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Government-Nonprofit Contracting Relationships

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Federal Government Contracts and Grants for Nonprofits

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The federal government spent more than 30 percent of its annual budget in fiscal year 2011 on purchasing services and supporting local and state governments, tribal organizations, nonprofit organizations, and for-profit firms through contracts and grants. The nonprofit sector, in turn, relies heavily on government for revenue to perform services and provide goods to clients. As of 2010, nearly one-third of revenue sources for reporting public charities comes from the government through contracts (23.9 percent) or grants (8.3 percent) (Blackwood, Roeger, and Pettijohn 2012). Despite nonprofits' widespread reliance on all levels of government for financial support, contracts and grants continue to be a mystery for many in the nonprofit sector. This brief provides an overview of the main funding mechanisms the government uses and highlights the characteristics of contracts and grants that make them similar to, but also quite different from, each other in risks, regulations, and redress of grievances.

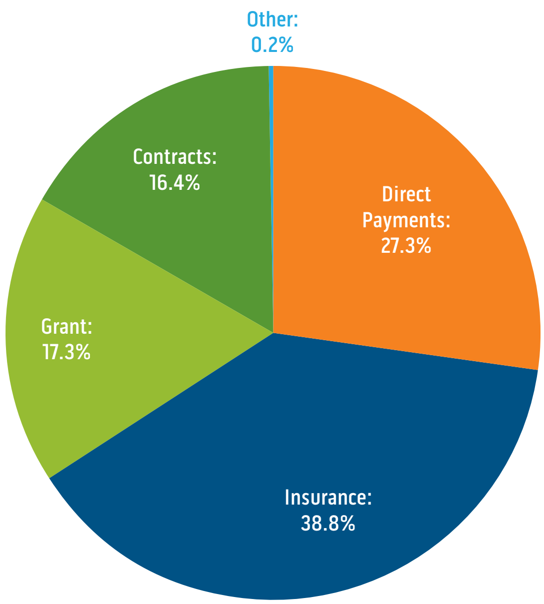
Types of Federal Spending

The federal government has several mechanisms it can use to provide funds to individuals and organizations to help address public problems. USASpending.gov highlights five methods the federal government most frequently uses to acquire products and services and assist individuals and organizations.

1. **Direct payments:** payments made to individuals through programs such as Social Security or housing choice vouchers.
2. **Loans/guarantees:** funds that require repayment such as federal student loans.
3. **Insurance:** payments to individuals uch as veterans through the Department of Veterans Affairs life insurance programs and displaced homeowners through the Department of Homeland Security's Federal Emergency Management Agency flood insurance program. Insurance payments can also be made to organizations, for example, the Department of Agriculture's crop insurance program.
4. **Contracts:** "mutually binding legal relationship obligating the seller [contractor] to furnish the supplies or services (including construction) and the buyer [federal government] to pay for them." [1]
5. **Grants:** "authorized expenditure[s] to a non-federal entity for a defined public or private purpose in which services are not rendered to the federal government." [2]

Government contracts and grants continue to be a mystery for many in the nonprofit sector.

Figure 1. Federal Government Spending, Fiscal Year 2011



Source: "Prime Award Spending Data: FY 2011," Office of Management and Budget, 2011, http://www.USAspending.gov.
Notes: Spending on loans was negative for fiscal year 2011. "Other" includes all other reimbursable, contingent, intangible, and indirect financial assistance.

Figure 1 shows how the federal government expended nearly $3.3 trillion in fiscal year (FY) 2011. This brief focuses on the one-third that encompasses contracts and grants, the two funding tools the federal government generally uses to fund nonprofit organizations and for-profit business firms.

Contracts and Grants

Federal contracts and grants share certain characteristics; they must be authorized by law and are subject to available appropriations, and they are awarded based on solicitation requests and a response from the interested party. Yet, even with these similarities, contracts and grants also have substantial differences—they are governed by different regulations, terms, and conditions.

The first step in the process requires the government to decide whether a contract or a grant is the appropriate vehicle to deliver funds to a third party. Concerned with perceived mishandling of federal spending, Congress authorized the Federal Grant and Cooperative Act of 1977, which provides standardized tests to determine whether to award a **contract** or a **grant**. The government must determine the principal purpose of the activity. If it is to provide goods or services the federal government will use to carry out its public mission, then the award will be a contract. However, if the principal purpose is to meet the needs of a third party carrying out an activity Congress has decided to support as a matter of public policy by statute, then the award will be a grant. Table 1 outlines the questions the government asks to determine which funding mechanism to use.

