September 24, 2018

Office of the Controller
City Hall, Room 316
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102
Attention: Ben Rosenfield, Controller

Dear Mr. Rosenfield,

The San Francisco Human Services Network (HSN) is a coalition of 80 community-based organizations advocating for cost-effective, sustainable policymaking in the human services sector. Our work involves monitoring how City policies affect day-to-day operations, discerning sector-wide trends, and communicating impact to strengthen programming and the administration that supports it.

In this letter, we set forth major contracting trends and their impacts on nonprofit providers of essential human services. The HSN appreciates the work your office has done to date to streamline citywide indirect cost guidance, and we urge you to consider the important relationship between the trends and impacts enumerated herein and the considerable indirect costs imposed on nonprofit contractors, over and above prevailing indirect rates. The operational and cash management impacts described below cut to the heart of financial health across the human services sector, affecting the strength of nonprofit systems, the job satisfaction and wellbeing of both entry- and executive-level administrative staff, and the long-term viability of San Francisco’s social safety net.

To effectively streamline operations across City departments, your office must not stop at issuing guidelines. It must work proactively across departments to simplify policies and procedures, eliminate unnecessary layers of administration, and most importantly, remove the unfettered discretion of individual departments to adopt policies and procedures that have severe unintended impacts on nonprofit finances with no corresponding benefits.

In the proliferation of policies, procedures, and systems, the City is losing sight of the prize: healthy and robust human services programs that reduce healthcare costs while improving lives and producing better life outcomes in our neighborhoods and communities. As a sector, we must be rigorous in ensuring that administration supports rather than undermines essential programming.
Departmental Trends and Impacts

The following paragraphs set forth the major contracting trends and their impacts on nonprofit operations over the past two fiscal years. Importantly, the list is non-exhaustive: it represents a current snapshot of the issues posing the highest barriers to efficient contract administration, which impose substantial negative externalities on nonprofit contractors.

Cross-Departmental Trends and Impacts. Several of the trends and impacts enumerated below span more than one department—notably, the protracted lags in the contract approval process, the burdensome level of review and monitoring involved in the invoicing process, and the lack of written policies and procedures to reign in the highly distinctive and discretionary ways individual departments operate. We have described the most salient points below as they relate to each department, to paint a more detailed and granular picture of the impacts of unfettered departmental discretion.

At the same time, there are trends and impacts at the City level that are not readily assignable to specific individual departments. One such trend relates to the actual spending of budgeted awards over the contract year. Specifically, federal guidance allows contractors some flexibility to move funding from one budgeted line-item to another in major personnel and operating categories, as long as the money being moved between line-items does not exceed 10% of the total budget for that category. For example, federal guidance would allow a nonprofit contractor to shift up to 10% of its total personnel budget for an award among the personnel line-items budgeted for the award. By contrast, City departments vary in what shifts do and do not trigger a (sometimes lengthy) budget modification process. In contractors’ experience, City departments generally tailor the federal guidance very narrowly, even in application to contracts funded with local dollars. Specifically, City departments usually allow contractors to move funding from one budgeted line-item to another only if the funding being moved is under 10% of the total for that specific line-item. This significantly reduces contractors’ ability to spend nimbly against their negotiated budgets, and it is inconsistent with federal guidance.

Importantly, federal guidance is uniform, such that nonprofit providers of human services can contract separately with federal departments and have a seamless contracting experience following uniform contracting guidelines. Whether a contractor in San Francisco administers an award from the United States Department of Health and Human Services (“HHS”) or the Department of Housing and Urban Development (“HUD”), the major contract administration rules are the same. By contrast, whether a contractor in San Francisco contracts with the Department of Children, Youth and Their Families (“DCFY”), the Department of Public Health (“DPH”), the San Francisco Housing Authority (“SFHA”), the Human Services Agency (“HSA”), the Department of Homelessness and Supportive Housing (“HSH”), or the Office of Economic and Workforce Development (“OEWD”) makes a substantial difference in how their funding is administered, from the written formal policies that vary among individual City departments to the unwritten informal policies that give insufficient guidance, notice, or predictability in how their awards will be administered. If our federal partners can develop and implement uniform contracting guidance that does not impede cost reimbursement for awards that operate in fifty different states across the country, then the City of San Francisco should be able to adopt and enforce uniform contracting guidance that is binding on all City departments.

