New York City Independent Budget Office

Focus On:
The Executive Budget

June 2021

City's Nonprofit Contractors Receive More Funding After Year of Uncertainty

For almost a year, nonprofit providers of health and human services and their advocates raised alarms about reductions to the city's Indirect Cost Rate (ICR) Funding Initiative that was launched by the de Blasio Administration in 2019. The 2022 Executive Budget restores some previous cuts and adds sufficient money to fully fund the initiative for 2021 and 2022, although questions about the future of the program remain.

After a $20 million reduction just as it was getting underway, the initiative was underfunded by approximately $48 million in its first fiscal year (2020). The city extended the $20 million cut to 2021 and later years in June 2020, opening what was until recently a roughly $60 million difference between the funding in the budget for the initiative and the de Blasio Administration's estimate of the cost of fully funding the initiative for both 2021 and 2022. (All years refer to city fiscal years unless otherwise noted.)

The April 2021 Executive Budget for 2022 added $61.2 million per year using federal coronavirus relief funds beginning in 2021 to increase the budget for the initiative to $94 million annually—sufficient to fully fund the program in both 2021 and 2022 (the cost of full funding for 2023 and beyond is unknown at this point). While in the near term this is good news for providers, the fact that the budget relies on American Rescue Plan Act (ARPA) dollars that are temporary—they must be used by the end of the 2024 calendar year—is a major concern. Another concern is that the city remains about $48 million short of fully reimbursing providers for costs they incurred in 2020 in anticipation of additional payments expected under the initiative.

Background. In March 2019, the city produced a citywide cost manual that standardized the process of defining and calculating indirect costs for providers' contracts with city agencies, and applying to have these new indirect cost rates recognized by the city.[1] Indirect costs can be broadly defined as expenses that are not directly connected to a contract's programming or service objectives, but that still help the provider to fulfill the contract. Examples may include rent, utilities, and office supplies.

Because many providers had been receiving reimbursement from the city for indirect costs at rates that were lower than their actual costs—in some cases far lower—additional funding would be necessary if the city were to fully cover providers' ICRs as defined in the new cost manual. The de Blasio Administration announced its ICR initiative in June 2019, and a total of $53.8 million a year in city funds across 12 city agencies beginning in 2020 was added to the budget in the November 2019 Financial Plan. The Mayor's Office of Management and Budget (OMB) and the Mayor's Office of Contract Services (MOCS) were jointly tasked with implementing the initiative.

Providers had the choice of taking a default 10 percent rate, which would require no verification, or choosing from two options that could result in a rate higher than 10 percent. Under the first option, they could submit documentation of an existing indirect rate exceeding 10 percent that they had previously negotiated with the federal government. Under the second option, they could submit verification from an independent accountant of their new ICR, based on the definitions in the cost manual. If providers were not ready to submit verification for 2020 by the deadline of June 30, 2020 (later extended to August 19), they could take a conditional ICR of up to 12 percent for 2020 only and submit verification paperwork for a higher rate for 2021. Providers could also choose to not enter the initiative in 2020 at all, but wait until 2021.

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According to information provided by OMB, 176 providers had new rates accepted for the 2020 fiscal year, and an additional 51 providers took a conditional ICR for 2020 only and then had a higher rate accepted in 2021.[2] Seventy-six of these 227 providers had had their rates approved as of March 24, 2020, shortly before the 2021 Executive Budget came out.[3] Another 83 providers entered the initiative for the first time in 2021. About one-third of providers took the default 10 percent rate, just over half had rates verified by an independent accountant, and the remaining providers—approximately 12 percent—submitted rates they had previously negotiated with the federal government.[4]

Once providers had new ICRs accepted, the rates were applicable for three years from the beginning of either 2020 or 2021. Their existing contracts with city agencies were amended, with the amendments accounting for the difference between providers' old ICRs and the new, higher rates. Originally, the $53.8 million in funding for the initiative was intended to cover the full cost of these differences.[5]

Funding Reduced

The 2021 Executive Budget, released in April 2020, decreased funding for the ICR initiative by $20 million for 2020, leaving the funding for 2021 and beyond unchanged. At the time, this was presented as a "right-sizing" of the initiative, rather than a reduction; OMB projected that less funding would be needed in 2020 because fewer providers than anticipated had applied for new ICRs for 2020 up to that point. Providers were told that they would still be getting the full amount of their contract amendments based on their new rates. Since some providers were not applying for new ICRs until 2021, or had taken the conditional 12 percent rate for 2020, it seemed to make sense that less money for the initiative would be necessary in 2020 than in the following years.