While the government uses the same test to determine whether a contract or grant is the appropriate tool to disseminate funds, significant differences between the two emerge when administering contracts and grants. The next section outlines the different regulations used to manage contracts and grants and highlights the types of contracts and grants the government uses.

Contracts

Federal contracts are governed by the Federal Acquisition Regulation (FAR), which is codified in Title 48 of the U.S. *Code of Federal Regulations* (C.F.R.). To establish consistent policies and procedures for acquisition, the Office of Management and Budget (OMB) issued FAR in 1984 and reissued it in 2005. The goal of the Federal Acquisition System is to deliver the best product or service to those in need of goods or services while having the flexibility to adjust to contractor or grantees needs, concerns, and feedback (48 C.F.R., 1.101–1.102).

Types of contracts. Federal contracts have two general groupings: fixed price and cost reimbursement. Within these two groups, FAR outlines seven specific types of contracts the government uses based on the liability placed on the contractor as well as the type of profit incentive offered to the contractor. Below is a brief summary of each type of contract:

1. **Firm-fixed-price.** The contract price is fixed or, when appropriate, provides an adjustable price that can include a ceiling price, target price, or both. Firm fixed-price contracts maximize the financial risk to the contractor because the contractor must take full responsibility for all costs, which can result in a loss or profit. Thus, these types of contracts offer the greatest incentive for

contractors to control costs and complete the project effectively and efficiently. Additionally, fixed-price contracts tend to require minimal administrative responsibility. The government may opt to use a fixed-price contract with certain types of adjustments and incentives such as an economic price adjustment, prospective or retroactive price redetermination adjustments, level of effort required, award-fee incentive, or incentives based on performance or delivery (48 C.F.R. subpart 16.2).

2. **Cost-reimbursement.** These contracts begin with an estimated cost reimbursement that contractors receive for allowable costs incurred while executing the contract. Cost-reimbursement contracts typically have a ceiling price that contractors cannot exceed unless the government contract officer approves the additional costs. These contracts minimize risk to the contractor because the contractor does not bear the full responsibility for all costs. However, there are greater administrative oversight and burdens for the government contract officer. The government uses cost-reimbursement contracts when specifications for a project contain a good deal of uncertainty. Cost-reimbursement contracts can be used to simply fund the cost of providing a service (no fee) or reimburse with an incentive or award (48 C.F.R. subpart 16.3).

3. **Incentive.** The government uses incentive contracts, also known as performance contracts, to tie the contractor's payment to its performance based on targets defined at the start of the contract period. The government uses incentive contracts to motivate activities of the contractor that are hard to define and specify as well as to discourage inefficiency and waste (48 C.F.R. subpart 16.4).

4. **Indefinite-delivery.** The government uses an indefinite-delivery contract, also known as a delivery-order or task-order contract, when the exact times and/or exact quantities are not known at the time the contract is awarded. This provides the government with flexibility in what it ultimately orders from the contractor as well as flexibility in scheduling delivery. While indefinite-delivery contracts specify a minimum and maximum amount of a goods or services to be purchased, organizations need to be careful because they must secure and are liable for resources to provide the maximum good or service, and the government may only order the minimum. The government can only enter into this type of contract with preselected companies (48 C.F.R. subpart 16.5).

5. **Time and materials.** A hybrid of fixed-price and cost-reimbursement contracts, time and materials contracts are what the government uses only when no other type of contract is suitable because these contracts present the greatest risk to the government and the least risk to the contractor. The government pays the contractor based on an hourly rate, which includes wages, overhead, general/administrative costs, and profits, as well as actual costs for materials. This type of contract

Table 1. Tests for Selecting the Funding Mechanism

CONTRACT: BENEFIT OR USE TEST	GRANT: SUPPORT OR STIMULATION TEST
Is the government agency the direct beneficiary or user of the activity?	Is the applicant performing the project for its own purpose?
Is the agency providing the specifications for the project?	Is the government agency merely supporting the project with financial or other assistance?
Is the agency undertaking the project based on its own identified needs?	Is the benefit to the agency incidental (i.e., do funded activities complement the agency's mission)

Source: Federal Grant and Cooperative Act of 1977.

provides no incentives for contractors to control costs or work efficiently, so the government must closely monitor time and materials contracts (48 C.F.R. 16.601).

6. **Labor-hour.** Similar to time and materials contracts, labor-hour contracts are what the government uses when it supplies the materials and the contractor provides the labor. The government pays the contractor based on an hourly rate, which includes wages, overhead, general/administrative costs, and profits (48 C.F.R. 16.602).