Department of Children, Youth and Their Families (“DCFY”). DCFY applies a heightened level of review to monthly invoice submissions that is out of proportion to the type and nature of the charged expenses. When one nonprofit contractor requested to retroactively bill $700 worth of personnel costs that had
been omitted on a prior month's invoice due to a clerical error, the matter took hours of administrative staff time and several emails to resolve.

There are several problems with this heightened level of invoice review. First, hours of administrative staff time create added personnel costs over and above the direct program costs that DCYF committed to fund at the contracted level. Second, private unrestricted funding must be used as a stopgap to cover disputed costs; this imposes opportunity costs on those dollars and diverts them from key agency priorities to fill gaps in publicly funded program budgets. Third, the heightened level of review and the refusal to consider prior months' expenses conflicts with federal OMB uniform guidance, which permits award-to-date billing as a standard practice. Award-to-date billing captures natural fluctuations in service delivery and spending cycles and promotes efficient grant utilization over the life of awards. Fourth, the heightened level of review conflicts with federal guidance that dictates a separation between cost recovery and fiscal monitoring. When fiscal monitoring occurs month-to-month as part of the invoice approval process, it impedes cost recovery, causes operational problems, and makes oversight more costly than cost-effective.

DCYF has also adopted a new personnel policy that stands to delay invoicing by two to three business days each time a staffing change occurs in DCYF-funded programs. The new policy requires nonprofit contractors to request that their electronic workplans be unlocked in DCYF's contract management system ("CMS") so that contractors can list the specific staff changes that will require approval from their DCYF program managers. This effectively creates a pattern of mini contract reapprovals throughout the contract year, imposing a burden on nonprofit contractors without a corresponding benefit to DCYF.

It is worth noting that DCYF implemented this new policy after eliminating a CMS functionality that had allowed contractors to make the same changes in a way that did not trigger workplan reapprovals. In this way, the invoice approval process has become more cumbersome and less efficient over time. The citywide rate of nonprofit staff turnover makes it a virtual certainty that staffing changes in DCYF-funded programs will create delays in the invoicing process as a result of the new personnel policy. This adds an avoidable and unnecessary administrative burden to the inherent burden of nonprofit staff turnover in a city where staff salaries cannot match the exorbitant cost of living.

Department of Public Health ("DPH"). DPH creates contracting delays and administrative inefficiencies at a level that imposes significant difficulties on nonprofit contractors’ daily operations. One contractor recently completed an entire contract life cycle without a dollar’s worth of reimbursement from DPH; the contractor in question delivered the negotiated services and reported the agreed upon outcomes without a certified contract, without an invoice template, and by extension, without any reimbursement for several months after the contract term expired. Generally, it is typical for the contract certification process to take several months under DPH’s purview, resulting in nonprofit contractors fronting two fiscal quarters’ worth (or more) of expenses that DPH committed to fund at the negotiated level. For DPH personnel, these delays are matters of routine contract administration confined to normal business hours, but for nonprofit contractors, the operational and cash management impacts cut to the heart of the agencies’ financial health, affecting the strength of nonprofit systems, the job satisfaction and wellbeing of nonprofit administrative staff, and the long-term viability of DPH-funded programs.

At DPH, routine administrative inefficiencies contribute substantially to these delays and their adverse impacts on nonprofit finance and operations. DPH personnel do not appear to coordinate internally: they issue duplicative or conflicting document requests; they reach out months after their own submission deadlines to request documents that nonprofit contractors submitted months before, in
advance of the deadlines; they make constant minor revisions to their standard templates and require contractors to resubmit scope of work and budget information each time the template changes; and they ask for same-day turnaround on document requests while allowing documents to languish in their own queues for weeks or months, proving the lack of accountability and urgency on their end of the contract approval process. One nonprofit contractor can document seventeen (17) submissions and resubmissions of scope of work and budget documents, simply to accommodate the minor edits made to standard templates. Another contractor submitted scope of work and budget documentation for all of its DPH-funded contracts simultaneously, and because of one issue with one contract, all of the contracts experienced a lag in approval, causing operational problems for no justifiable reason.

