not whether to take money from the government but how best to do it. Whether you are considering your first RFP (Request for Proposals) from a government agency or are knee-deep in existing grants and contracts, there is a set of organizational capacities that are especially critical to develop and actively maintain when government money is part of your income mix.

Identify and Preserve Core Competencies

It has become cliché to talk about government funding and mission-drift: the image of the money-chasing organization that keeps multiplying, doing many things but none of them well. In my experience, the truth in that cliché is less about an overt “money-chasing” mindset (though that happens in some cases) than it is a tendency for social service nonprofits to stretch optimistically beyond what they are structured and best-suited to accomplish. This could be an after-school youth program that takes on a contract to work with at-risk parents, or a recovery program that begins providing job training and placement services to its graduates. Many times, this stretch is in fact encouraged by government agencies that think highly of a nonprofit and want to see it address an emerging issue or new target population. But it is not up to funders to understand the competitive strengths and limitations of your organization; nor can you rely
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upon them to advise you that a nonprofit in your neighborhood is already providing—or better suited to provide—the services you are considering adding.

We recently worked with a grassroots HIV prevention and education organization serving the Latino gay community that faced this dilemma. Because their office was located at an epicenter of IV drug use and sale, the City asked them to begin a needle exchange program—a key strategy in the effort to curb HIV infection rates. What they quickly learned was that their approach to serving Latinos, at-risk for or living with HIV, was incompatible with a needle exchange program. The population of IV drug users in that area was largely not Latino, so adding this program broadened the organization's target population. Their core clients liked being able to congregate in the safe LGBT-centric (lesbian, gay, bisexual, transgender) space the organization created; sharing that space with the broader IV drug user population was alienating to their clients and eroded the success of their original services. The organization turned down the contract the following year. Leadership has to determine what the organization wants to accomplish (its mission) and how it is going to concentrate its efforts to that end (competencies); then, it has to have the discipline to seek and accept government funding aligned with both. This is not an anti-entrepreneurial stance; competencies are broad enough to align with many potential programs, but just not with all of them. In preserving core competencies the organization can stretch strategically (not just optimistically) into new program arenas without undermining their signature strengths.

**Become an Advocate**

Political engagement is an essential capacity of government-funded social service organizations. It is not enough to help clients deal with the aftermath of our systems’ inadequacies. Nonprofits need to assume a position at the budgeting and policy table—be it local, state, and/or federal—to inform policy direction and protect the vital services they provide. Historically, the public sector—in the form of its employee unions—has been well-represented in the annual political haggling over the allocation of government resources. Increasingly in communities across the country, multi-disciplinary groups of nonprofit leaders are organizing themselves and generating sufficient political power to be included in these discussions too. In San Francisco, a seven-year-old group called the Human Services Network (HSN) is having real success on this front. With a membership of more than 100 social service nonprofits, HSN can talk in aggregate terms about the safety net they represent and the millions of dollars they leverage from non-City sources. Member executive directors attend monthly meetings, turn out at key City Hall hearings that affect nonprofit services, and have steadily gained a place at the political table. Unlike in the past, there is now a collective social service nonprofit voice in San Francisco that elected officials must contend with.

**Know What it Costs to do Your Work**

Like all targeted program funding, government grants and contracts are, in effect, purchase agreements. The government is the buyer and your nonprofit is the vendor. Of all the buyers of nonprofit social services, government tends to be the most exacting and the least willing to pay full price. A guaranteed way to jeopardize your organization’s financial health is to enter into contracts that don’t come close to covering the costs of the services you are providing. Even a $1,000,000 contract is a disaster if it ends up costing you $1,500,000 to meet the deliverables—right?

The fact is that many nonprofit organizations confuse cost and price. Imagine a for-profit company deciding what to charge for something by simply asking customers what they would like to pay. In reality, companies base the sales price on their actual costs to produce the goods. And they include in those actual costs such things as advertising and executive salaries, not just production costs. In other words, for-profits are perfectly clear on the distinction between their cost and the price they set. Because nonprofits have to track expenses in order to report back to funding agencies showing their compliance with an approved contract budget, they begin to view the contract (price) and the program (cost) as one and the same. Many even distribute internal financial statements that report only by contract and program (cost) as one and the same. Many even distribute internal financial statements that report only by contract (price) and the program (cost) as one and the same. Many even distribute internal financial statements that report only by contract (price) and the program (cost) as one and the same. Many even distribute internal financial statements that report only by contract (price) and the program (cost) as one and the same. Many even distribute internal financial statements that report only by contract
budget often get pushed somewhere else—to some nebulous “administrative” or “unfunded” dumping zone—and the full cost of the program delivery is lost forever. So instead of renegotiating the contract for the next year based on an analysis of their actual costs—or at least intentionally developing other revenue streams to complement the contract—the organization happily signs on for another money-losing year. Too many managers and board members don’t anticipate the organizational subsidy (through annual donor campaigns, special events, and the like) that government contracts typically require over time. It is critical that organizations budget and track costs by activity as well as by funding source so that the discrepancies between the two—usually costs grow faster than contracts—are always in plain view for staff and board.