7. **Letter.** The government uses a letter contract when authorizing the contractor to start work before a final contract is complete. The government uses a written preliminary contractual letter until a definitive contract is completed within a specified timeframe (48 C.F.R. 16.603).

Many factors, such as types of goods or services to be produced and the level of government oversight, influence which type of contact is most appropriate in a given situation. Organizations entering into a contract with the government should be aware that not all contracts carry the same level of risk for their organization. Table 2 highlights some of the differences between specific types of contracts.

Occasionally, the government will ask the contractor to share in the cost associated with producing the good or service. Cost-sharing is used when the contractor has the potential to gain substantial commercial benefits from the project. The sharing of costs is most common during the research and development stages of a project.

Grants

While FAR regulates federal contracts, no comparable government documents are available to determine how to award grants. The Federal Grant and Cooperative Act outlines when a grant should be used, but the authority to award grants lies in legislation of each of the 26 federal agencies. Additionally, OMB issues circulars and regulations that provide guidance on authority issues related to grants.

Types of grants. Federal agencies offer more than 1,000 grants annually (USA Spending.gov). The government uses four main grant types for allocating funds.

1. **Block.** The government began using block grants in 1966 during a "new federalism" era to transfer decisionmaking from the federal government back to local and state entities. Block grants are broad and flexible and provide a fixed sum of money sent to state and local governments (who pass some of the money through to nonprofit organizations). The federal government uses block grants to provide states with funding that is more flexible than other grant types, which allows state and local governments to adapt programs and provide services that meet the needs of their area. Block grants are used for a diverse set of activities, including healthcare (e.g., Mental Health Block Grant and Maternal and Child Health Services Block Grant), community and social services (e.g., Community Service Block Grant and Social Services Block Grant), and housing (Community Development Block Grant). Throughout the past 47 years, however, Congress has "eroded the flexibility of block grants by adding restrictions, requiring that a share of funds be set aside for particular purposes, or creating new categorical programs with the same or related objectives" (Finegold, Wherry, and Schardin 2004, 4).

2. **Project.** The government uses project grants for specific projects with fixed or known time periods. Examples of project grants include fellowships, scholarships, research, training, evaluation, planning, and technical assistance.[3]

3. **Formula.** Using a formula prescribed in authorizing legislation, the government determines formula grants, which are noncompetitive awards based solely on a formula of quantifiable elements such as housing, population, or families with children. For example, eligibility for Medicaid is determined by the ratio of family income to the official poverty level.[4]

4. **Categorical.** Categorical grants are offered for a narrowly defined purpose and can be awarded as project or formula grants, but most are formula grants. These grants are given with strict conditions and include programs such as Head Start and Medicaid. Categorical grants can be classified as direct or pass-through grants. Direct categorical grants support programs the states administer, while pass-through categorical grants allow states to develop a grant program and pass funds on to local governments, tribal organizations, nonprofit organizations, and/or for-profit firms. These pass-through funds are considered to be federal funds because the money originates from the federal government.[5]

Grants are unique funding mechanisms that vary greatly in the amount of oversight and administrative requirements. While the federal government has tried to streamline and simplify its grant processes, a great deal of work remains to be done. Public Law 106-107[6] laid the groundwork for grants.gov, an online one-stop shop to find and apply for federal grants. However, managing and reporting on grants continues to be complex, burdensome, and overwhelming to nonprofit organizations

Table 2. Overview of Government Contract Types

TYPE	USE	GOVERNMENT OVERSIGHT	RISK TO CONTRACTOR
Firm-fixed-price	To acquire commercial items or other goods that have a definite function; or, when the specifications have little uncertainty.	Minimum. Contractors must act efficiently and effectively to ensure costs do not exceed the price of the contract.	Maximum. Government pays negotiated cost regardless of the actual cost incurred by contractor.
Cost-reimbursement	When there is too much uncertainty in the function or specification of the good or service being procured for a firm-fixed-price contract.	Maximum. Government closely monitors expenses to ensure costs submitted for reimbursement are authorized.	Minimum. Contractor does not bear the full responsibility for all costs.
Incentive	When government wants to motivate the contractor to perform tasks that are hard to define and specify, and when government wants to discourage contractor inefficiency and waste.	Moderate.	Moderate.
Indefinite-delivery	When exact times and/or exact quantities are uncertain at the time the contract is awarded.	Moderate.	Moderate.
Time and materials and Labor-hour	Time and materials contracts are used only when no other contract is appropriate. Labor-hour contracts are used when the government is supplying the materials and the contractor provides the labor.	Maximum. There is no incentive for contractors to control costs so government will monitor contractors for quality and cost controls.	Minimum. Contractors are reimbursed costs associated with time and materials (if a time and materials contract) consumed for the service.
Letter	When government needs work to begin immediately but a final contract has not been negotiated; used until a final contract is complete.	Maximum. Government closely monitors expenses to ensure costs submitted for reimbursement are authorized.	Minimum. Contractors are reimbursed authorized costs until a final contract is complete.