The budget adopted in June 2020, however, extended the $20 million decrease to 2021 and later years. Then in August, providers were informed that if they had a rate higher than the 10 percent minimum, they would not be getting full funding for their 2020 contract amendments after all. Instead, under a new funding policy, they would receive either 60 percent of the value of their ICR contract amendments or a 10 percent rate, whichever was higher. The decrease in the initiative's budget for 2020 thus turned out to be not a right-sizing but an actual budget reduction.

OMB's explanation is that near the end of the 2020 fiscal year—after the Executive Budget, with its $20 million decrease in funding for the ICR initiative, had been released—an influx of providers applied for new rates, and it became clear that the money that remained allocated for 2020 was no longer sufficient.[6] With the economic impact of the Covid-19 pandemic threatening city tax revenues, funding for 2020 was not restored at budget adoption and the $20 million reduction was also extended to 2021 and beyond.

The Problems Facing Providers. Because the August 2020 announcement of the reduced reimbursement policy for 2020 contracts came after the fiscal year ended on June 30, providers had already spent the money they expected to receive for the difference between their old and new indirect rates. At a November 2020 City Council oversight hearing on the ICR Funding Initiative, many providers testified about the negative impacts of the 2020 funding policy on their organizations, with some reporting losses in the hundreds of thousands of dollars. Providers that had gotten new rates verified by independent accountants also pointed out that they had paid to do so. In addition, providers cited the use of staff time in applying for the new rates and communicating with OMB and MOCS. Some felt that their organizations were worse off for having applied for new ICRs, a problem that was compounded by the rising costs of assisting vulnerable populations during the pandemic.[7]

At the time of the November hearing, the funding policy for 2021 had still not been decided, and many providers expressed fear over the uncertainty for the current fiscal year. Many also made it clear that they viewed the reductions to the initiative as a promise broken by the city, as they had been told they would be funded for the full difference between their old and new indirect rates and now would not be.[8]

When the funding policy for 2021 was announced in March 2021—with only a few months left in the fiscal year—it marked another step back from the original goals of the ICR initiative. Providers would now be reimbursed only 30 percent of the value of their amendments, or a 10 percent ICR, whichever was higher. Since all providers that were interested in getting new ICRs accepted had done so by this point, and ICRs are applicable for three years, it appeared that this 70 percent reduction would apply not just for 2021, but also for 2022. Providers that faced losses in 2020 were contending with facing even greater losses in 2021 and 2022.

In March 2021, OMB finally acknowledged that the full cost of the initiative, taking into account providers' new approved rates, would be an estimated $91 million in 2021—considerably higher than the $53.8 million that was originally budgeted, before providers actually began applying for their new rates. Since rates are good for three years, the initiative was also estimated to cost $91 million in 2022 as well. This left a gap of approximately $57 million between the likely cost of the program and the $33.8 million that was budgeted for the initiative at the time.

Federal Dollars Will Temporarily Fund the Initiative

The Executive Budget for 2022, released in April 2021, added $61.2 million in federal ARPA funds for the initiative's budget for each year from 2021 through 2025, the latest fiscal year that city budget documents currently cover. These funds are temporary and must be spent by December 31, 2024—six months into city fiscal year 2025. Previously, the initiative had been covered solely with city dollars. Once the ARPA funding is exhausted, the city will need to come up with funding using its own resources to replace those dollars, or else scale back the initiative.

Both the Executive Budget and January's Preliminary Budget showed small decreases in technical adjustments totaling $970,000 in city funding. Adding the $61.2 million to the $33.8 million already in the budget, and subtracting the $970,000, brings the total provided for the initiative every year beginning in 2021 to $94 million.