Establish a Contracts Management Role on Your Staff

Recognize that being effective at managing government grants and contracts takes more than basic bookkeeping skills. From the proposal stage to the successful completion of a contract requires, among other skills, the following: an ability to analyze how much of a program’s actual cost can be recovered given any contract limits on allowable costs; the design and maintenance of an adequate accounting system to capture full program costs as well as the portion chargeable to your contract(s); a system for tracking the programmatic deliverables that you commit to in the contract; and ongoing monitoring so that any problems meeting the contract’s deliverables by year-end are anticipated early enough for successful negotiation with the funding agency. These are not entry-level skills! As organizations grow and take on multiple contracts, we often recommend creating an explicit Contracts Manager role on staff. That is, designating a person or group of people whose job it is to evaluate potential contracts with an eye toward cost-recovery, to help program staff develop strategic contract budgets, and to monitor financial and programmatic performance throughout the life of each contract. Your organization may be too small for this to be someone’s full-time job, but assigning this responsibility (and perspective) to someone is a critical step toward being in control of—rather than at the whim of—your government funding.

Find Meaning in the Data You Are Required to Collect

Government contracts for social services typically require tracking clients and units of service such that an organization can provide numerical data on the scope of its government-funded work. One challenge that arises in a mixed-income stream environment is that an organization’s data collection may evolve unevenly—those programs with contract-mandated client tracking have at least some good data to build upon, while programs funded with other resources do not. The organization is left with a patchwork of program data that does not tell the complete story of its impact. It is important for board and staff leadership to develop internal answers to the question, How will we know we are being successful? Some of the ways an organization decides to answer that question may coincide with required tracking, while others may not. For instance, leadership may want to know how many teen mothers the organization serves quarterly (mandated by contract) and how many of the teen mothers demonstrated better parenting skills after 12 weeks of mother-child workshops (not mandated by contract). The challenge to staff leadership is to develop a systematic way to combine externally mandated and internally desired data to allow the organization to monitor its mission progress. When organizations view data collection as merely fulfilling a contract requirement, they miss an opportunity to develop their own, internal sense of success.

Build Your Individual Donor Base

In our consulting practice, we routinely encounter community-based nonprofits—often those working in communities of color—whose seed funding came from government grants and contracts. Unlike nonprofits that start on the dollars of their founding volunteers and board members, these groups often have a delayed development of their individual donor bases. The result is too many 10- and 15-year-old organizations that have grown to be million-dollar programs but have fewer than 50 semi-active donors listed in an outdated FileMaker database nobody knows how to use. At any lifecycle stage, non-
The language of nonprofit finance—and contracts management in particular—can be dizzying. Here are six terms every nonprofit leader who pursues and receives government funding needs to know:

**A-133 Audit**
This special audit is required of organizations expending $500,000 or more in federal awards—including those passed through local and state funding agencies—in a given year. The A-133 audit is in addition to your standard audit of financial statements, and thus means an additional cost. The A-133 audit is particularly concerned with financial processes (e.g., internal controls and compliance).

**Fee-for-Service**
In this type of contract, the nonprofit negotiates a fee per unit of service that the funding agency will pay. Once that fee is approved, the nonprofit invoices the funding agency based on the number of units of service it completes in the billing period.

**Cost Reimbursement**
In this type of contract, the funding agency reimburses the nonprofit based on actual expenditures. While an annual contract budget is approved upfront, the nonprofit has to demonstrate actual expenses to trigger payment.

**Indirect Costs**
Indirect costs are costs that the funding agency does not consider to be directly associated with the delivery of the program in question. They are typically expressed as a percentage of the direct costs. The critical point here is that you have two opportunities (direct and indirect) in building a contract budget to recover three kinds of internal costs: program-specific costs (e.g., salary of your program manager); common costs (e.g., rent, telephone, and office supplies) and administrative costs (e.g., finance, executive salary, and board-related). This is a place where an experienced contract manager is critical to avoiding money-losing contracts.

**Cash Flow**
Cash flow refers to the timing of receipt and disbursement of cash—sometimes a big issue in predominantly government-funded organizations. There are inherent delays in awaiting payment on reimbursement contracts, for instance. There can also be delays in receiving cash when you are in the process of certifying or renewing a contract but are already providing services. In these cases, nonprofits go “in the hole” in order to maintain seamless service to clients and meet their annual deliverables. Non-governmental funding streams are important for maintaining sufficient cash flow to meet payroll and other operating expense obligations.

**Reserves**
A reserve is the accumulation of unrestricted surpluses over time. A reserve allows the organization to weather cash flow problems and financial crises, as well as invest in new opportunities. Government contracts are typically not the way to build reserves. They are not intended to generate surpluses to be retained from year to year. Again, building the financial health of your nonprofit means establishing additional, less restrictive funding streams.
profits that don’t actively maintain an individual donor base are limiting their ability to raise unrestricted funds, and in so doing, are limiting their ability to build financial reserves. During the economic turbulence of the last five years, this has come back to haunt young and well-established nonprofits alike. Even raising five to 10 percent of your operating budget from individuals is better than nothing; it gives you some flexibility in spending and is a form of staying connected and accountable to the communities you serve.

