Perceptions of Overhead in International Development

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Dedication

The author wishes to dedicate the thesis to her husband, David, and daughter, Mina.

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Abstract of Thesis

Perceptions of Overhead in International Development

Revised foreign assistance policies of the United States Agency for International Development (USAID) now include a limited allowance to cover overhead expenses incurred by those non-governmental organizations (NGOs) that do not maintain negotiated rates with the U.S. Government. This includes local NGOs (LNGOs) newer to direct funding. The limited allowance provides a fixed maximum percentage that NGOs without a negotiated rate can apply to any U.S. Government funded program. The new limited allowance is one key element of USAID Forward, the reform initiative launched in 2010 that among other features seeks to strengthen the capacity of grant-recipient LNGOs to achieve greater impact with development programs. Nevertheless, as this thesis based on original qualitative research will show, the staff of many of LNGOs upon which USAID is focusing are unaware of the options and requirements for obtaining sufficient overhead cost coverage. The affected NGOs thus in fact operate at a disadvantage, especially in comparison with larger international NGOs (INGOs) with negotiated rates and greater financial knowledge.

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Glossary of Terms

Contractors: Organizations or individuals that maintain principally contracts with USAID, rather than grants or cooperative agreements. Contractors are usually for-profit entities (See: For Profit Contractors). They may also maintain grants or cooperative agreements but contractors are not NGOs. While the purpose of this thesis is to examine the NGO perspective, some contractors are included in the taxpayer group of key interview informants.

Cooperative Agreements: A cooperative agreement can be described as a hybrid between a grant and a contract. It is typically a mechanism for financial assistance between a U.S. federal awarding agency (i.e. USAID or the Department of State) and a non-federal entity (i.e. an NGO or Contractor), which receives funds to implement a program. If sub-awards are present, the non-federal entity could also be the prime recipient, or pass through entity. It is distinct from a grant in the "substantial involvement," meaning the additional and extensive oversight provided by the federal awarding agency under a cooperative agreement.

De Minimus Rate: A new overhead cost recovery mechanism proposed by revised procurement policy, Code of Federal Regulations (CFR), section 2CFR200. This allows for organizations that do not have a Negotiated Indirect Cost Rate Agreement (NICRA) to recover up to 10 percent of direct program costs on any USG grant or cooperative agreement to which they apply (USAID, 2016).

Direct Costs: Costs that are directly attributable to a specific project, distinguished from indirect costs.

Donations: Distinct from grants, cooperative agreements or contracts, some amount of money provided by an individual or corporation for the organization to continue their work. Donations could be restricted for a particular purpose or unrestricted for general use.

Donors: Corporations or individuals providing funds for NGOs to continue their activities. For the purposes of this thesis, both donors and funders will be described as funders.

For-Profit Contractors (FPCs): For-profit contractors are for-profit entities that obtain contracts or cooperative agreements from the USG to implement international development programs. While the purpose of this thesis is to examine the NGO perspective, some FPCs are included in the taxpayer group of key interview informants.

Funders: Government agencies or foundations providing funds for NGOs to continue their activities. For the purposes of this thesis, both donors and funders will be described as funders.

Grant Agreement: A legal instrument of financial assistance between a Federal awarding agency and a non-Federal entity, known as the prime recipient. If sub-awards are present, the non-Federal entity could also be the prime recipient, or pass-through entity. In contrast to a cooperative agreement, which has significant oversight by the federal awarding agency in the form of "substantial involvement," a grant provides relatively more freedom for the non-Federal entity to implement the program.

Indirect Costs: Indirect costs frequently overlap with overhead costs, although they are not synonymous. The indirect distinction does not refer to a specific category of costs but

rather, how they are allocated across programs. Overhead costs can be billed to a program, making them direct, or across a number of programs, making them indirect. USAID defines indirect costs as follows:

> "Indirect costs are costs which cannot be directly identified with a single contract or grant. The indirect costs are applied equitably across all of the business activities of the organization, according to the benefits each gains from them. Some examples of indirect costs are office space rental, utilities, and clerical and managerial staff salaries" (USAID, 2014, pg. 3).

See also Overhead Costs.

International Development: For the purposes of this thesis, international development is defined as "international efforts to reduce poverty and inequality and improve health, education and job opportunities around the world" (Rosenkranz, 2011). International development is distinct from short-term humanitarian aid and disaster relief and is meant to be long-term and sustainable (Rosenkranz, 2011). These activities have traditionally been dominated by organizations whose origin is in developed countries, referred to as the global North, whose aim is to affect outcomes in developing countries, also known as the global South. South-South cooperation and discussions of ownership of development outcomes by the host countries of the global South are becoming increasingly common. These new directions have been formalized at the international level through the Paris Declaration and Accra Agenda for Action passed in 2005 and 2008 (OECD, 2016).

International Non-Governmental Organizations (INGOs): Also known as private voluntary organizations, these are organizations with operations in more than one country that use funds from a number of sources to implement programs and projects for international assistance and development efforts. In the U.S., these organizations may be eligible for a tax-exempt status conferred by the Internal Revenue Service (see NGOs). In

this thesis, INGOs includes organizations that are all based in the U.S., given the focus of this research on U.S. Government funders. Examples of INGOs include: FHI360 and Mercy Corps.

Local Non-governmental Organizations (LNGOs): Organizations that may or may not be legally registered and that receive funds to implement activities in the area or nation where they are based. Also known as community based organizations (CBOs) or Southern Non-Governmental Organizations (SNGOs), LNGOs can be prime recipients of funds from the U.S. Government or sub-recipients working under a prime-recipient that is an INGO or another LNGO.

Negotiated Indirect Cost Rate Agreement (NICRA): INGOs that receive at least $10 million in direct U.S. Government funding can cover institutional support or overhead costs through an arrangement known as a Negotiated Indirect Cost Rate Agreement (NICRA) (U.S. Government Publishing Office, 2016). NICRAs allow organizations to charge the USG an agreed percentage of all direct program costs on U.S. Government grants, contracts or cooperative agreements.

Non-Governmental Development Organizations (NGDOs): NDGOs are NGOs that focus on international development programs or advocacy on behalf of marginalized populations. NDGOs will be included within the more general nomenclature of NGOs for the purpose of this thesis.

Non-Governmental Organizations (NGOs): NGOs are a tremendously diverse group of organizations with several key features in common. Essentially, if based in the U.S., they maintain non-profit status, exempting them from paying U.S. taxes under Internal

Revenue Code Section 501(c)3, and implement international development activities. They are called non-profit organizations when operating only within the United States. In spite of their immense diversity in mission, size, funding and location, NGOs have three main features in common: (1) they do not coerce participation, which makes them similar to private sector companies; (2) they do not distribute profits to stakeholders (i.e. the non-distribution constraint), making them closer to the public sector and generating a sense of trust and legitimacy; and (3) they do not necessarily have clear lines of ownership and accountability to governments or other public actors (Frumkin, 2002).

Official development assistance (ODA): Refers to funds provided by official state agencies or governments with the promotion of the economic development and welfare of developing countries as its main objective (OECD, 2016a).

Overhead: As defined for interview respondents in the thesis and based on the definition used by Inside NGO, an INGO membership association that offers training and resources for INGOs, overhead includes: "functions and activities necessary to conduct the affairs of an organization" (Walker, 2016). Examples of overhead cost could include fundraising, administrative or management costs, such as hiring an accountant that oversees a number of programs. Overhead rates are calculated by summing up administrative and fundraising costs as a percentage of total revenues. Overhead costs can be direct or indirect, although USAID defines them principally under the umbrella of "Indirect Costs," meaning costs that are not attributable to a specific project. Rent and utilities are overhead costs that can be either direct or indirectly budgeted. See also Indirect Costs.

Private Voluntary Organizations (PVOs): are synonymous with NGOs; this term was more commonly used up to the late 1970s although USAID still uses it to register organizations in its database.

Sub-Awards: These are defined by 2CFR200 as "an award provided by a pass-through entity to a sub-recipient for the sub-recipient to carry out part of a federal award received by the pass-through entity [i.e. the prime]." A sub-award "does not include payments to a contractor or payments to an individual that is a beneficiary of a federal program" (U.S. Government Publishing Office, 2016). In other words, funds pass from the Federal awarding agency to the prime recipient in the form of a grant or a cooperative agreement. Funds are then passed on to a second tier recipient, a sub-recipient, in the form of a sub-award. Sub-awards can be fixed, where payments are delivered upon completion of set deliverables, or cost reimbursable, where payments are linked to actual funds spent by the sub-recipient.

Sub-Recipients: As defined by 2CFR200, a sub-recipient is:

> "a non-federal entity that receives a subaward from a pass-through entity [i.e. a prime recipient] to carry out part of a Federal program; but does not include an individual that is a beneficiary of such program. A subrecipient may also be a recipient of other federal awards directly from a federal awarding agency" (U.S. Government Publishing Office 2016).

This means that sub-recipients for one grant or cooperative agreement can also be a prime recipient for another grant or cooperative agreement. Sub-recipients can be INGOs or LNGOs although a common practice for a USAID program involves identifying an INGO as the prime recipient of funds and LNGOs as secondary, in-country sub-recipients.

United States Agency for International Development (USAID): As per its website, USAID is the lead U.S. federal agency that works to deliver U.S. government foreign assistance with the mission to "end extreme global poverty and enable resilient, democratic societies to realize their potential." (USAID 2016).

Chapter 1: Introduction

Key leaders within the U.S. federal government (USG) and the field of international development, particularly the United States Agency for International Development (USAID), currently emphasize strengthening the capacity of local non-governmental organizations (LNGOs) within international development policy and programming. Paradoxically, increased funding of NGO activities, particularly to LNGOs, will likely increase these organizations' overhead expenses. USG funders, including USAID, support a limited, de minimus, indirect overhead allowance for eligible NGOs. The sufficiency of this rate for full overhead cost recovery and the knowledge of NGOs of this new option is unclear. If NGOs do not request and recover their full overhead costs from funding sources, however, those organizations may be less effective and shorter lived. A fuller understanding of how LNGOs, new to direct USG funding, are beginning to receive direct USG funding in response to revised USG guidelines is needed to help the development community succeed with intended NGO capacity strengthening and wider aims of economic development. Further, an analysis of how international NGOs (INGOs) have reacted to USAID policies may provide valuable insights for USAID as it looks to support LNGOs directly, rather than through INGOs.

To examine these issues, semi-structured group and individual interviews with NGO representatives were held to test the following three main hypotheses:

(1) INGOs have adapted to USG funding requirements and have full overhead coverage using the more flexible, negotiated and approved indirect cost rate (NICRA), whereas LNGOs without this rate will increasingly experience insufficient overhead coverage;

2) INGOs, and increasingly LNGOs, are or will be suffering from insufficient overhead coverage and recent policy reforms have not corrected these issues;

(3) LNGOs maintain distinctly simpler accounting systems than INGOs and can cover overhead needs with the lower de minimus rate allowed.

As the study indicates, results largely confirm the first hypothesis and further, demonstrate that LNGOs are likely not aware of the de minimus rate. As such, at the conclusion of the study a series of recommendations for USAID will be provided to assist it to better support the overhead cost requirements of LNGOs, which are likely to suffer from a gap in overhead coverage before they are able to negotiate the same type of indirect cost rate agreements as INGOs.

Since 2008, the Obama Administration has made an established commitment to enhancing local ownership and sustainability of development initiatives. This commitment has been demonstrated, in part, through increased direct funding to LNGOs that work within their community to develop programs. By way of USAID Forward, an initiative launched in 2011, the U.S. government has committed itself to support local ownership and sustainability as measured by increasing direct funding to local organizations from 9.7 percent of overall USAID funding to all NGOs in FY 2010 to 30 percent by FY 2015. Placing LNGOs in the prime recipient position aims to ensure that communities drive their own programming (i.e. local ownership) and development outcomes last beyond the life of the program (i.e. sustainability). This commitment accompanied government-wide changes in procurement and other regulations, formalized through the new Code of Federal Regulations, or CFR, part 2CFR200. (USAID, 2013). This portion of the CFR covers the "Administrative Requirements, Cost Principles, and

Audit Requirements for Federal awards" and was streamlined by the Office of Budget and Management in order to reduce the administrative burden on grantees and reduce the risk of fraud (Federal Register, 2013).

The financial and reporting requirements for organizations receiving prime funding from USG agencies are greater than those of the sub-recipient, requiring a shift for LNGOs moving into this role and likely, higher overhead expenses to cover. These costs can be covered differently for NGOs depending on the overall amount of funds they receive from the USG. Large organizations, typically INGOs, which receive at least $10 million in direct USG funding can cover overhead costs through requesting and finalizing a Negotiated Indirect Cost Rate Agreement (NICRA) with their principal USG funding agency (U.S. Government Publishing Office, 2016). Once approved, NGOs can charge the USG an agreed percentage of all direct program costs on U.S. Government grants, contracts or cooperative agreements to cover most, if not all, overhead costs. Identifying this cost involves a separate calculation of overhead needs by the organization which is then submitted to the USG for approval. After the USG approves the overhead rate and provides an organization with a NICRA, it is able to charge a blanket percentage of all its direct costs in grants or cooperative agreements for the next year. Most LNGOs that receive direct USAID funding will not have reached the $10M threshold, and therefore will not be eligible to seek a NICRA, presenting them with a serious challenge in overhead cost coverage.