Most importantly, DPH personnel can take up to several months to produce a final invoice template for contractors to use when submitting invoices; without the template, it is impossible to invoice, creating an unjustified and substantial barrier to prompt cost recovery. In sum, the administrative inefficiencies that result from poor coordination drain nonprofit time and resources, create confusion over which versions of documents are final, and prolong the contract certification process, which prolongs the reimbursement process in turn, causing significant cash management and operational impacts. One contractor who maintains half of its contract portfolio with DPH (the other half is administered by HSA) currently has accounts receivable comprising more than 25% of its total agency budget.

DPH also uses opaque and arbitrary-seeming criteria to determine which contracts may be eligible for advances in funding, which may be necessary to remedy the fiscal and operational impacts of protracted lags in contract certifications. Particularly where contracts are fully funded with local general funds, there should be flexibility to accommodate advances to alleviate the substantial adverse impact of delays generated on DPH’s end. One contractor had a contract work-ordered to DPH from another department whose staff confirmed the full transfer of funds; despite the contract’s being fully funded with general funds, DPH personnel determined it was not eligible for an advance, and their reasoning was never made clear. This points to a broad trend within DPH and to some extent other City departments, where processes and procedures appear to be driven more by personalities than by a simple set of clearly defined rules available for contractors to consult and plan against.

Finally, because DPH persistently refuses to use any contract management system or standardized submission tool for scope of work and budget documents, the default system is email, and as several contractors have repeatedly experienced, submissions to DPH get lost over email when DPH staff make no efforts to respond to communications, letting submissions languish in email queues with no movement forward in the contract approval process for weeks or months. What is more, the use of email as a submission tool makes it extremely difficult to track the status of scope of work and budget approvals, meaning that contractors never (or rarely) know where their contracts are in the process at any point in time. All other City departments, including DCYF, HSA, HSH, the Mayor’s Office of Housing and Community Development (“MOHCD”), and OEW, utilize some form of contract management system, and DPH’s refusal to do so on the basis of its uniquely complicated processes means that those processes should be revisited and firmly streamlined. One contractor recalls a meeting three years ago in which DPH committed to implement a tracking process in response to coordinated complaints, but no follow-up occurred and no tracking process was ever implemented.

San Francisco Housing Authority (“SFHA”). The SFHA practices allow substantial lags in cost reimbursement, causing operational and cash management problems. The SFHA owed one contractor more than $1.6 million in cost reimbursement for day-to-day operating costs, and it took a full six months for the contractor in question to recover these unpaid expenses. Nonprofit providers of housing
and services for some of San Francisco’s most vulnerable residents should not be put in a precarious cash management position; this contractor’s situation is similar to the situation described below, in which HSH owed another contractor approximately $1.5 million in unpaid expenses—mainly fixed monthly payments to landlords and semimonthly payroll expenses for the staff operating the programs.

**Human Services Agency ("HSA").** Please see the references to HSA included with the section above on DPH and the section below on HSH. Generally, HSA operates similarly to HSH, a fact that is not surprising given that many HSA staff transferred to HSH with the launch of that department in August 2016. Under HSA’s purview, the contract approval process can lag substantially, in tandem with the payment approval process, which involves several layers of departmental review, delaying cost recovery, causing fiscal and operational problems, and demonstrating a lack of trust between HSA and its nonprofit contractors delivering services. HSA staff take an unnecessarily firm hand with contractors; on the administration side, they do not make or reciprocate efforts to build positive working relationships with their nonprofit contractors.

**Department of Homelessness and Supportive Housing ("HSH").** HSH launched in August 2016 and absorbed a load of housing contracts transferred from other City departments without the staffing to implement administrative systems. As a result, HSH has not yet developed or adopted the standard operating procedures that would streamline contract administration, resulting in protracted contracting delays that result in protracted invoicing delays, creating reimbursement delays of two months or more that force contractors to absorb months’ worth of expenses that HSH committed to fund at the contracted level. The practical impact is that contractors spend the first two fiscal quarters struggling to manage the cash to meet basic rent and payroll obligations, leaving the second half of the fiscal year to recover costs and stabilize cash flow before the cycle repeats.