Foster a Nonprofit Culture

This final capacity is in some ways the net result of the six listed above—but also requires intent from managers, executives, and board members. By culture here, I mean more than dress code and communication styles; I mean reinforcing that the organization is fundamentally mission-driven. Paul Light talks about the value of “nonprofitness” as a reminder that pressures on nonprofits to be efficient and management-oriented should be tempered by an appreciation of what makes us unique. Many of the capacities mentioned above contribute to—or in their absence detract from—a sense of “nonprofitness.” If an organization uses predominantly external contract language to discuss its programs and their financial health, that can undermine the culture of “nonprofitness.” So too can taking on too many disparate contract opportunities, thus diffusing the sense of purpose and clarity ideally associated with “nonprofitness.” Moreover, when we don’t engage the community as supporters of our work, we encourage them to see us as quasi-governmental institutions rather than as organizations providing responsive, community-based services.

So building these capacities is not only about “compliance” with external requirements; it is about developing and maintaining a culture that is palpably nonprofit, irrespective of who is funding your work. If you are leading or managing in a nonprofit that receives substantial funds from the government, you might consider whether you can reinforce your nonprofit culture by more consistently:

- Convening some planning and strategy discussions that don’t start from a contract perspective, but from a client perspective;
- Discouraging the siloed-thinking that contracts can foster by having frequent cross-program dialogue;
- Demonstrating the same care and precision in tracking and communicating with your individual donors as with your institutional funders, and
- Engaging in community needs assessment and feedback, even if it isn’t required by a funding agency.

All of these actions send a message to staff, board, and community that your organization has a client- and community-centered culture and orientation—that it is in fact driven by its desire to make the world a better place. Sure, managing government contracts well requires adequate systems and management structures, but nonprofits that can do that and preserve a distinctly nonprofit culture get to have their cake and eat it too.

Endnotes

2. If you want to learn more about the San Francisco Human Services Network model, visit their Web site at www.sfhsn.org. Other groups to look at include Human Services Council of New York City at www.humanservicescouncil.org and Silicon Valley Council of Nonprofits at www.svcn.org.

About the Author

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Let’s Talk

Let’s move this topic forward! Any ideas or arguments you’d like to share with the authors and editors? Contact us at: feedback@nonprofitquarterly.org.
The Federal Financial Assistance Management Improvement Act of 1999 was the result of a dialog about devolution between non-profits and government that quickly became focused on the problems created by complicated federal grant procedures. Many nonprofits were frustrated with administrative burdens imposed by the receipt of federal funds, including having to send different reports to multiple agencies for essentially the same programs. The solution was the grant streamlining law, which mandates uniform grant application-and-reporting procedures across all federal agencies. Nonprofits and government agencies are working together to implement this law, including using Web-based and electronic resources to find, apply for, and report on federal grants.

**What is the Federal Financial Assistance Management Improvement Act of 1999?**
The Federal Financial Assistance Management Improvement Act of 1999 (P.L. 106-107) covers all domestic “federal financial assistance” programs. The law requires the Office of Management and Budget (OMB) to work with other federal agencies to establish:

- A uniform application for financial assistance (e.g., grant applications) for use by all federal agencies;
- Methods to simplify reporting requirements and administrative procedures, including uniformity and standardization of rules;
- Electronic methods for applying for, managing, and reporting on financial assistance funds; and
- Improved approaches for the collection and sharing of data on financial assistance programs, and increased efforts to strengthen the information management capacity of state, local, and tribal governments and nonprofit organizations.

**What has been accomplished so far?**
- All federal grant announcements are now posted on www.grants.gov, a searchable site that allows nonprofits to find grant opportunities by topic, agency, and other factors.
- Nonprofits can sign up to receive e-mail notices of grant opportunities in specific areas.
- All federal agencies are now required to use a standard application form, and they may only require additional information with permission from the Office of Management and Budget.
- www.grants.gov is capable of accepting electronic grant applications.

**What remains to be done?**
Nonprofits and state governments are developing uniform financial standards, and the federal agencies will be reviewing them this fall. Discussions about activity reporting and performance measures are just beginning.

**How can nonprofits get involved?**
OMB Watch is working with other nonprofits, including the National Council of Nonprofit Associations and the Urban Institute, state governments, and federal agencies on the implementation of this law. Nonprofits can obtain notice of proposed changes and offer direct input by contacting Kay Guinane at guinanek@omb-watch.org or by signing up for the Govgrants listserv operated by OMB Watch. See www.ombwatch.org.

Kay Guinane is counsel and manager of OMB Watch’s (www.omb-watch.org) nonprofit advocacy and civic engagement work.