The new indirect cost policy spelled out in regulation 2CFR200 provides a substitute mechanism called a 'de minimus rate' for organizations that do not have a NICRA. The de minimus allows organizations without a NICRA to charge up to 10

percent to cover their indirect costs (U.S. Government Publishing Office, 2016). Unlike larger INGOs, LNGOs with growing programs may find it very difficult to run large projects without receiving sufficient support for overhead costs. This new allowance, if not high enough to cover increased overhead costs presented by direct USG funding, could create challenges for the infrastructure of LNGOs. These organizations must grow in size and capacity to manage direct USG funding, and without sufficient overhead they may be forced to sacrifice spending on administrative costs, such as infrastructure and financial management in order to conduct project-linked activities. Alternatively, they may need to seek more funding from non-USG sources, increasing the fundraising cost or administrative cost component of overhead as more reporting will be required on additional non-USG funds. Without sufficient funds for overhead costs, NGOs will ultimately fail to achieve their missions and sustain their organization, and thus their programming.

To determine how the USG can provide sufficient overhead coverage in order to directly support LNGOs as effective and sustainable development actors, this study undertook 21 semi-structured, qualitative key informant interviews, carried out in small groups and individually. Informants were placed in one of three representational categories: INGOs, LNGOs, and U.S. taxpayers. Those in the last category had experience working with either for-profit contractors or LNGOs. Due to the sensitive nature of divulging overhead information, interviews focused on perceptions of overhead costs from various perspectives as opposed to asking respondents to speak officially on behalf of their organizations.

In interviews, respondents focused largely on four major themes: (1) external conversations with funders surrounding overhead; (2) funder views on overhead; (3) organizational response to perceived or real funder views; and (4) the impact of those responses on organizations. A significant correlation was found among funder acceptance of organizational overhead needs, the presence of a NICRA rate among INGOs, and the perception of funders as more flexible. Responses directed toward LNGOs touched on shortages in overhead recovery more frequently than did discussions linked to INGOs, which are able to use accounting strategies to cope with potential gaps. Conversely, few LNGO-affiliated informants described such strategies. Also, few LNGOs mentioned NICRAs and none mentioned the de minimus rate, demonstrating a lack of awareness or usage of the tools available to them to garner sufficient overhead coverage. Responses from across the interview categories demonstrated that overhead rules affect the pools of funds that are available for different types of NGOs to avoid significant overhead shortages. Respondent comments also made it clear that insufficient overhead recovery for LNGOs has consequences, namely lower salaries and programmatic quality.

Based on these findings, a number of policy recommendations elaborated more fully in the final section of this thesis have been developed to support the sustainability and effectiveness of LNGOs based upon the experiences of INGOs. They include financial capacity building and skill transfer from INGOs to LNGOs and extending for LNGOs education on indirect cost principles espoused by the USG. A re-evaluation of the sufficiency of the 10 percent de minimus rate for LNGOs may also need to be considered.

To arrive at these recommendations, the thesis traces the following trajectory. Chapter 2 provides a literature review, focusing on three major areas:

1. INGO relationships with funders and how this affect their organizational practices, legitimacy and sustainability;
2. Overhead issues among U.S.-based non-profit organizations not engaged in development activities and the lessons they provide for NGOs, and;
3. USAID broader policy and procurement reform related as to the new CFR.

Chapter 3 discusses methodology used in the individual and small group interviews with key respondents. Chapter 4 examines results of the interviews and focus group discussion, and Chapter 5 provides concluding discussion and analysis.

Chapter 2: Literature Review

This thesis focuses on perceptions of overhead costs in international development,more specifically, the experience of INGOs and LNGOs in covering their overhead expenses related to the receipt of USG funding. The relevant literature includes readings on three major themes: (1) INGO-government relations and the repercussions of these relations on the former's organizational legitimacy and sustainability; (2) the chronic underfunding of U.S.-based, domestic-focused non-profit organizations and related consequences and (3) USAID policy and procurement reform.

INGOs

In the first theme, the topic of overhead is dispersed among a number of sub-topics. Sub-topics include: the history of INGOs working in international development as well as their unique features, which provides context and reasoning beyond the perceptions of overhead (i.e. higher overhead rates as competing with the mission focus); some of the challenges facing INGO – government funding relations; and relations between INGOs, based in the Global North, and LNGOs, based in the Global South. The predominant finding on this topic is that government-NGO relations have consequences for organizational legitimacy, as upwards accountability to the funder replaces downwards accountability to the recipient of services. These relations also result in higher overhead cost requirements to support the long-term stability of organizations to achieve their mission. Partnerships between INGOs, traditionally the prime recipient of funds, and LNGOs, traditionally the sub-recipient of funds although this is changing, have distinct attachments to power that must also be examined in this discussion.

Understanding the role of INGOs in international development requires analysis of the American context since the early 20th century and the role of the voluntary sector, within which NGOs are situated, as complementary to the state. Literature on INGOs has grown rapidly since the late 1980s, the era Salamon (1993) described as the "associational revolution," which witnessed a rapid multiplication of the number and type of NGOs, both international and local, engaging in these activities. However, the history of voluntary sector organizations collaborating with government dates much earlier, to the early 20th century, through the Carnegie, Sage and Rockefeller Foundations. These early foundations carved out a role for future INGOs, demonstrating their societal value in light of the tremendous humanitarian need among poorer groups in the U.S., and growing after the 1936 Tax Act, which introduced the concept of tax-deductible charitable donations (Smillie and Helmich, 1999). Following the two major world wars, U.S.-based non-profits began operating in Europe to respond to emergency humanitarian situations (Reid and Kerlin, 2006). After World War II, these organizations moved into newly independent countries to begin operations, marking the beginning of the INGO. From the post war period up to the late 1960s, INGOs, then called private voluntary organizations (PVOs), worked primarily in emergency situations and refugee assistance (Smillie and Helmich, 1999).

History of INGOs in the U.S. Subsequent to the creation of USAID in 1961 relationships between INGOs, then referred to principally as PVOs, and the U.S. Government became significantly closer in spite of ongoing concerns over voluntary sector need for 'privateness' or independence. USAID was founded under President Kennedy with a focus on providing technical assistance to help the world's poor and to

ensure freedom, more broadly. Until this period, many U.S.-based organizations were reluctant to take government funding due a concern over sacrificing both their connection to grassroots communities and their independent ability to advocate for those with whom they worked. The 1973 'New Directions' legislation that reformed the 1961 Foreign Assistance Act introduced the "human needs approach," expanding international development and the role of PVOs. As a result, PVOs began to take on a stronger development programmatic role as sustainable, community organizers (Smillie and Helmich, 1999). This legislation also formalized the relationship between the U.S. Government and PVOs, which previously was cobbled together largely in response to natural disasters and other emergencies (McCleary, 2009). Further, a resulting huge increase in the size of grants to PVOs served to boost the sector as USAID began to use PVOs as a proxy in countries where its missions closed, leveraging their perceived advantage in local programming (McCleary, 2009, p. 104). From 1972 to 1973, the actual number of USAID grants with PVOs dropped by one while the cumulative amount (in 2005 USD) increased from $184M to $403M (McCleary, 2009, p. 104). In other words, in one year the average grant size went from $4.7M to $10.5M. Grant sizes peaked in 1974. Subsequently the number of grants to PVOs increased to bring the average grant size back down to $4.4M by 1981. The Office of Private and Voluntary Cooperation was created within USAID in 1974 to solidify the relationship between USAID, PVOs and any other types of development organizations. By the late 1970s the term PVO began to be eclipsed by the use of NGO to characterize these organizations that were increasing their presence outside of the U.S. (i.e. INGOs).

Unique features of NGOs. A number of authors have analyzed the tremendous growth of INGOs during this time through the lens of the comparative advantages of NGOs over other development actors. Such factors include their independence from governments, connection with grassroots communities and responsiveness to their needs, participatory methodology, and innovation. NGOs of all types were believed to fulfill roles that the government and private sector either could not do at all or could not do efficiently, and to be more flexible and responsive to heterogeneous consumer demands, while less bureaucratic and subject to political shifts (Meyer, 1992). NGOs of both types were often described as homogenous entities, characterized by a certain "moral and political legitimacy" (Tvedt, 2006). Located apart from government and private sectors, NGOs of both types were viewed as able to step in when governments failed and to act as political and financial free agents, in spite of their close financial ties to government (Tvedt, 2006). Promising strong local networks and committed staff, INGOs were increasingly viewed among advocates of international development as a vehicle to make much-needed development initiatives more people-centered, participatory, sustainable, and considerate of good governance and democratization and transparency (Hailey, 2000). As summarized by Tvedt (2006), "NGOs were portrayed as independent voices of the people or as forces of democracy and civic courage" (p. 679). They were also seen as less susceptible to "contract failures," which may occur when monitoring becomes difficult and organizations implementing programs are therefore not as incentivized to maintain a high quality. Contract failures became a common issue in lesser developed operating environments without active funder presence (Hansmann, 1980). INGOs as seemingly independent agents appeared to be a panacea for some of the main challenges

of the development field, such as sustainability, adaptation to local context, local networks and knowledge. [1]

Challenges facing NGO-government relations. In spite of their aura of independence, NGOs have had a long-standing relationship with government agencies through their receipt of the government financing. This financing, in turn, impacts their organizational practices in response to tighter compliance and financial requirements. As U.S. government funding to INGOs grew, the organizations multiplied. Tvedt (2006) deems the mid-1980s the 'NGO decade.' In the late 90s, direct funding by officials funders to NGOs of all types grew to represent 85-95 percent of NGO funding among USAID-registered NGOs (Tvedt, 2006).This financial relationship has clear implications for organizational structure and outlook, including heightened resource dependence, a theory first outlined by Pfeffer and Salacik in 1978. The theory indicates that leadership of organizations are forced to select from a circumscribed set of choices due to environmental constraints (see also: Kramer and Grossman, 1987). Environmental constraints for NGOs with USG funding includes all external impositions and restrictions placed on the organization, such as a large number of competitors and significant compliance regulations, which in turn shape organizational choices. This environment creates clear accountability lines that channel upwards to the funder, undermining the NGO's comparative advantage of "stakeholder ambiguity" (Billis and Glennerster, 1998). As Billis and Glennerster elaborate,

[1] For a general overview of NGOs and voluntary sector advantages see Smillie (1995), Salamon (1993), Salamon (1994), Frumkin (2002), and Ronalds (2010). For a discussion of of multi-lateral – NGO collaboration see Sollis (1992). Mohan (2002) questions comparative advantage narrative and critiquing the neo-liberal discourse that supported the rise of NGOs. For domestic, U.S. non-profit focused studies that support these conclusions, see Billis and Glennerster (1998). On the advantage of stakeholder ambiguity in the sector and for non-profit mission fulfillment and linkage to innovation see McDonald (2007).

> "the less the stakeholder ambiguity, the lower the comparative advantage. If paid staff, governing body and users are all quite separate all the problems faced by agencies in other sectors begin to appear. If service volunteers begin to depart the agency and/or begin to move out of any governance roles as well, then ambiguity diminishes" (p. 96).

Further, the type of evaluation preferred by the funder, mostly quantitative examinations of short-term outputs, increases the risk of contract failures because they increase NGO incentives to deliver services or goods of a lower quality to the in-country beneficiary since the government funder and the beneficiary are unlikely to have direct contact. NGOs receiving government funds may lose a key advantage of their sector if they fail to maintain responsibility for high performance to the recipients of services. In this situation, NGOs would begin to resemble "public service contractors," or private sector companies delivering public goods (Robinson, 1996).

Increased government financing of NGOs is likely to increase overhead rates, which if not covered by funders undermines NGO effectiveness and sustainability. Overhead requirements are likely to rise as a percentage of overall revenue when incoming funds drops. Total revenue for any organization will include program and overhead costs, both of which can be expressed as a percentage of total revenue. As a percentage of total revenue, overhead rates rise proportionally as the total revenue falls, or as program-specific revenues grow slower than overhead costs (See Figure One: Overhead Rate Calculations). As organizations age and grow, they naturally have higher rates of administrative expenses, especially if their growth comes from an increasing dependence on government grants (Rooney, Hager and Pollak, 2003).

Figure One: Overhead Rate Calculations

In a non-profit structure where expenses = revenue,

Program costs + overhead costs = Expenses = Revenue

Percent program costs + Percent overhead costs = 100% Revenue

Overhead costs / Total Revenue = Overhead Rate

In Edwards and Hulme's (1996) critically important volume on government-NGO relations, Bebbington and Riddel (1995) express particular caution about funding LNGOs, elaborating that as funders "use SNGOs to deliver aid this inevitably implies an increase in the size and activities of the NGO. This can have an adverse impact on quality… and can undermine effectiveness and institutional coherence" (p. 113; See also: Prakash and Gugerty, 2010 for accountability requirements distracting NGOs from their mission). Bornstein (2003) looks at the expectation for NGOs to work within tighter funder regulations and greater levels of professionalism in South Africa, noting that these pose significant costs for the organizations. The most successful organizations were predominantly larger organizations that were able to negotiate a more equal relationship with funders. Similarly, Jalali (2013) also discusses the dangers of international funding for Southern NGOs as undermining movements that inherently create conflict in the society, for example to empower a disenfranchised group, and turning those movements into "consensus" movements that do not fit into the community or respond to community needs. Bano (2008) uses the Pakistani context to demonstrate a correlation between receipt of international aid, reduced performance and inability to attract members to local membership-based civil society organizations, which are NGOs by some definitions. The type of organization also has implications for typical overhead expenses, with organizations with higher government funding requiring greater overhead funding to

cover expenses. Reid and Kerlin (2006) look, in part, at overhead rates among different types of INGOs receiving funding from the U.S. Government for international development activities, with international relief organizations being far lower and civil society and agricultural development organizations being "four – five times" the level of administrative costs of relief organizations. Civil society and agricultural development organizations also had higher percentages of government funding.