The cycle begins with the contract approval process that starts each fiscal year. Budgets and scopes of work must be loaded or re-loaded into CARBON, HSH’s contract management system, and contractors must wait for departmental approvals on each contract before the invoicing function can be unlocked to process billing. It is important to note that the contract approval process creates delays even for continuation contracts with three- to five-year contract terms. This means that contracts with continuation services and identical scopes of work and budgets must undergo the same protracted reapproval process as new contracts, impeding contractors’ ability to recover costs for services that must be delivered seamlessly and ongoingly.

Delays in the contract approval process can delay invoicing by two months or more, making it difficult if not impossible for contractors to invoice on pace with this steady flow of services. It imposes a substantial cost recovery burden, for example, when expenses accrued in July cannot be invoiced until mid-September, and when the invoice approval process takes an additional three weeks from the day an invoice is finally submitted to the day it is paid. Without standard operating procedures, and with several layers of departmental review, invoices get kicked back to contractors, who must submit additional or different back-up documentation depending on which personnel are reviewing the invoice. There are two problems with this: first, the time-consuming layers of intradepartmental review, and second, the conflating of cost recovery with fiscal monitoring, which should occur once during the contract year and not on a monthly basis in tandem with the payment approval process.

One contractor, a housing provider, has sustained this operating cycle twice, approaching HSH for the second September in a row to request an advance on approximately $1.5 million in unpaid expenses accrued from the start of the fiscal year in July. For housing providers particularly, the ripple effects of
poor administration can be substantial across a contract portfolio that demands fixed monthly payments to landlords and semimonthly payments to staff operating the programs. To manage the cash in the absence of timely reimbursement, contractors must have several months’ worth of operating cash, immediately accessible third-party lines of credit, and sources of private unrestricted funding that must be diverted from key agency priorities to fill gaps in publicly funded program budgets.

Another pervasive contract problem concerns HSH’s vacation pay guidelines (and those of HSA), which conflict with federal guidance and impose substantial costs on nonprofit contractors by stipulating that accrued vacation is not a reimbursable cost when vacation time is earned but not taken within the grant period. On the accrual method of accounting, vacation expenses become a billable cost to HSH- and City-funded contracts when employees earn their vacation time, but HSH and HSA have refused to reimburse these expenses on the basis that contractors could erroneously double-bill departments both when employees earn the vacation and again when they take vacation days. This conflates the cash and accrual methods of accounting and conflicts with federal guidance, which says explicitly that the accrual method of fringe benefits for vacation is allowable. The Controller’s Office reiterated this guidance in a memo dated August 3, 2017, which among other findings found that the City’s vacation pay guidelines are internally consistent and should be revised to comply with federal guidelines.

Finally, another contracting problem involves the 2.5% cost of doing business (“CODB”) addition to HSH-funded contract budgets, which must be compounded into the base contract amount for each successive fiscal year, rather than added to the same flat contract amount year over year. If the CODB addition is not compounded into the base contract amount for each successive fiscal year, then the CODB addition remains the same from year to year as the real cost of doing business rises. This defeats the underlying purpose of the CODB addition. Clear, written policies should dictate how the CODB is added to contract amounts, so that contractors do not have to monitor the arithmetic across their HSH-funded contract budgets.

Office of Economic and Workforce Development (“OEWD”). OEWD is the only City department we are aware of that will not permit nonprofit contractors to bill indirect costs at federally negotiated rates without a current negotiated indirect cost rate agreement (“NICRA”) in hand. The United States Department of Health and Human Services (“HHS”) is dealing with a backlog of NICRA applications for the second year in a row due to a spate of staff retirements, and HHS representatives have advised nonprofit contractors with pending NICRA applications to treat expired rates as current until their applications can be processed. OEWD has refused to accept that guidance (or delayed so long in considering the guidance that it has functionally refused to accept it). This is an informal policy at OEWD that does not exist in writing, and there appears to be no benefit to justify the administrative burden on nonprofit contractors, who must wait for their approved NICRAs and then bill indirect costs several months after they have accrued, despite submitting timely NICRA applications to HHS.

The HSN appreciates the opportunity to present you with the foregoing analysis of trends and impacts. Please contact me at debbilerman@sfhsn.org or 415-668-0444 with your questions or comments.

Sincerely,

Debbi Lerman
Director, San Francisco Human Services Network