Source: 48 C.F.R. subpart 16.

(Boris et al. 2010). OMB has recently published proposed reforms to federal grant policies to better manage federal grants and would codify prior OMB guidance into the *Code of Federal Regulations*.[7] Additionally, this reform "is intended to both increase the efficiency and effectiveness of grant programs by eliminating unnecessary and duplicative requirements and strengthen the oversight of grant dollars by focusing on areas such as eligibility, monitoring of sub-recipients, adequate reporting, and other areas that are potential indices of waste, fraud or abuse."[8]

Addressing Grievances

While contracts and grants allow the government to disburse funds to third parties, nonprofit organizations should be aware of some differences to better understand government funding. One of the most critical distinctions between contracts and grants is that FAR and the Competition in Contracting Act[9] do *not* apply to grants, because both, by definition, apply only to acquisitions "by contract…by and for the use of the Federal Government" (48 C.F.R. 2.101). Because federal agencies are not constrained by this regulation for their grants, they can use more discretion in selecting grant recipients.

While agency discretion due to lack of regulatory guidance can be appealing to potential grantors, it also presents opportunities for abuse. For example, if an organization applying for a contract feels its bid was unfairly rejected, it can protest before the Government Accountability Office (GAO). The same is not the case for grant applicants who were not selected for a grant. The case *Energy Conversion Devices Inc.* (B-260514, 95-2 CPD), holds that GAO reviews "protests concerning alleged violations of procurement statutes or regulations by federal agencies in the award or proposed awards," but GAO does not review "protests of the award, solicitations for the award of cooperative agreements or other nonprocurement instruments because they do not involve the award of a 'contract.'"[10] Thus, there are few options open to organizations that feel they were wrongfully overlooked for a government grant.

Conclusion

Government funding covers approximately one-third of the nonprofit sector's revenue. Nonprofits need to be aware that the purpose of contracts and grants are distinct. A contract allows the federal government to procure goods and services for its primary use, while a grant allows the federal government to assist a third party in support of that party's mission. Understanding the different purposes, regulations, and risks of different government funding mechanisms can help nonprofit organizations better navigate the government contract and grant process.

Acknowledgments

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Notes

1. *Code of Federal Regulations,* Title 48 (Federal Acquisition Regulation), sec. 2.101.
2. "Glossary," Office of Management and Budget, March 19, 2013, http://www.USAspending.gov.
3. "Types of Assistance," Catalog of Federal Domestic Assistance, https://www.cfda.gov/?static=assistance&s=generalinfo&mode=list&tab=list&tabmode=list.
4. Ibid.
5. "Main Types of Grant Funding," The Ferguson Group, http://www.federalfunding.net/grants_types.htm, accessed February 20, 2013.
6. The Federal Financial Assistance Management Improvement Act of 1999 (P.L. 106-107) attempted to improve the effectiveness and performance of federal grants by simplifying application and reporting requirements.
7. This rule would consolidate "OMB Circulars A-21, A-87, A-110, and A-122 (which have been placed in 2 CFR Parts 220, 225, 215, and 230); Circulars A-89, A-102, and A-133; the guidance in Circular A-50 on Single Audit Act follow-up; and pending further review, the Cost Principles for Hospitals… If and when this proposal is finalized, OMB will integrate this guidance into Title 2 of the *Code of Federal Regulations*" ("Reform of Federal Policies Relating to Grants and Cooperative Agreements; Cost Principles and Administrative Requirements (Including Single Audit Act)," 78 Fed. Reg. 7283 [Feb. 1, 2013]).
8. "A Proposal for Better Management of Federal Grants," Danny Werfel, U.S. Chief Financial Officers Council, February 1, 2013, https://cfo.gov/cofar-reform-grants/.
9. The Competition In Contracting Act (CICA) makes "for full and open competition through use of the competitive procedure or combination of competitive procedures" (41 U.S.C. 253). The purpose of CICA is to increase the number of competitors and thus increase savings through lower, more competitive pricing.
10. "Grants and Cooperative Agreements: Wolves in Sheep's Clothing?" Chris Jensen, Kilcullen, Wilson & Kilcullen, 1998, http://www.attny.com/gci01983.html.

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