Elbers and Arts (2011) examine the tighter regulations on local organizations located in Ghana and India, which often depend on the international aid system to implement their programs. As the relationship becomes more contractual and asymmetrical,local ownership and sustainability are increasingly undermined. This has critical linkages to overhead because "funders' unwillingness to fund overhead costs has an enormous impact on SNGOs' [southern NGO] ability to sustain and strengthen themselves" (Elberts and Arts, 2011, pg. 719). As one of Elbers and Arts interview respondents stated:

> "they just give you enough money to cover stationary costs... . But it creates huge problems. Because how do you function, how do you pay your rent, how do you keep your staff, how do you build and maintain your expertise?... You can't grow your organization on that kind of funding" (p. 719).

There is significant consensus that government financing of NGOs will increase their overhead. Insufficient overhead coverage poses particular risks for small, local civil society organizations' connection with their beneficiaries and organizational sustainability.

As a result of these financial and legitimacy vulnerabilities, Van der Heijden (1987), puts forth a commonly accepted thesis that organizations should diversify away

from public funds to maintain their comparative advantages described above and support their organizations through flexible and stable relationships. Similarly, Edwards and Hulme (1996) recommend funding diversification to maintain NGO legitimacy and politicization and cautiously weighing funding particularly for LNGOs. Wood (1996) also warns about funder dependence and compliance requirements, writing: "NGOs cannot easily insulate themselves from the prevailing organizational culture. This is especially the case as they become larger, more significant, receive more funds and have to account for those funds through complex review and reporting procedures" (p. 87). Chikoto and Neely (2014) refute these claims about funding diversification from a financial perspective rather than organizational legitimacy. They argue instead for the positive long-term financial benefits of revenue "concentration."

North-South NGO relations and power differentials. Increasingly government financing patterns have created growing INGO – LNGO "partnerships," a major area of analysis. As NGOs have grown in number and capacity to contribute to development activities, 'partnership' became the prefered term among funders to characterize their relationship with NGOs and among INGOs in reference to their relationships with LNGOs (Lister, 2000). Because many organizations are cynical about the term 'partnership' they are seeking alternatives to its use. Much literature has discussed ideal partnerships as equating relationships between equals characterized by mutuality, interdependence and with shared intentions (Fowler, 1997b; See also Brinkerhoff, 2002). Lister argues that the ideal partnership is more likely to be rhetorical than practical due to the power dynamics and control of money. Her primary data source is a case study

looking at a INGO with significant funding from a bilateral funder working in Central America with a LNGO with the intention of building the latter's capacity.

Notably, the term partnership is generally only used in a downwards fashion, by funders characterizing their relationship with 'their' INGOs, and by those same INGOs characterizing their relationshp with LNGOs. Power distinctions were noted in organizational procedures and influence in design of programs and activities (p. 234). Lister concludes that the construct of upwards compliance and reporting dependence towards, for example, either the funder or the INGO prime recipient, comes at the expense of accountability towards the local recipients of services. The upwards accountability has the affect of legitimizing the non-local entity to the funder and reducing the significance of local legitimacy (p. 235; See also: Ebrahim, 2003). Morse and McNamara (2006) critique Lister's analysis for assuming that all the power lies with the funder rather than taking an interdependent view of the relationships. Mawdsley, Townsend, Porter and Oakley (2002) concur with Lister's conclusion, providing concrete recommendations for LNGOs to increase their authority in these relationships.

A number of scholars use the term 'partnership' to refer to a process by which Northern NGOs build up Southern NGOs and transfer responsibilities to them, making the Northern NGO redundant. Harrison (2007) questions the linkage of the skill transfer process with the partnership concept. He demonstrates that not only do INGOs and LNGOs have different notions of 'partnership,' but their differing views often lead to conflict. Conflict resolution, he notes, is notably absent in literature discussing NGO partnerships, arguing that it should be (pg. 397).

The first sub-set of literature agrees on two important points: NGOs share certain comparative advantages over other development actors, and government financing poses risks to these advantages through changing accountability lines and increasing overhead costs. When funders do not sufficiently cover overhead costs, organizations fail to achieve their mission and cannot work with a long-term view. Increasing engagement among funders, INGOs and LNGOs reveal significant power differences and different interpretations of the relationship among and between parties.

U.S. non-profit literature

Domestically-focused non-profits face similar challenges to internationally-focused NGOs: increasing accountability requirements result in both greater overhead costs and increased funder focus on these costs, creating a cycle in which non-profits are motivated to underreport overhead needs to meet sector norms, do not receive sufficient overhead and therefore cannot invest in their organizational infrastructure.

Declining public trust and greater accountability. Overhead-focused scandals are occasionally created when news of apparently high overhead rates of NGOs or domestic non-profits reach the press, with indictments of waste or fraud. Although not fully researched to date, declining public trust in charities and NGOs generated by such scandals may be related to the increasing accountability requirements for domestic non-profits and internationally focused NGOs. Glanz's (2006) commentary demonstrates how the recent and ongoing experience in Iraq and Afghanistan highlights this issue for international NGOs:

> "Overhead costs have consumed more than half the budget of some reconstruction projects in Iraq, a U.S. government estimate shows, leaving far less money than expected to provide the oil, water and electricity needed to improve the lives of Iraqis (p. 1)."

In the domestic context, telemarketing campaigns run by private fundraising companies have been criticized for failing to disclose significant allocations from the total amount raised to cover overhead rates. While this concern raises eyebrows, the case of Madigan v. Telemarking Associates Inc. rules that firms are not under an obligation to disclose this information. They must provide it only when requested (Keating, 2003).

Private sector norms and overhead containment. The private sector business outlook that organizations should value, improve and 'control' their overhead expenses appears to relate to funder views of how organizations cover overhead costs. Hence, it will briefly be discussed here. Schmenner (2012) discusses frequently overlooked overhead processes, particularly compliance, accounting and human resources, and advocates for the organizational benefits of strengthening these processes and maximizing funds to cover them. Finkin (1988) also advocates for enhancing these processes, through dividing necessary and unnecessary overhead processes, and "containing" unnecessary overhead costs, defined as those that do not increase financial control controlling overhead expenses. Notably, he does not call for low overhead but rather, "optimization" of overhead which leads to "significantly decreased total costs" (Finkin, 1988, p. 50). Similarly, Assaf, Bubshait, Atiyah, and Al-Shahri (2001), conclude that failure to budget for and cover overhead costs for construction firms hurts the business' competitiveness and in some cases, has resulted in a number of surveyed businesses shutting down. Also in the construction industry, Enshassi (2008) identifies such key reasons for unexpected overhead in projects as, "project complexity, location and size, percentage of subcontracted work, payment schedule, needs of works, type of

contract (p. 38).” Furthermore, Enhassi (2008) demonstrates that a more detailed overhead estimation resulted in greater success rate in winning bids.

Private sector organizations must look inward to understand and evaluate their overhead processes to remain cost effective and produce a high-quality product, which are indicators of a successful business. Determining the cost-effectiveness of a non-profit or NGO in light of the product produced, however, is a much more difficult exercise. Efficency should be valued and overhead processes should still be re-examined to ensure internal efficiency. When organizations’ activities or outputs are not clearly understood by external stakeholders, particularly in environments where contract failures are likely (See Hansmann, 1980), efficiency measures can be used as a proxy for effectiveness (Pfeffer and Salancik, 1978). However, determining internal efficiency from an external perspective, perhaps by using the overhead rate, is impossible (See also: Mitchell, 2013; Wing and Hager, 2004b; for measures of effectiveness beyond financial indicators see Liket and Maas, 2015).

Funder motivation and overhead. In addition to the confusion between internal efficiency measures and external organizational effectiveness judgments, problematic domestic reporting systems and charity rating sites may be related to funder aversion to overhead. The IRS-990 form completed annually by all 501(c)3 registered non-profit organizations in the U.S. requires submission of administrative and fundraising costs. These two costs are taken as a percentage of the overall revenue, also reported on the form, to yield the organization’s overhead rate. The IRS does not enforce a particular approach with calculating these rates, thus allowing some organizations to indicate that they have no costs in one or both of these categories (Hager and Pollak, 2004; Froehlich

and Knoepfle, 1996, Gordon, Greenlee, and Nitterhouse, 1999). Further, organizations may have an incentive to underreport overhead in response to predicted funder aversion (Krishnan, Yetman, and Yetman, 2006). A number of studies[2] have examined the linkage between individual funders and organizations with relatively high overhead rates, with a significant number that looked directly at the relationship concluding an inverse correlation. This conclusion of funder aversion to high overhead is seen in Weisbrod and Dominguez (1986) , who used a supply and demand perspective to predict that greater administrative costs increase the 'price' to the funder and therefore an alternative will be sought out. Tinkelman's 2007 study builds on several others, including Greenlee and Brown (1999), which demonstrate a negative association between donations and higher administrative and fundraising costs, and Frumkin and Kim (2001) who demonstrate no relationship between these factors. Tinkelman's (2007) study, which concludes an inverse relationship between overall donations and overhead ratios, must be taken in context. That relationship does not hold, he elaborates, if organizations are in the following context:

> "start-up phase, when the administrative or fund-raising ratios are too low to be plausible, or when the overall organizational figures are unlikely to reflect the funder-supported segment of the organization (p. 61) or if organizations are primarily supported by sources other than individual funders (p. 62)."

An organization's inclusion in one of these contextual settings makes the data useless for the funder and therefore, irrelevant. Caviola, Faulmuller, Everett, Savulescu, and Kahane (2014) are also firmly in the camp of the inverse relationship between low

[2]Including: Weisbrod and Dominguez, 1986; Tinkelman, 2007; Greenlee and Brown, 1999; Frumkin and Kim, 2001; Caviola, Faulmuller, Everett, Savulescu, and Kahane, 2014; Bowman, 2006; Imas, 2014; Duncan, 2004; Worth, 2016; Ribar and Wilhlem, 2002; and Glaeser, 2001

overhead ratios or overhead expenses and higher donations, demonstrating an 'evaluability bias' for these rates over cost-effectiveness indicators, which may be more difficult to evaluate. The evaluability bias helps to explain the efficiency and effectiveness measure confusion described above (See: Private sector norms and overhead containment, above).

Other studies explain that overhead may be one factor but not the sole determinant in funder decision-making. Bowman's (2006) study contradicts this group in using a workplace giving program to demonstrate that funders care about overhead among other topics but it is not the sole determinant of the organization which will receive donations, causing him to conclude that "importance of overhead ratios in the larger context of public policy is easily exaggerated" (306). Similarly, others look at broader motives for individuals engaging in charitable giving or supporting charitable organizations, beyond overhead, include warm glow (Imas, 2014), impact philanthropy (Duncan, 2004 and Worth, 2016), and joy of giving motivations (Ribar and Wilhlem, 2002). Glaeser (2001) concludes that non-profit organizations have an advantage in attracting donations, even in the absence of tax benefits, due to the greater level of influence funders exert in non-profit settings.

To further examine what motivates funders to financially support a particular non-profit, some studies have examined the reliability of such non-profit and NGO rating sites that may influence funder choices as Better Business Bureau and Wise Giving (Bhattacharya and Tinkelman, 2008) and Charity Navigator (Szper tand Prakash, 2011). These watchdog sites, also including Guidestar, provide ratings for non-profits based on a wide set of indicators, although they are frequently known for focusing exclusively on

overhead rates, a major focal point for funders who want to know the percent of their donation going directly to the cause (Szper and Prakash, 2011). All of the sites make use of the publicly available IRS-990 form, which presents an immediate problem due to the well-documented underreporting or misreporting of administrative and fundraising costs. The Overhead Myth Project, a movement started in 2013 by the Better Business Wise Giving Alliance, Charity Navigator, and GuideStar, urges funders to avoid make giving decisions solely on the base of overhead rates. The creators of the Project advocate using their sites to determine organizational performance based on transparency, accountability, governance, leadership, and results, as well as finances, in accordance with GuideStar's Money for Good II research (Overhead Myth Project, 2016). Clearly, these sites do not advocate selecting an organization based solely on overhead rates, as indicated by this response on the FAQ page of the Overhead Myth:

> "Q: 'I don't have a lot of time to make this decision. I'm looking for a simple, easy-to-digest statistic that tells me about a nonprofit's performance. Are you telling me there isn't one?' A: 'That's what we're telling you. Much as it would be nice to be able to look to one simple number to determine how to give our charitable dollars, it simply doesn't exist—and probably never will. You can't judge a company or a university or a person by one statistic, and the same is true for nonprofits. But if you focus your attention on performance, you're heading in the right direction.' "

Ultimately, these issues are intertwined: the charity rating sites tell funders to evaluate charities based on transparency, including transparency of publishing their finances, however organizations have a disincentive to accurately publish their finances as high overhead rates as seen as wasteful and de-legitimize the organization, so organizations can't be transparent in reporting their overhead, which further de-legitimizes them to funders (see: Hyndman and McConville, 2015). Saxton, Kuo and Ho (2011) using a

sample of organizations in Taiwan, conclude that voluntary disclosure systems, such as the IRS-990 form are not likely to encourage public accountability. The role of these sites is up for debate and some say their importance is overestimated: Cnaan's (2011) study demonstrates that 78 percent of individual funders do not consult charity ratings when making donations.