This is enough to fully fund the initiative for 2021 and 2022, meaning that for at least these years providers will be reimbursed the full cost of their approved indirect expenses. (Between March and April, OMB updated their estimate of full funding from $91 million to $94 million.) The full cost for 2023 and later years is not yet known, as rates for providers that entered the initiative in 2020 are only applicable through 2022. Presumably, these providers will need to either reapply for new rates in 2023 or confirm their existing rates, and those that entered in 2021 will need to do so in 2024. The de Blasio Administration has not yet provided clarity about this process, however.

Some providers have also lobbied to have more funding added back into the budget to reimburse providers that lost 40 percent of their amendment values in 2020. OMB estimates that the total 2020 cost of the initiative at full funding would have been $82 million, including $14 million for providers that took the conditional rate for 2020 only and the remainder for providers that had new rates accepted in

Changes to Indirect Cost Rate Funding Initiative
Dollars in millions

	2020	2021	2022	2023, 2024, 2025
Initial Funding for Initiative November 2019	$53.8	$53.8	$53.8	$53.8
Funds Cut in April 2020	-20.0	0	0	0
Funds Cut in June 2020	0	-20.0	-20.0	-20.0
Funds Added in April 2021	0	+61.2	+61.2	+61.2
Funds Provided for Initiative as of April 2021	**$33.8**	**$94.0***	**$94.0***	**$94.0***
Memo:				
OMB Estimate of Cost of Fully Funding	$82.0	$94.0	$94.0	N/A
Additional Funds Needed to Fully Fund	$48.2	$0	$0	Unclear

SOURCE: Mayor's Office of Management and Budget
NOTE: *Over the 2022 Preliminary and Executive budgets, $970,000 in city funding was removed from the initiative's budget, making the current budget for 2021 and later years $94 million.
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2020.[9] This leaves a gap of roughly $48 million between the $82 million required for full funding and the $33.8 million that was actually in the budget for 2020. April's Executive Budget for 2022 did not include funding to address the hit to providers' budgets. If funding is not added at budget adoption, then much of the indirect costs incurred by providers in 2020 in anticipation of the city paying higher ICRs will not be covered, despite earlier promises.

Concerns have also been raised about providers that either did not apply for new ICRs or applied and were denied. It is not clear at this time if or when these providers may be able to enter the initiative. Covering indirect costs for all providers, including those not currently in the initiative, would increase the initiative's full cost.[10]

Perhaps the biggest concern with the initiative is the city's reliance on one-time federal pandemic relief funding for an initiative that has already faced funding cuts and has left providers uncertain about the sustainability of higher ICR payments under the initiative. What will happen to the ICR Funding Initiative after ARPA funds run out is an open question.

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Endnotes

[1]The cost manual was developed by the city in collaboration with the Nonprofit Resiliency Committee, a coalition of health and human services (HHS) providers and advocacy organizations, in order to standardize cost definitions, indirect cost rate calculations and ICR claiming policies for City of New York health and human services contracts. Effective fiscal year 2020, the manual is the primary source for allocating costs in the city's HHS contract budgets and determining, establishing, and claiming ICRs.
[2]OMB email to IBO, 4/9/21
[3]ICR Fund Initiative March 2020 Report (1).docx (nyc.gov)
[4]OMB email to IBO, 3/2/21
[5]Mayor de Blasio Announces the Launch of the Indirect Funding Initiative | City of New York (nyc.gov)
[6]OMB emails to IBO, 9/25/20
[7]Hearing Testimony for City Council Committee on Contracts Oversight Hearing, "Reviewing the City's Indirect Cost Rate Funding Initiative During the COVID-19 Pandemic."
[8]Ibid.
[9]OMB Email to IBO, 4/9/21
[10]Another concern is that new health and human services Requests for Proposals direct respondents to include an ICR of 10 percent for all proposals, regardless of their new accepted, higher ICRs. This is meant to be a placeholder, with providers' actual rates to be negotiated later. Some providers and their advocates have expressed concerns that without language in their proposals codifying their new ICRs, the city could end up funding new contracts with only 10 percent ICRs for all providers. (Source: IBO Conversation with Human Services Council, 3/26/21.)