Under-funding of NGO overhead and sustainability. The chronic under-funding of overhead among organizations, or "non-profit starvation cycle" (Gregory and Howard, 2009) is a significant topic of discussion with follow-on in Lecy and Searing (2015), the controversial work of Pallotta (2012) and Hager and Flack(2004) who all examine how this pertains to the sustainability of organizations. The Urban Institute reports that "public sector funders tend to favor nonprofits with low reported overhead costs. This practice appears to have encouraged both underinvestment in organizational infrastructure and underreporting of overhead costs" (Wing and Hager, 2004a, p. 4). Pressure on charities to spend less on overhead negatively impacts "charities' ability to initiate fundraising campaigns, invest in long-term planning, and sufficiently support overall infrastructure, which ultimately undermines efforts to serve their causes effectively" (Gneezy, Keenan and Gneezy, 2014, p. 1; See also Wing and Hager, 2004b). Woodwell and Bartczak (2008) discuss the gap in overhead and recommend funders provide more general operating support, multi-year support and maintain "supportive and respectful" relationships with grantees. Taylor, Harold and Berger (2013) discuss the 'overhead myth,' within the context of a letter sent to organizations throughout the U.S. advocating that

> "many charities should spend more on overhead. Overhead costs include important investments charities make to improve their work: investments in training, planning, evaluation, and internal systems—as well as their efforts to raise money so they can operate their programs (p. 1)".

This notable letter is part of the toolkit developed by the Overhead Myth Project, developed jointly by the Better Business Wise Giving Alliance, Charity Navigator, and GuideStar.

Rooney and Frederick (2007) conclude that many non-profit organizations have challenges meeting their full overhead needs, although larger organizations are more likely to have fewer of them. They conclude that organizations which do not not rely on charitable foundations for full overhead coverage but have various sources of income have greater overhead coverage and organizational infrastructure. Bedsworth, Gregory, and Howard (2008) who analyzed a cycle of under-reporting on the IRS 990-form found that funders rewards organizations with lower overhead, creating pressure for organizations to conform to lower overhead rates. With insufficient overhead recovery, management at these organizations will under-invest in the organization and ultimately the beneficiaries, intended recipients of the intervention or services, suffering. To ameliorate this issue, they conclude that both funders and organizations need to take concrete steps to openly discuss the issue of administrative costs. This will require a commitment on the funder side and honesty about the cost of doing business by the organization that receives the funds. They also recommend that organizations should put forth an alternative measure of effectiveness (i.e. cost per outcome) to avoid the evaluability bias of overhead indicators and the confusion of efficiency measures for effectiveness. Smillie and Helmich (1999) conclude that by accepting lower rates than organizations need, funders force organizations to allocate as much administration to

projects as possible and to take contracts that earn a surplus or to charge the cost to private funder income. Using private funder resources to cover these costs, they conclude, may make the NGOs look illegitimate and hurt their funding base . Chikoto and Neely (2014) also recommend investments in administrative and fundraising support of organizations, although limiting executive salaries.

USAID-NGO Relationship Literature

The third sub-set of overhead focused literature reviewed for this study includes that written about USAID's historical relationship with NGOs. This relationship is characterized by increasing interdependence, recent policy shifts and associated procurement reforms. The reforms have major implications for both international and LNGOs and their overhead rates, yet little literature looks critically at this linkage or the financial disadvantages of LNGOs.

USAID-NGO relationship development. As outlined above, the 1973 New Directions legislation led to the formalization of USAID – NGO relations and formal grant-making. Early grants, simple to manage with minimal funding requirements, were "administratively easier, requiring minimal USAID staff oversight" (McCleary, 2009, p. 105). Organizations receiving the bulk of this funding in the 1970s were relief agencies. USAID provided two types of grants at this time, Development Program Grants, and Operational Program Grants, in part to introduce these relief agencies to conducting longer-term development activities (McCleary, 2009). Development Program Grants were institutional support grants that created secular, technical organizations closely tied to USAID. Only organizations that had the capacity to carry out in country programming were able to receive the Operational Program Grants. Notably, the latter group of grants

had a cost-sharing component, requiring that the PVOs find 25 percent of the funds in cash or in-kind contributions (McCleary, 2009). The grants were led by the mission overseas and as such increased overhead costs. To respond to this "financial burden," USAID introduced overhead allocations into their budgeting practices (McCleary, 2009, p. 106). In the late 70s, USAID introduced a Matching Grants program in which PVOs had to contribute 50 percent of the funding and in exchange, the PVO would receive institutional support and capacity building to carry out activities in country (McCleary, 2009). The process for becoming eligible for these grants was cumbersome, clearly favoring the larger organizations. Congress, viewing the matching grants as 'cash cows' for long-standing PVOs that already had large budgets, became wary of this program. As a result, it pushed for the decentralization of the grant process with more authority going to local missions and the nature of the agreements moved from grants more to contracts. In this context, USAID created the cooperative agreement, within which USAID would design the strategy according to its overall mission plan, money would be provided as a grant with a larger degree of USAID oversight, and the cost sharing component was waived, allowing PVOs to become 100 percent dependent on the USG (McCleary, 2009; Smillie and Helmich, 1999).

Extensive and more compliance-heavy funding to PVOs, by now more commonly called NGOs or INGOs, continued in the 1980s as Cold War strategic interests allowed INGOs to provide greater foreign policy reach and personnel cuts in government sector favored channeling funds through non-governmental service providers. Congress fixed the percentage of development and disaster funding in 1981 to be channeled through INGOs at 12-16 percent (McCleary, 2009). INGOs grew in budgets, staff and operations

to keep up with the extensive demands (Smillie and Helmich, 1999). In the 1980s, development goals focused on Cold War foreign policy aims partially reflected by Congress' amendment to the Foreign Assistance Act to allow INGOs to continue working in countries from which USAID had been ejected from in the name of U.S. interests (Smillie and Helmich, 1999). In the 1980s, when Ronald Reagan was president, USAID was stripped of the staff required to manage its own programs, creating the dependence of USAID on the INGOs to implement activities through grants and contracts that were awarded primarily to large organizations that could fill the gap (p. 141). Cuts in government expenditure and Republican leadership preference for private sector service delivery over government provided an environment for INGOs to expand social service delivery through government funding (Robinson, 1996; See also: Kristiansen, 1995). INGOs struggled with implementing contracts and cooperative agreements as grant sizes grew. Cooperative agreements that behaved more like contracts became the favored mechanism beginning in the 1980s and INGOs lost even more autonomy. McCleary summarizes the NGOs perspective as follows:

> "contracts were too demanding and binding. Contracts required professional financial and staff resources to keep up with the RFPs and bidding process. The PVOs historically preferred grants, which gave the agencies more independence" (p. 132).

The 1990s witnessed additional cuts to USAID's budget and greater demands for professionalization, providing an additional boost to the contracting model. During the Clinton administration, USAID's budget was reduced to the lowest amount in real dollars since before World War II. It was forced to lay off one third of its staff in 1997 (Smillie and Helmich, 1999, p. 248). As a result, the contracting model begun in the 1980s with

INGOs became mandatory as procedures and regulations were streamlined and development became about demonstrating results and impact, creating a new type of relationship between the government and INGOs based primarily on competition and outputs (Smillie and Helmich, 1999, p. 10). INGOs and USG became increasingly inter-dependent over time, with more compliance-heavy funding coming to INGOs, which relied on this funding for their organizational existing.

As USAID became increasingly dependent on INGOs for program implementation, LNGOs were becoming important on the global scale. In understanding the evolution of USAID contracting policy since the 1990s it is useful to look through the lens of four high level fora on international aid effectiveness hosted by the Organization for Economic Co-operation and Development (OECD, 2016b). Each fora, hosted sequentially in Rome, Paris, Accra and Busan, increasingly recognized the importance of local ownership of development priorities, monitoring and demonstrating development results, and joint (recipient and funder) responsibility for these results. The disconnect between USAID's close relations with INGOs and the rising significance of LNGOs required a paradigm shift.

USAID policy and procurement reform and problematic approaches of local ownership. These high level fora have had significant impact on USAID policy and related procurement reforms. Viewed in the context of USAID's historical relationship with what are now labeled INGOs , the agency has significant reason to promote local sustainability and ownership, and support LNGOs in achieving these goals. This shift began under the administration of George W. Bush. With the advent of the Obama administration, USAID launched a series of reforms, including USAID Forward in 2011,

putting muscle behind an agenda of local ownership and sustainability, promising to increase funding directly to local organizations from 9.7 percent in FY 2010 to 30 percent by FY 2015 (USAID, 2013). Following this change, a set of new government regulations, particularly 2CFR200, was developed, active of as December 26, 2014, to apply universal standards across all government agencies. A major change in this regulation was the allowance of 10 percent indirect cost rate percentage for organizations that do not have a formal, Negotiated Indirect Cost Rate Agreement (NICRA) with the U.S. government.

Given the recent administrative changes at USAID and development's traditional focus on evidence-based development approaches to achieve greater outcomes, procurement reform has not been a significant area of research or policy discussion outside of the agency itself and InterAction, a coalition of U.S. NGOs (Worthington, Lotwis, and Greenberg, 2012). Rather, the regulations themselves provide a critical outlook. As indicated in "Best Practices for Indirect Cost Costing" (2014) an official document dated one month before the release of the new regulations and three years following the launch of USAID Forward, USAID states that local organizations have:

> "a handful of employees, few U.S. Government awards at one time and basic accounting systems. Indirect cost rates are generally not warranted unless an organization has many government awards at once necessitating a system to equitably allocate shared costs (i.e. indirect cost rates). Thus, it is generally best for local non-U.S. organizations to charge all costs direct when possible, rather than establish indirect cost rates (p. 7)."

This statement clearly conflicts with the effort of USAID Forward to provide direct funding to local organizations, which will require more than "basic accounting systems." Perhaps this issue is to be addressed through the capacity building component, also significant in USAID Forward, either directly from the agency or in partnership with

INGOs. Regardless, the statement that local organizations generally should not have NICRAs, assuming they were able to go through the time-consuming and demanding application process, demonstrates the following unequal expectations and flawed thinking: LNGOs have basic accounting systems and few staff (i.e. low overhead) so we (USAID) should channel more compliance-heavy funding through them, which will in turn demand higher overhead.

In addition to anticipated insufficient overhead coverage, LNGOs are at a distinct competitive disadvantage with INGOs pertaining to accounting practices and apparent overhead rates. Indirect costs, including many items which organizations would categorize as overhead, such as rent, proposal writing, and support staff that work on more than one project, are often grouped into a percentage of the total programmatic, or direct costs. Organizations with more experience in government grants or cooperative agreements understand that many of these costs can be directly billed as a programmatic cost, making their indirect cost appear smaller than it would be if they lumped all the costs in that category, although the regulations should prevent these practices. LNGOs that are receiving direct funding for the first time are unlikely to possess this financial acumen, putting them at a distinct disadvantage if they do, in fact, require more than 10 percent indirect cost rate recovery. This disadvantage has yet to be fully examined in the literature.

Anticipated insufficient overhead coverage coupled with different expectations for overhead needs of LNGOs and INGOs would likely put LNGOs in the aforementioned, ‘non-profit starvation cycle’ in which theyneed constantly to apply for additional funding, further draining their resources. Scholarly examinations of the

application of the non-profit starvation cycle to local organizations are limited and not up-to-date. Bornstein's (2003) and Elbers and Arts' (2011) important studies were published prior to the release of the new government procurement reform.

Direct funding presents a threat to local organizations' sustainability. Based on the existing bodies of literature, one can assume that achieving maximal NGO effectiveness and fulfilling the organization's mission contributes to larger development outcomes due to the advantages of NGOs in the sector and the long-term NGO – government relationship. Further, the sustainability of LNGOs is often threatened by international funding which comes with heavy compliance requirements and political agendas. Local sustainability is not only a specific tenet of USAID Forward but a key to unlocking major development challenges. This creates a fundamental question: How should the U.S. Government support local organizations directly, as outlined in USAID Forward, while ensuring their sustainability? The thesis examines how USAID can best fulfill the goal of providing direct funding to LNGOs while considering administrative and management financial needs, specifically the need for overhead costs. As these organizations become more professionalized and able to fulfill the heavy administrative burdens posed by USAID's regulations, LNGOs need to cope with increasing overhead, using lessons learned from INGOs which have already undergone this professional transformation.

Chapter 3: Methods

This thesis seeks to examine the effectiveness of USG overhead coverage for LNGOs as part of international assistance. To study this issue, relevant scholarship was reviewed, as seen in the previous chapter, and in-depth original qualitative semi-structured interviews with 21 respondents were conducted. All interview responses were coded for analysis.

Three general hypotheses appear in the existing literature related to this topic: 1) the resource dependency theory, 2) the non-profit starvation cycle model, and 3) the argument that locally-focused NGOs have fewer limited overhead costs relative to their overall expenses in comparison with INGOs. According to the resource dependency theory, INGOs have adapted to the constraints of their environment and developed specific mechanisms for ensuring overhead coverage under funding regulations (Pfeffer and Salacik, 1978). The non-profit starvation cycle literature meanwhile indicates that INGOs as a group suffer from insufficient coverage of overhead, but within this group, larger INGOs, such as FHI 360, have relatively more coverage than smaller INGOs, such as Freedom House (Bornstein, 2003). Finally, USAID documents claim that local organizations maintain basic accounting systems that do not require the application of NICRAs, and this in turn allows a 10 percent indirect cost rate recovery to be sufficient for local ownership and sustainability (United States Agency for International Development, 2014).

To examine these hypotheses in greater depth, semi-structured interviews were chosen as the qualitative research technique to be applied for this study. The semi-

structured interview methodology was selected instead of a survey because the latter has been found to provide only limited access to information about financing and costs, while semi-structured interviews have gained relevant rich data, as demonstrated by the usage of qualitiative interviews in Bornstein (2003) and Elbers and Arts (2011). Based on the precedent set by these studies, a series of semi-structured qualitative interviews were conducted with professionals employed at INGOs and LNGOs as well as U.S. taxpayers, the ultimate funders of U.S. international assistance.

Interview respondents were asked to provide individual perspectives rather than institutional viewpoints and were assured of anonymity. There were four categories of respondents, as follows: U.S. taxpayers, employees at INGOs, employees at INGOs with sub-awards with LNGOs, and employees at LNGOs. Taxpayers were all U.S. taxpayers involved in international development but were not be eligible for inclusion in one of the other three categories of respondents. The inclusion of this category allowed for slightly nuanced views to be explored. For example, the inclusion of employees at USAID contractors provided some depth to responses provided by employees of INGOs. A total of 21 interviews were carried out over a period of five months and were conducted either in person or using Skype audio and, when possible, video.

Inclusion criteria varied according to membership in each of the four groups of interest. For individuals affiliated with U.S.-based INGOs, the inclusion criteria were that the organization be a 501(c)3 registered organization and/or self-defined as an NGO conducting international development activities. INGOs also had to receive at least some bilateral funding from an official development assistance (ODA) source, including the U.S., in the form of grants or cooperative agreements. For individuals affiliated with

LNGOs, inclusion criteria required that the organization must be self-defined as an NGO, as tax exempt status is irregular outside of the U.S., and conducting development activities in the country in which they are based. LNGOs also had to maintain at least some bilateral funding from an ODA source. Inclusion in the U.S. taxpayer group required that respondents were currently or previously linked to international development, were not to be members in one of the previous groups, and were also U.S. taxpayers, as confirmed by the individuals. Notably, the taxpayer group did include individuals related to the sector: one LNGO employee without official development assistance (ODA) type funding, two USAID contractors and one consultant for a U.S.-based NGO.

Two major modifications were made during the course of the study, one of which affected an additional respondent category. Funders were removed as a target group as they were unwilling or unable to discuss this topic, and were replaced by a second group of U.S.-based INGOs with sub-awards, as the prime and sub-recipient relationship quickly became a major area of discussion. Second, focus group interviews initially envisaged for a larger portion of the activity were subsequently removed when it appeared that respondents were less willing to speak openly in groups about this subject.

Chapter 4: Results

Data Analysis Strategy

Each of the individual or group interviews was transcribed upon completion. The researcher conducted several phases of response coding, an approach which involves categorizing responses into groups, proceeding from the most general to the most specific topics (See Figure Two). The researcher conducted the initial phase of coding to analyze common themes and phrases used by respondents by examining each completed transcript, adding new codes as needed. Once the first phase was completed, the researcher developed a master code list and consolidated or expanded where needed. The researcher then applied the master list to the transcripts in a second phase of coding. Once all transcripts were in the penultimate code list, a few codes with only one or two responses were eliminated. A maximum of double coding of responses was enforced, meaning that no more than two codes were applied to any single response. Codes developed in this study reach as low as the fourth level (See Figure Two).

Through this process, four major themes emerged. These themes include: External Conversations; Funder Views; Organizational Response; and the Response Impact. The full coding list is provided in Figure Two. *External Conversations* examines how organizations engage with external agents, principally funders, on these issues. *Funder Views* addresses how organizations perceive funder or funder views. *Organizational Response* analyzes these perceived views. *Response Impact* dissects these responses on the organization. The four major themes of responses was developed using a formative theory of Resource Dependency, which assumes that organizations must respond to

constraints in their environment. The major themes are independent variables, which pose questions. The responses to those questions, the dependent variables, are provided by lower level codes (i.e. Under Code I, External Conversations, A. Funder Acceptance is a dependent variable).

Figure Two: Codes

I. External Conversations: How do organizations and funders engage on overhead?
- A. Funder Acceptance
  1. Accepts
     a. Unspecified Funder
     b. USG
     c. Non-USG
  2. Doesn't Accept
     a. Unspecified Funder
     b. USG
     c. Non-USG
  3. Questions and / or Transparency
- B. Funder priorities
  1. Available funding pools
- C. Comparing Rates
  1. Type of organization
  2. Project or sector

II. Funder Views: How do we know funders' views on overhead?
- A. Overhead as an Indicator
  1. Misunderstanding or shortcut
  2. Value and necessity of overhead
  3. Overhead and effectiveness
  4. Overhead and efficiency
  5. Changes in rate
- B. General Funder Expectations and Rules
  1. Standardization or billing structures
     a. NICRA
     b. De minimus
     c. Organizational standards
     d. Funder-led standardization
  2. Reporting
  3. Bureaucracy, rigidity or strict qualities
  4. Taxpayer perceptions
     a. Waste
  5. Congress
  6. Flexibility

III. How do organizations respond and what shapes those responses?
- A. Budgeting –

1. Burden or Complexity
2. Base of application
3. Creative accounting
4. Cost of business and Profits
5. Direct versus Indirect Costs
6. Overhead versus Programs
    i. Impact of funds
7. Internal Conversations
8. Drive / Pressure to keep overhead low

B. International versus local
1. Prime recipient versus Sub-recipient
    i. Overhead for sub-recipients
2. Capacity
3. Risk
4. Locals less overhead
5. Field versus DC
    i. Cost of living
    ii. Field offices
6. Staff

IV. Impact of Organizational Responses
A. Organizational Structure
a. Organizational infrastructure, Support and Sustainability
b. Organizational values
c. Size or Age

B. Insufficient overhead
a. Organization contribution to overhead or earned income
b. Covering overhead from multiple sources

C. Salaries
a. Mission Driven
b. Staff retention

D. Overhead and Program Quality

Respondent Categorization

Respondents from all informant groups were identified, beginning in September 2015 and continuing until February 2016, using the researcher's personal and professional networks. Of the 21 respondents from 20 different organizations, the researcher categorized 17 as 'recipients' and four as 'taxpayers,' Herein is a more detailed breakdown of respondents according to their group of origin:

Table One: Participant Overview

Category	**Number of Informants**
Recipient Group 2a: Non-profit status or	Five: One focus group discussion (4

self-defined as NGO + funding within 1 calendar year in form of cooperative agreements or grants + primarily ODA-type funding + US-based (i.e. INGOs with primarily ODA funding)	respondents) and one interview
Recipient Group 2a-1: Same as 2a + has managed sub-awards to local organizations within 1 calendar year (i.e. INGOs with primarily ODA funding)	Four: All interviews
Recipient Group 2b: Non-profit status or self-defined as NGO + primarily non-ODA type funding (i.e. INGOs with primarily non ODA funding)	Four: All interviews
Recipient Group 2c: Non-profit status or self-defined as NGO + "local" (i.e. based in country where implementing development activities and described as LNGOs in this study)	Four: All interviews
Taxpayer Group 3: Not a member of any of the groups above or of a funding agency, US based taxpayer and currently or previously involved in international development in another capacity	Four: All interviews
Total	21

Notably, individuals surveyed in Taxpayer Group Three were related to the development sector. Two worked for for-profit contractors receiving USG funds, one worked as a consultant for an international NGO, and one worked as a staff member at a LNGO that did not receive USG funds.

Data Analysis

External conversations. Beginning with the first major theme, respondents described different external conversations surrounding overhead, including funder acceptance of organizational overhead needs, the significance of questions from the funder, and finally, funder priorities and the linkage to overhead funding of NGOs. Comments within this code indicate that INGOs with primarily ODA funding report

acceptance of their overhead requirements. NGOs that do report acceptance of overhead needs mentioned two standard rate options, the NICRA or de minimums rates, and largely did not describe receiving questions from the funder. When NGO respondents indicated that their funders did ask questions about their overhead rates, questions did not always signify rejection but rather signified funder concern with transparency surrounding overhead. Finally, NGOs indicated that funder requirements related to overhead dictate, in part, the available funding pools for their NGOs. However, INGOs with primarily ODA-type funding did not describe funder priorities surrounding overhead as affecting their overhead recovery rates. Significantly, NGO respondents describing low overhead rates largely had less reliance on ODA funds. Respondents also provided recommendations for stakeholders outside of their group, for example the INGOs to the LNGOs and the NGOs to the funders. Finally, respondents indicated that funders should only compare overhead rates in very particular circumstances to enable a meaningful comparison.

Funder acceptance. ***INGOs with primarily ODA funding report funder acceptance of overhead needs.*** Respondents indicated that their funders largely accept overhead requirements. Of the nine total INGOs with primarily ODA funding, slightly less than half reported acceptance of their overhead requirements. One participant stated, "the USG portion of that [multiple funder pool] just simply accepts what they are gonna pay." Another participant echoed this statement, focusing more particularly on the presence of a NICRA:

> "So if you are funded by the U.S. Government, I think they will provide as long as and you have a Negotiated Indirect Cost Rate with the due diligence that goes

into the establishment of that Negotiated Indirect Cost Rate. For them, makes it acceptable."

No respondents of this group indicated that the USG did not accept their overhead requirements, although two focus group discussion respondents mentioned unspecified funders that did not accept their rates.

Notably, few or no respondents from the INGOs with primarily non-ODA funding Group and LNGO Group discussed acceptance of overhead requirements from the USG. One taxpayer respondent from a U.S.-based for-profit organization that maintains contracts with the U.S. Government indicated that USG did not accept organizational overhead needs negotiated at the project's outset. Another respondent from this same category and a similar type organization discussed this issue among non-USG bilateral funders, particularly those affiliated with the British Government.

Respondents indicating acceptance of overhead needs mentioned NICRA or de minimus rates, not funder questioning of overhead. USG acceptance of overhead rates will be cross-referenced with NICRA and de minimus discussions, as these are the most likely agreed upon rates for USG funds channeled for INGOs and LNGOs, respectively. There was overlap between respondents describing USG acceptance of overhead requirements and a NICRA rate with two-thirds of all respondents describing USG acceptance also mentioning either the NICRA or the de minimus 10 percent rate, favoring the NICRA. This establishes a linkage between USG acceptance of overhead and the standard rate options of the NICRA or de minimus rate, as would be accepted.

Questions and Transparency. ***Funder questions on overhead may not signify pending rejection but rather, funder concern with transparency.*** Questions about

overhead requirements were discussed by respondents of all categories with minimal representation of INGOs with primarily ODA funding, likely due to the presence of established NICRA rates and the reported acceptance of these rates by the USG by many in this group. Three respondents overlapped between indicating acceptance of organizational overhead needs and discussing questions from the funder about overhead requirements, indicating that questions do not necessarily signify funder rejection of overhead needs. One respondent explained questions from the funder and transparency from his organization:

> "We are very transparent. So this is our normal rate so which one do you want. It's not like. Uh. It's not hidden like oh, this is right, you are giving us $100, we will charge you 40 percent. We are very up front. This is the type of product for the overhead you are paying."

An LNGO respondent discussed publishing annual financial reports and funders' appreciation of this transparency. And another respondent described non-USG, individual funders visiting the field as part of the organization's relationship cultivation and questions being asked during this visit as related to acceptance of overhead:

> "It makes a huge difference when you come visit… And so I think that without even having to say it, that adds to that perception of maybe the necessity of overhead and what it's doing. You see that money donating is going to the program you see happening right now."

Notably, another respondent that did not clearly communicate funder acceptance of overhead requirements did mention similar questions being asked of the organization when foundation or government representatives visited the field, indicating that funder questions on overhead are not linked to a specific typology of funders. This organization and comment was a very similar to the second respondent, an LNGO based in the same

region. On the foundation visits, this respondent indicated potential foundation funders were asking questions demanding:

> "(v)ery detailed about the level of knowledge I had on each program. They wanted to know percentages and numbers and various other funding we had… Whereas when the [individual] funder visits would come, it would be more like, wanting to have contact with the kids and having and having that kind of experience. Some of them would drill me but I would say most of the time, they wanted to see the impact that we had."

Funder priorities. ***Overhead requirements of different funders constrain organizational choices of funding streams across Groups.*** Similarly, almost all respondents in the study, including 100 percent of LNGOs, 75 percent of INGOs with primarily non-ODA funding and the Taxpayer Group, and approximately 77 percent of INGOs with primarily ODA funding discussed feasible funding pools for their organizations or other organizations and the linkage to overhead requirements. Within this group, two focus group respondents indicated organizational decisions to avoid funding due to insufficient overhead coverage policies: "We've stop accepted money from UNFPA [United Nations Population Fund] because of this issue;" and another respondent commented, "I think we're not going for World Bank anymore."

LNGOs discussed the funding pools available to similar organizations in their countries of operation. Two India-based and one Middle Eastern-based LNGOs discussed the different funding options for locals with the Indian organizations emphasizing the availability of corporate funding for LNGOs in light of recent legislation passed to guarantee two percent of profits be granted as part of Corporate Social Responsibility. A respondent affiliated with a Southern African LNGO elaborated on this concept by discussing the external labeling of her organization as either an advocacy or policy and

research organization by funders and the impact of this perception on available funding. "When you go and you try to solicit,' she elaborated, "the first thing you are told is that you are not really a policy institution or you are not really research institution therefore, you are not really eligible for those funds."

Responses on the topic of funding pools from the Taxpayer Group represented a combination of responses from other groups. One respondent provided recommendations in line with the respondent from an INGO with primarily ODA funding discussing the extensive USAID rules governing funding: "I think it's not without restrictions in how they do their work. So it's a really difficult thing because it's like. You take money from AID and you do it the AID way, more or less." Other respondents in this group described general funding pools and how the funding pools of an organization impact perceptions of overhead. Notably, one respondent from a Southern African LNGO, went beyond the funder distinction and mentioned the project or sector as relevant for the level of overhead to be recovered. Specifically, this respondent specified that during elections in the country of operation, the pool of available funds to NGOs allows for more overhead support.

Funder priorities affect overhead recovery, but not for INGOs with primarily ODA funding. Also within the context of External Conversations, respondents discussed funder priorities as affecting not only available pools of funding, but also overhead recovery rates. Notably, no respondents from INGOs with primarily ODA funding discussed funder priorities as impacting overhead levels and funding availability. Two respondents from other groups made similar comments about trends in official funding and relatedly, the availability of specific funding pools: "So yeah there was a phase

where there were a few countries and everybody was like what can we do, how can we help these poor people?"

Similarly, from a LNGO respondent, "And so, if I'm not a doom and gloom organization [pertaining to a negative outlook on the operating environment], I'm going to really struggle to articulate for resources. So the envelope of resources I will access will be smaller."

Low overhead linked to lack of reliance on official development assistance (ODA) funds. Within the INGO with non ODA funding Group, respondents described the funding streams of their organization and particularly their lack of reliance on ODA funds to qualify follow-up responses about overhead coverage. Two respondents from the same organization commented on this topic, both focusing on the sizeable amount of private donations to qualify the organization's relatively low overhead rate. "Our organization," one stated, "is unique because we have extra private funding available which gives us a little more padding whereas other organizations might be over 90 percent US grant funded." However, this organization still seemed to struggle with funders that provide lower than required overhead rates, echoing the comments of a respondent from the INGO with ODA funding group who stated "(b)ut it [overhead standards for different funders] does make us re-evaluate on a regular basis like especially with the World Food Programme example."

INGOs recommend local organizations start working with USAID as sub-recipients. Within funding pools, a distinct group of responses, mostly from the INGOs with primarily ODA funding, described some recommendations for LNGOs, including

maintaining fixed amount mechanisms, either through sub-awards or direct funding, until reaching a certain threshold and then switching to a cost reimbursable system, involving documentation of all costs incurred. One respondent emphasized that LNGOs should focus on funders with consistent paying habits. Another hypothesized that most first-time grantees would be likely to go after USAID funding directly and discussed the clear, yet extensive, rules maintained by USAID. This respondent concluded that LNGOs that have had experience with these funders before would more likely prefer channeled funds through a prime recipient.

Comparing rates. ***Respondents advise funders only conduct comparisons of different organization's overhead rates carefully.*** Comparing rates arose as another area of interaction between funders and organizations and was discussed by INGOs, particularly respondents from INGOs that received primarily non-ODA type funding. Respondents discussed the circumstances under which funders should be comparing overhead rates and many demonstrated the clear understanding that a simple comparison of rates without knowledge of the base of application against which the percentage is charged (i.e. salaries or all direct costs) is an unreliable measure. The comments made were very similar. Here are several examples:

> From the INGO with ODA type funding Group: "a partner that had a 40percent, almost a 40percent, they had like a 39.5 percent. My CEO was saying we were much more effective. I was like well, no. We can't really say that. They don't charge overhead on loan funds, they don't charge overhead on. We were both in the microfinance industry. They don't charge overhead on equipment. Whereas we charged overhead on everything…So you see my point, and the spread and the way you are calculating can make a huge difference in the percentage even though you guys may be just as efficient and effective."

> From the Taxpayer Group: "That an organization that's reflecting a 10percent overhead, they might have the exact same costs as an organization with 30percent overhead. They are just billing it differently."

And lastly, from the INGO with non-ODA type funding group: "Because if we collect $1 from 100 people with only seven percent, it's much more than you collect $5 from 103 people with 20 percent."

Summary: External Conversations. The data revealed that many NGOs must engage in external conversations or negotiations surrounding overhead. These conversations occur mostly with funders. Funders largely accept organizational overhead requirements with some exceptions, which apply mostly to for-profit contractors with USG funds or NGOs with non-USG funders. USG acceptance of overhead needs was closely linked to discussions of the NICRA or de minimus rates. Organizations which did not express acceptance or rejection of overhead requirements indicated that they received questions about their overhead requirements. Funder priorities and overhead policies shape the funding pools for all groups and overhead recovery for all groups excluding the INGOs with primarily ODA funding. Respondents across groupings cautioned against comparisons of overhead rates across organizations.

Funder Views

The second major theme of responses focuses on Funder Views. Respondents discussed external audiences using overhead as a proxy indicator of efficiency and mistakenly, as a 'short-cut' to determining effectiveness. Respondents also described funder rules surrounding overhead definitions and standard rate options, the NICRA or de minimus rate, for USG-funded programs and offered thoughts on the types of

organizations that should have NICRAs. NGO usage of standard rate options was linked to the respondent's perception of their funder as flexible or strict. Finally, NGO respondents discussed anticipated low taxpayer awareness of overhead issues and the consequences of this lack of understanding, occasionally mentioning charity rating websites specifically and the concept of 'waste'.

Overhead as an indicator. ***Respondents describe that overhead is incorrectly used as a 'shortcut' to determine efficiency and effectiveness.*** A number of respondents of different types discussed overhead as a proxy variable or indicator for something else, principally efficiency, and perceptions surrounding this. A number of respondents indicated misunderstanding surrounding overhead and several described funders using overhead rates as a "shortcut" to evaluate an organization's effectiveness or capacity. Two respondents discussed looking at the trend or change in an organization's overhead over time in cases where judgments need to be made. A minority of respondents actually linked overhead and effectiveness, outside of the shortcut discussions. Overhead as an effectiveness measure was discussed by half the number of respondents as compared with efficiency and 75 percent of those respondents mentioning effectiveness spoke to disprove the correlation or indicate that overhead alone is insufficient as a measure of effectiveness: "there is zero relationship between … what the rates are and the effectiveness of the organization." Finally, the internal organizational value and necessity of overhead was sometimes discussed in connection with the misunderstanding on the part of funders.

General funder expectations or rules. ***INGOs, not LNGOs, principally discuss standard rate options.*** Funder rules surrounding overhead were linked to overhead

definitions, particularly differences between funders, as seen by way of these comments from a respondent in INGO with primarily ODA funding Group:

> "AID is pretty generous with what they allow NGOs to account as overhead… Then you start working with other funders. The Norwegians, for example, it's pretty minimal. Gates Foundation, it's pretty minimal. There's a lot of funders out there that don't allow for a lot of overhead." And from Group 2c: "The UN agencies, or the international, or any other funders. So sometimes they allow to put some of the overhead costs and others, no."

Beyond comments on funder definitions of the types of expenses included in overhead, a number of respondents discussed the option for standard overhead rates, including the NICRA and de minimus rates. Respondents that discussed standard rates primarily included INGOs. Among INGOs with primarily ODA funding, respondents described standard percentages applied by funders, particularly DFATD (Canadian government), Gates Foundation, and private corporations. One respondent described using standard rates as a "shortcut to real, good due diligence." More specifically, he elaborated that

> "(b)y saying you have to have to adhere to this really low overhead rate. They don't have to pay attention and do the work of looking at what's involved in your overhead and how does this affect your program and all of that."

Twenty five percent of all groups compared funders' policies on the application of standard overhead rates. Specific funders named included USAID, the EU, an unspecified international funder, and corporations.

Comments on the de minimus 10 percent rate, made exclusively by respondents from the INGO with primarily ODA funding Group, were highly varied. One respondent, whose organization does not have a NICRA, said that it makes use of the de minimus and described its insufficiency and the time required for budgeting. Two respondents also

described the de minimus option for LNGOs, echoing its insufficiency and negative impact.

> "I do feel like locals are penalized with that 10 percent cap. I think the government saw Gates doing it and they were like, oh Gates is doing it, let's do it… I do understand that the government is trying to limit this and they are trying to say, listen we know accounting is hard and it can be even harder when you don't have the tools and resources you need to do it appropriately for our needs so we will just let you charge 10 percent for whatever, we don't care what those costs are. But it has the unintended consequence of making 10 percent sound like a norm instead of the maximum they will allow you to charge when you can't meet the minimum accounting standards. It kind of sets this false norm out there."

> "That number didn't come out of nowhere. The community of the implementing partner was reporting to the funders that everybody wants 10 percent. It seemed to be like a European thing. I don't know. So when USAID said fine, we are going to change the rules, we are going to make it 10 percent. It was interesting to me. It seemed consistent."

No local organizations discussed the de minimus 10 percent rate for organizations which do not have NICRAs, either indicating that they do not have awareness of this new option or are not using it.

Differing views on whether LNGOs should not have NICRAs. Respondents from all groups commented on NICRAs including a majority of respondents from INGOs with non-ODA type funding group. Beyond comments defining a NICRA and its usage, and mentioning that their organization has one, comments focused on what types of organizations should have NICRAs, namely the prime recipient of funds, often INGOs and second tier sub-recipient of funds, often LNGOs (although this is changing with USAID Forward). Respondents described organizational interest in obtaining a NICRA from a LNGO respondent or the strategic choice of the organization to not obtain a NICRA. The NICRA was of particular importance to two respondents, one taxpayer who

had seen her for-profit organization through the process of obtaining a NICRA, and one from the INGO with primarily ODA funding Group.

Two respondents presented opposing views on the appropriateness of local organizations to have NICRA rates:

> From the INGO with primarily ODA funding respondent: "For a local organization to really get a NICRA, AID really has to agree that they need one. It's not that they can just go in. It's a slightly different variation to a theme. It's painful. It's sort of like if you've never done a merger. You have to go into USAID and ask for sign off on that merger. The process is so painful. Half of them don't know what they need to do... Some missions don't really understand how to do it. There are a whole bunch of international organizations. That don't really do NICRAs."
>
> From the LNGO respondent: "You're giving someone free funds for just existing and yet they don't do the work, someone else is doing that work. And yet you can't give free funds to… For example, we have a Swedish grant. We have free funds. It's not much, it's free funds 20 percent. What that does, it's our lifeline… What it does is that it helps us to be able to take care of ourselves. They don't care what we use it for, it's our money, we do whatever we need to do with it. As long as it's administrative, that's it. This week I can use it to pay the bills. Next week if I have a crisis, I can. It allows us to be innovative in how we manage ourselves. It helps us to be more sustainable, then I can come up with clever ways of keeping the doors open, respecting the grants I have but at the same time, being able to take care of the needs we have as an organization."

No other local organizations mentioned the NICRA in their responses, perhaps indicating a lack of awareness of the NICRA.

NGOs using NICRAs or de minimus rates view funders as flexible. A number of respondents described either rigidity or flexibility on the part of their funders in regards to budgeting. Given the apparent contradiction between these concepts, the concepts of bureaucracy, rigidity and flexibility will be analyzed together. Respondents described rigidity in terms of ODA-type funders' unyielding institutional policies surrounding overhead and procurement, overhead definitions and administrative procedures. One

taxpayer respondent commented, "AID is so strict on how money needs to be spent, how overhead is. Everything is pre-defined." Similarly, about other ODA-type funders, a respondent from a local organization stated, "Because institutional funders [defined as: USAID, DFID, ECHO, EU] have their own organizational structure, their policies. Which they really don't divert with that. Their flexibility is limited."

Conversely, another group of respondents, mostly from the INGO with primarily ODA funding, described flexibility of USG funders with one respondent indicating this quality for corporate funders. Comments focused on the flexibility of what can be included in overhead costs, the "versatility" of the USG approach, and "flexibility" and support of one particular USG agency in the Department of State.

To analyze the significance of the NICRA and de minimus rates and the perception of funder rigidity or flexibility in the acceptance of overhead requirements, these codes were cross-referenced. No respondents that discussed the de minimus rate described their funders as strict while 50 percent of respondents describing flexibility also mentioned a NICRA and funder acceptance of their overhead needs. Only one respondent described funders as strict and mentioned a NICRA. Notably, this was a local organization that did not have a NICRA.

Perceived low taxpayer understanding of overhead issues. Respondents described low levels of taxpayer understanding of overhead, the foreign aid budget and international development generally. Several respondents linked this awareness to charity rating sites, either Charity Navigator (25 percent of respondents discussing this topic) or GuideStar (12.5 percent of respondents), and to the impact of public scandals. Regarding

the latter, respondents from the INGO with primarily ODA funding Group offered the following comments:

> "You hear those studies where they ask people how much money they think goes to the foreign aid budget. They think it's like 25percent of the budget. And when you work in health it's like a quarter of a percent of the national budget. The public perception that we are giving away all this money, people are profiting of it… I think that that misperception about the international development world and the government"
>
> "I think that comes a lot more from relief work type of activities, like tsunami and everything like that. Where is our money going?"

One respondent described Charity Navigator and Guidestar in connection to false perceptions communicated to taxpayers or potential individual funders surrounding overhead. Another respondent cited these websites as incentives to keep their organizational overhead low to continue attracting donations.

Two respondents also discussed the concept of waste referred to by one respondent as insufficient overhead coverage for programming resulting in a waste of taxpayer funds, and by the other as the outgrowth of a complex capacity building project that experienced several significant delays.

Summary: Funder Views: Respondents indicated an accurate understanding of how to use overhead rates as a proxy indicator for organizational efficiency, by evaluating trends over time. Respondents described instances where their funders have used overhead as a short-cut for evaluating organizational capacity. INGOs principally discussed standard rate options. On the funders' qualities, international NGOs mostly described the funders as flexible while the taxpayer group and LNGOs indicated rigidity. Additionally, no NGOs that had a NICRA described funders as rigid. NGOs that used these options were more likely to describe their funder as flexible. Notably, respondents

disagreed on whether or not local organizations should be eligible to apply for and receive NICRAs. Respondents discussed taxpayer misperceptions as well as misunderstanding of overhead on the part of the funder as contributing to the treatment of overhead in the sector.

Organizational Response

The third major theme discussed by respondents was the Organizational Response to real or perceived funder policies on overhead. In this group, respondents described the burden of budgeting for overhead, managing differing expectations, and the connection between overhead and cost of business or profits. To respond to these challenges, respondents explain accounting strategies to cope with insufficient overhead. Notably, respondents that described an organizational focus on impact also reported a strong concern with keeping overhead low. Responses within this code indicate a distinction between the prime and sub-recipients of funds in their responses to overhead constraints, perhaps due to anticipated differing overhead financial capacity, differing field and headquarters costs and salary norms for international compared with local staff.

Budgeting. ***The burden of budgeting for overhead and creative accounting to cope.*** More than half of the INGO with primarily ODA funding Group discussed general budgeting challenges, specifically the burden and complexity of budgeting for overhead. Respondents largely described burdens in terms of reconciling varying and sometimes conflicting views among different funders regarding overhead cost direct billing practices. In contrast to managing multiple overhead rates, having one standard rate, such as a NICRA, was described as reducing this burden. As one respondent suggested, "Its

one standard applied to all of our grants. Is that it's fair, and that it reduces the burden on us to break down minutiae in every single budget." Notably, of the seven respondents mentioning NICRA rates, only one also described burdens and challenges of budgeting. A higher proportion of respondents from the de minimus category described burdens and challenges.

To cope with these challenges, several respondents across categories made remarkably similar comments about "creative accounting" strategies to ensure full overhead coverage and for some, maintain a competitive edge with similar organizations while being compliant with funder rules. One respondent described the disadvantage posed to LNGOs by use of these strategies among INGOs:

> "Unless you want to tell everyone those accounting. I don't want to call them tricks because they are all legal. Maneuvers. Then you're… either intentionally or unintentionally disadvantaging local organizations. So I have a fundamental problem with organizations looking at that."

Notably, no respondents mentioned both creative accounting and burdens, indicating that the creative accounting strategies may alleviate budgeting burdens. Two respondents also mentioned both the NICRA and the de minimus rate in addition to the creative accounting concept. One respondent from the INGO with non-ODA type funding Group compared overhead rates of his organization with other similar organizations that are doing "clever accounting." In a separate discussion, this respondent indicated that his organization does not have and would not like a NICRA, in an effort to avoid dependence on USG funds. In this case, the clever accounting may be used to compensate for the NICRA.

Managing different sets of expectations on overhead particularly affects LNGOs not using a NICRA or de minimus rate. Respondents described how their NGOs respond to dominant views on overhead in the sector in terms of the burden and difficulty in managing different sets of expectations, particularly in cases where a NICRA or standard rate, excluding the de minimus rate, is not used. Respondents discussed both direct and indirect costs from a budgeting perspective and programmatic and overhead costs with a greater focus on the ultimate impact of funds. Respondents described overhead as part of the cost of running a business and some suggested that funders may project norms from their sector (i.e. government or corporate) onto grantees. Finally, the breakdown between INGOs and LNGOs was critical, with prime, INGOs supporting their pass-through role and some sub-recipient, LNGOs questioning the prime – sub-recipient structure. Prime recipients also described capacity and risk of sub-recipients. Respondents described locals receiving less overhead as well as the different cost of living and salary requirements for headquarters compared with the field office location in a developing country.

Handling multiple funding sources with different overhead requirements was discussed by 50 percent of LNGOs and taxpayers and less among INGOs. However, two of the three respondents in this category discussed this issue at length, even describing their approach as using one overhead recovery rate to "subsidize" others, in one case using private donations from individuals to cover the gap created by corporate funding:

> "Or what functionally happens to an organization that fundraises from individual funders, which not all INGOs do… is that we fundraised unrestricted money that is subsidizing it. Which feels uncomfortable when it's the Vodaphone company that is not covering our full rate they don't get why they should and then I'm asking like our major gifts officer to complement it with this budget."

Notably, both respondents discussing "subsidizing" were in the focus group discussion.

Impact and low-overhead focus linked. Within discussions of overhead versus programmatic costs, a number of respondents discussed the impact of funds and a desire to ensure funds ultimately reach the beneficiary rather than be consumed internally for overhead purposes. The presence of ODA-type funding among INGOs divided those that expressed a strong concern with keeping overhead low, principally those without primarily non-ODA type funding. One hundred percent of respondents that described concerns over impact also discussed the need to keep overhead low.

U.S.-based and LNGOs describe overhead linkage to cost of business and profits. Cost of business mentions were common among all groups except LNGOs, and interestingly, mention of profits was seen among INGOs and LGNOs, not only among the for-profit contractor respondents of the Taxpayer Group. Seventy five percent of respondents describing cost of business underscored the same basic point, summarized by one participant as follows: "We are in the market and we are selling services and even sometimes goods. Overhead is a necessary indirect cost for the sustaining of those services." Fifty percent of respondents described factors tied to the cost of business, including adherence to different labor laws, registration, and import and export costs. Comments related to profits were more varied although more than half of respondents indicated that funders of specific sectors communicate overhead expectations from their sector-specific point of view:

> From the INGO primarily ODA funding Group: "I also wonder if the officials at World Bank and officials at… at phone companies or foundations. Are they privy

> to that [public misperceptions that non-profits are somehow profiting] or are they just thinking about their bottom line and the way they do business and think we should be doing business like that?"
>
> "[About non-USG allowances for overhead being too low] there is this for-profit standard they can apply to us that doesn't apply."
>
> From the LNGO group: "Because. First of all, it's the nature of our organization, as an institutional organization, what I have called like the USAID and the DFID, they have the mandate to do these kind of development activities. But for corporates, it's kind of their liability that they have to do…They don't have like a clear mandate for what they want to do. It's in their nature. They want to optimize their resources, to make a profit… So all kinds of overhead, they want to negotiate on the percentage. Why so high?"

International versus LNGOs. ***Prime and sub-recipients' responses to overhead constraints differ.*** Finally, discussions of how prime recipients, usually INGOs, and sub-recipients, usually LNGOs, respond to overhead constraints were commonplace. Slightly more than 50 percent of INGOs and 100 percent of LNGOs discussed overhead costs of prime and sub recipients. Respondents in this group described general overhead divisions between prime and sub recipients and the nature of the relationship in these types of programs with respondents from INGOs speaking more favorably about the role of primes and respondents from the taxpayer and LNGO groups describing specific challenges.

> From INGO with primarily ODA funding Group: "I think it [using international NGOs as intermediaries to channel funds to locals] reduces a lot of administrative and bureaucratic burden on USAID."
>
> "For those of them [local organizations] that have dealt with funders before, especially ones that have gone through a funder-initiated audit to figure out if there has been misappropriation. I think they would much rather have an organization they partner with, that can worry about all those issues and all they need to worry about is doing the technical implementation the right way."
>
> From Taxpayer Group: "But I think you also have to have an understanding prime. So that the example… the prime is like screw you, lower your rates. Not understanding that they are not made up out of thin air. They're our rates."

> From LNGO Group: "I think that the perception we have is that funding partners find it more acceptable to hand over money to them [international organizations functioning as primes]. They are becoming like the UNs of funding, you know, good faith brokers between local organizations and you know, the primary givers of funds. But what that does is that. Because at the end, they want to show the money delivers, I don't know if they can actually articulate the context of partners. They become like bank managers. They are interested in… Not that we don't think there is a need to respect the source of the funds and therefore treat it with the appropriate respect. But it becomes more of an accounting relationship."

A number of respondents across Groups discussed overhead for sub-recipients and organizational strategies for managing this. Five out of six respondents spoke from the perspective as the prime organization and described their approach for managing overhead for sub-recipients. Only one organization indicated that they did not provide overhead for sub-recipients. This respondent indicated that this practice stemmed from personal experience with NGOs in this country which he believed had sufficient time to generate overhead coverage in early grants: "They have enough to work with. I feel like they've had enough opportunities to get overhead costs from previous projects... Because I know exactly what they are going to do. I pay them only for services." Another respondent, which spoke from the perspective of the sub-recipient described a similar practice by paying local organizations a flat consulting fee, which may have had some overhead costs lumped in, to avoid having two tiers of sub-awarding, which becomes complex under USG regulations. All other respondents described using a standard rate, including: the NICRA if the sub-recipient had one; another rate negotiated with another funder if under 10 percent; or more recently, the 10 percent de minimus rate. One respondent explained regular communication with sub-recipients explaining the standard rate or direct billing options to partners:

> "I had like a template email that responded to somebody saying we need to have, like a 10 percent... We had a standard response to this. No, no. We will pay these costs. We just can't have them rolled up into a number. You have to just write down whatever it is. 2 hours of an accountant. Which you always thought was absurd. But that was the way we, uh, operated."

More specifically, on LNGOs receiving less overhead, responses were more varied across groups with representation. One respondent indicated this overhead breakdown, and more generally patterns of funding, can be viewed as a North – South division. INGOs with primarily ODA funding respondents that mentioned LNGOs receiving less overhead justified the lower overhead allowances for locals due to lower cost of living justifying lower salaries, or the advanced stage of civil society in the country, among other reasons. Only one of five respondents discussing this issue highlighted the differing attitudes between LGNO and INGO allowances without attempting to justify it and notably this respondent was not an employee at an INGO but rather at a for-profit company with USAID contracts and cooperative agreements. She commented: "I think there has been, for domestic NGOs based in the US, a forgiving, well, it's really expensive to operate in DC. Then we turn and say to a LNGO in Zambia, 12 percent that's terrible. [Laughter]."

INGOs with primarily ODA funding and LNGOs linked organizational financial capacity and overhead management. Respondents spoke extensively about organizational capacity and overhead. One hundred percent of the INGOs with primarily ODA funding Group discussed issues of capacity and specifically financial capacity of organizations and budget know-how. This was also a major topic of discussion among LNGOs (75 percent). Risk and monitoring of partners was discussed by slightly less than one-third of INGOs primarily ODA funding respondents, who would more likely be

prime recipients of funding. One hundred percent of respondents that mentioned risk also mentioned capacity.

LNGOs poorly represented in detailed accounting discussions. Another major point of discussion included two related by separate codes: direct versus indirect costs and overhead versus programmatic costs, with only two out of fifteen respondents overlapping between the categories. Respondents describing this first concept did so within the context of organizational break down of direct costs attributable to a program and indirect costs that run across programs. One respondent described the transition between managing overhead with funders with a lower overhead cap, requiring direct billing of other costs, and the NICRA." Similarly, another respondent described dealing with the lower overhead caps of non-USG funders: "So I am currently involved in an agreement we have with an international funder. Where they cap the overhead at a certain percent. Then we just direct bill what we would normally charge as indirect, as direct."

In overhead versus programmatic costs, respondents, principally the INGO with non-ODA type funding group, discussed one of two approaches. The first described organizational priorities to ensure maximum funding goes to programmatic costs with one respondent from a U.S.-based contractor with USG funding stating:

> "I could do two activities for $10,000 in the amount that the fee is… We were just going over budgets this morning. And it's difficult because like I look at that as like an activity. I could do more work if our fees were at a different percentage."

The second category of responses was more focused on USG or non-USG funder priorities to keep overhead low:

> "That your funding is going, vast majority of funding is going directly to programs. I think a lot of organizations that are looking especially for small,

> individual funders, will do it by saying this percentage will go to this, this percentage goes to this."

One respondent fell outside of these two main groups describing the difficulty of breaking costs into administrative versus programmatic costs in certain sectors, for example work with women victims of violence:

> "Therefore, I need to be able to have fuel because I need to be able to go in the middle of the night and pick her up, and talk to her. I need to be able to call her and say, have you arrived at the hospital? I'll be there in ten minutes. But that is considered to be an administrative cost."

Overhead in the field compared with headquarters. Similarly, respondents mentioned overhead cost requirements for the field as compared with Washington, D.C. or a headquarters location. Respondents specifically mentioned cost of living and field office expenses. LNGOs were poorly represented in these discussions, although they did provide comments related to international compared with local staff salaries, described below. Speaking more generally about the field compared with D.C., two respondents described costs in the field beyond cost of living, including promotional and fundraising materials being cheaper to produce in the field, and another respondent described budgeting appropriately to match the "local regulation, the culture, and the business environment in the hosting country." Another respondent described a category in addition to overhead costs in the field, for example travel and per diem costs, that ultimately do not reach beneficiaries and the common attitude towards overhead and this second category of costs: "All those things aren't technically overhead if they are done in the field but they are not going to the beneficiaries [pause] directly [emphasis] either… they are necessary but they are not directly going to the beneficiaries either." Cost of living comments largely agreed that U.S. or E.U. based organizations or local organizations

based in urban environments will have higher overhead costs to cover rent and salaries for employees. Field office expenses were a distinct category, particularly for INGO respondents with primarily non-ODA funding, with respondents commenting that overhead was used to cover costs for the field office or funders were paying more attention to field office overhead costs.

Lower salaries for local, compared with international staff. Salaries for international compared with local staff were another major area of discussion. Differences between international and local staff were discussed by LNGOs and the Taxpayer Group with particular emphasis for one respondent within the latter that is an international staff member working at a LNGO which does not receive USG funding. General salary issues are covered in the fourth major theme, Impact, and will be cross-referenced in that section. All respondents described the lower salary levels for local compared with international staff, meaning staff at INGOs, the U.N. or non-local staff at local organizations. One respondent indicated, "If someone is paid $1,000 a month at a LNGO and $2,000 at an international NGO, $3,000 at the U.N.. So the same post with three different types of salaries." The international staff member working at the LNGO indicated that her salary, while higher than local co-workers, is still lower than an international-level salary and linked this issue to staff retention: "I'm still not on an international salary, the salary of a worker at an international NGO. I'm on a local salary. That also affects people's ability to stay with organizations for very long." One respondent also noted that as a woman head of a local women's organization, she would be paid less than the male head of a mainstream civil society organization.

Summary: Organizational Response: NGOs respond to budgetary challenges and management of differing expectations through "creative accounting" mechanisms, although responses vary based on status as an INGO or LNGO, favoring INGOs. Challenges are more common among LNGOs not using a standard rate option and respondents anticipated that LNGOs have lower costs in the field, compared with headquarters locations, and pay their staff less. INGOs and LNGOs also differ on their views of the funder-prime recipient-sub-recipient relationship with INGOs speaking positively about the role of the prime as shielding the sub-recipient from compliance-heavy funder requirements and LNGOs questioning the added value of the prime recipient.

Impact of Organizational Responses

Finally, the last major theme discussed includes the Impact of Organizational Responses to real or perceived funder views on overhead, focusing particularly on the impact of overhead on organizational structure, insufficient overhead, which was described most frequently for LNGOs, and the constraints insufficient overhead presents to salaries for staff members and program quality.

Structure. ***Overhead constraints affect organizational structure of U.S.-based and LNGOs, independent of the principal funding source*****.** The impact of funder overhead views on organizational structure was discussed by respondents across Groups with almost equal representation. Comments focused on limiting headquarters staff, in the case of the two respondents with E.U. or U.S.-based headquarters, or for the two LNGO respondents, creating flexible structures, allowing staff to move fluidly between

tasks or responsibilities, to avoid hiring additional staff. Few respondents, principally LNGOs, linked insufficient overhead coverage to weakened organizational infrastructure and sustainability. Notably, one respondent linked low overhead to greater sustainability in funder relations.

> From INGO respondent with non-ODA type funding: "Also when you think about staff time, you're only able to hire a certain amount of staff and they are almost overworked in some ways… You're on a tight budget and you wish you could provide more support to help them."
>
> From an INGO with primarily ODA funding speaking about an LNGO: "Most recently, just an example, an organization here, they released like 15 or 30 of their staff due to the lack of funds. So apparently they hire people based on how much they get. And when their project is over or the fund is over, they let their people, let them go. That's a signal that they don't really structure or build their other income than grants."

From a INGO respondent: "So it's [overhead] uh, it's definitely critical in terms of, primarily in terms for us in terms of infrastructure and um, standardization."

Organizational values linked to structure. Organizational values were tied to structure for some respondents (one per group). Two of the three respondents, who also described the importance of impact, outlined similar organizational processes:

> "The idea was to grow the community within. It wasn't to hire somebody from the United States or a different country that would be more expensive and an added overhead cost. Instead invest in people that were already living in the communities to be able to build those capacities as well."
>
> "At the end of the day, I think it's all a question of values. How many senior management do we need? How many VPs do we need? How much do we need to pay everybody [emphasis]? Do we need to promote everybody up? What are the benefits?"

Inconsistent connections made between organizational age or size, structure and overhead needs. Mostly respondents from INGOs primarily ODA funding described organizational size or age as related to structure, although very inconsistently, and

shaping organizational choices with lesser representation in other groups. Respondents disagreed on the characteristics of an organization that would determine higher or lower overhead. Of the six respondents, there were several sets of contradictory statements. Two respondents stated that smaller organizations would require more overhead for set-up and establishment costs with another respondent stating the opposite that a small NGO will need less overhead. Both respondents were from LNGOs. Two others indicated that mature organizations should need less overhead with the caveats from one respondent that this may not hold true if they are computing their costs in a unique way or have had a sudden loss in programmatic revenue. Two others indicated the opposite that as organizations grow in budget and age, they will likely require more overhead.

Insufficient Overhead. ***Gaps in overhead most common among LNGOs.*** The local organizations were most represented among those indicating a gap in overhead with 75 percent of respondents from the LNGO group. Of the organizations discussing a gap, two respondents out of six also mentioned the NICRA rate, yet neither of these respondents had an organizational NICRA rate. One organization described no gap and used the de minimus rate. Seventy five percent of INGOs with primarily non ODA-type funding described their organizations providing a contribution to cover overhead, with one respondent overlapping with the "gap" code. Notably, all respondents providing overhead contributions were religiously established Christian or Catholic NGOs.

Mostly LNGO respondents described a gap in their overhead coverage and INGO with primarily non-ODA type funding respondents frequently reported providing an organizational contribution to cover overhead. All groups described handling multiple sources of funding with various overhead rules although it was not correlated with either

a gap in funds or being a burden. Several respondents did, however, link insufficient overhead coverage to long-term organizational sustainability. Respondents varied greatly on organizational characteristics and the link to requiring more or less overhead.

Salaries. ***Salary constraints and overhead coverage.*** A number of respondents described salaries as tied to overhead coverage. Mission-driven salaries, usually in the context of keeping remuneration lower than comparable positions in other sectors, were discussed by a cross-section of organizations. However, two organizations described their mission as motivating their organizations to provide higher salaries for local staff. These two respondents were speaking from the perspective of religiously founded organizations both working in Central America. From an LNGO that does receive USG funding and therefore was placed in Group 3: "And the fact that we can be an LNGO here in this small community provides those opportunities for work, not just for salaries and for income, it's better than you would otherwise get." And from another group speaking about local office employment:

> "Always comparing our salaries to our teachers to like a public school teacher salary. Because that was something that we were trying to do as well with our organization. Is that we were trying to say that if our organization wasn't there, there wouldn't be those jobs. In most of the communities we worked, we were the number one employer."

Staff retention issues tied to relatively low salary was discussed by former or current NGO employees within the Taxpayer Group, who did not fit the inclusion criteria as previously described, followed by INGOs of both types.

Overhead and program quality. ***Insufficient overhead linked to lower programmatic quality.*** Finally, program quality was linked to low coverage for some

respondents, mostly from INGOs with primarily ODA funding, with four out of five respondents agreeing that insufficient overhead negatively impacts programmatic quality.

> "But sometimes there is a significant difference between in an international organization that may charge that 40 percent rate and an international organization that may charge a 20 percent rate. Both in terms of the quality of their deliverables and also in terms of their compliance with your norms both legal as well as technical norms, right?"

And similarly, "We wish we could put more staff time, technical expertise, technical support, more services towards the grant to make it even more, even better."

Summary of Impact of Organizational Responses. Overhead constraints affect the organizational structure of both INGO and LNGOs, although respondents demonstrated inconsistent understanding of the nature of how overhead, structure and organizational characteristics, such as size and age, fit together. Gaps in overhead were reported to primarily affect LNGOs, with resulting downwards pressure for salaries and programmatic quality.

Chapter 5: Discussion

The results of this study largely confirm Hypothesis One, namely that INGOs have adapted to the constraints of their environment. They adapt by obtaining NICRAs, by making strategic choices about available funding pools and by conforming with funders priorities. INGOs have also developed specific mechanisms for ensuring overhead coverage under funding regulations, including the described "creative accounting" measures. They conform to industry standards for salaries. The acceptance of overhead rates seems to color the perspective of the NGOs on the rigidity or flexibility of the donor. In cases where funders accept the overhead requirements of NGOs, largely through the issuance and use of a NICRA, NGOs view their funders as flexible and accomodating. The reverse holds true for organizations that did not mention a NICRA. In agreement with the anticipated disadvantage of LNGOs in terms of financial capacity, LNGOs did not describe mechanisms for adapting to the constraints of their environment, as demonstrated by low representation in the creative strategies discussions as well as those focusing on NICRAs, de minimus rates or other standard rates provided by funders. LNGO and INGO respondents, however, did both describe similar salary constraints.

Hypothesis Two, that international NGOs, and increasingly LNGOs, are or will be suffering from insufficient overhead coverage on account of these policy reforms, was disproved. INGO respondents did not seem to suffer from a lack of sufficient overhead coverage for their organizations or challenges to long-term sustainability. Results did confirm the concept of the non-profit starvation cycle more broadly, particularly LNGOs. Mostly INGOs described the acceptance of their organizational overhead rates, while LNGOs more frequently described a gap in coverage. Respondents described how their

organizations respond to dominant views on overhead in the sector in terms of the burden and difficulty in managing different sets of expectations, particularly in cases where a NICRA or standard rate, excluding the de minimus, is not used. This is largely the case for LNGO respondents who did not describe standard rates or donor acceptance of overhead needs as frequently as INGOs. LNGOs described insufficient overhead coverage, which was occassionally linked to sustainability and lower programmatic quality. From the design of this study, which broke down organizations by INGO and LNGO, rather than size, it is not absolutely clear if larger organizations have relatively more coverage. However, the results demonstrate that INGOs have greater coverage and given that INGOs and larger NGOs are often one in the same, Bornstein's (2003) results are tentatively confirmed. In this study, INGOs reported higher acceptance of their overhead requirements at least in part due to the presence of NICRAs and negotiating power, demonstrated by the link between NICRA and funder acceptance discussions.

The results neither fully confirm nor disconfirm Hypothesis Three, that LNGOs maintain simplistic accounting systems, thereby removing the requirement for overhead recovery beyond the de minimus rate. Some INGO respondents did attempt to justify lower overhead requirements for LNGOs citing lower cost of living and salary requirements for the field, compared with a developed country. INGOs also described lower financial capacity of LNGOs, indicating that some INGO respondents may agree with Hypothesis Three. Further, few LNGO respondents indicated any knowledge of the de minimus rate option for USG funding or standard rates from other funders and they were more strongly represented in discussions of a gap or insufficiency in overhead coverage. These results indicate that current practices are leaving LNGOs with a gap in

their overhead particularly when they are not aware of or not using standard rates, including the de minimus. Only INGO respondents discussed knowledge of the 10 percent overhead rates, with most agreeing that this rate is not enough.

The linkage between lack of LNGO knowledge of standard rates, simplistic accounting systems and lower overhead needs remains unanswered. A proxy code for the complexity of the accounting system may be the discussion of indirect versus direct costs and overhead versus programmatic costs, a preliminary understanding of which are required for USG grant fund management. LNGO were poorly represented in the direct versus indirect discussions although they did describe overhead versus programmatic costs, indicating an understanding of these two funding pools, albeit not in the terminology used by USG funders. LNGOs may have lower financial capacity and knowledge of available options for overhead recovery but this does not allow for the conclusion that their overhead needs will be met by the ten percent de minimus rate.

In addition to the three hypotheses, research and survey results confirm different funder expectations for LNGOs and INGOs, particularly as related to the dynamics of the prime and sub-recipient relationship. International organization respondents, likely functioning as prime recipients of funds, viewed the prime – sub relationship often in terms of risk and financial capacity of the sub-recipients. On the desirability of the funder – prime and recipient – sub-recipient relationships, respondents whose perspective was that of a sub-recipient question the necessity of the relationship and anticipated common challenges.

Respondents also attempted to trace the perceived funder aversion or at least, distaste, for overhead to poor taxpayer awareness, scandals in the NGO or domestic non-

profit communities and charity rating websites. These findings are consistent with the tentative linkage defined in the literature review between declining public trust and greater accountability demands and is deserving of further research.

Respondents across categories describing how they were diversifying funding pools and managing multiple funders, consistent with the findings of Van der Heijden (1987), Edwards and Hulme (1996) and Wood (1996). Notably, managing multiple sources of funding was not linked to a gap in overhead coverage or viewed as an organizational burden.

Future areas of research should focus on the causes of insufficient overhead costs reported by LNGOs. Namely, is it linked to overly simplistic and inefficient accounting systems that cannot fulfill demands placed on LNGOs by more compliance-heavy USG funding? With efficient accounting and other overhead processes, would the 10 percent de minimus rate suffice or would a higher amount be required?

Another key area of future research includes the organizational legitimacy threats to LNGOs posed by USG funding. Although a clear emphasis in the literature, this issue of how organizations must change their focus from the communities they serve to USG funders was not discussed by respondents in this study.

In response to the fundamental research question - 'How should the U.S Government support local organizations directly, as outlined in USAID Forward, while ensuring their sustainability?' - it is recommended that USAID and other USG funders take the following, sequential steps in order to more effectively support local organizations directly:

1. Encourage prime recipients to continue working with sub-recipients that do not have NICRAs and do not make use of the available de minimus rate option as well as either direct or indirect costs as a part of their capacity-building efforts. Some of this work is currently underway, for example the Capable Partners Program Guide published by FHI360 and Management Systems International (Singer, Cowan, Mahler, and Bonner, 2010). This study underscores the value of this work and the necessity for it to continue.

2. Engage in discussions with LNGOs directly about how overhead coverage is linked to long-term organizational sustainability.

3. Address the comparative advantage of organizations using "creative" accounting techniques by either:

    a. Encouraging open accounting forums and exchanges between INGOs and LNGOs and openly publish a best practices guide for indirect cost rate recovery, updated per the current regulations. This will likely be the more popular supported approach; or

    b. Eliminating the use of such techniques to ensure all organizations are billing with the same restrictions. Namely, if INGOs maintain NICRAs, remove any option for direct billing of overhead costs. This will likely be the less popular approach.

4. Upon further research and confirmation of the appropriate rate for LNGOs, USAID may need to re-evaluate the sufficiency of the 10 percent de minimus rate or establish an alternative, such as an abbreviated NICRA process for LNGOs, which would be the likely preference of these organizations, based upon research

findings. USAID should consider revising this rate especially in cases where the USG is directly granting to LNGOs as the prime recipient, rather than sub-recipient, of funds.

5. Conduct internal USAID trainings on overhead policy and best practices to ensure that staff are not comparing organizations or using overhead as an evaluation factor while looking at budgets, which is expressly prohibited by current USG regulations but was described as commonly practiced by survey respondents.

Without implementing these recommended steps, the current regulations run the risk of damaging relationships with LNGOs who exist as essential partners for desired USG aid reform effectiveness. These LNGOs are likely to come to view USG funding as rigid and bureaucratic, hence undermining USAID Forward's commitment to local ownership by these partners and subsequently greater development outcomes.

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