

October 7, 2010

An Open Letter to All Americans

Dear Fellow Americans:

The hundreds of thousands of nonprofit organizations that serve millions of individuals daily in local communities across our country are dealing with a serious and growing problem, one that threatens the ability of many nonprofits to continue delivering services.

Because nonprofits work with you, for you, and through you daily, they know the American people are smart and caring. When given straight facts, you will take action to support others. That's why we write now, to both present the core facts in the attached **Special Report: *Costs, Complexification and Crisis: Government's Human Services Contracting "System" Hurts Everyone***, and announce the related new web portal to keep you informed and provide a place to engage with this critical issue: [www.councilofnonprofits.org/govtcontracting](http://www.councilofnonprofits.org/govtcontracting)

The government contracting problem stems from our nation's long-ignored and severely broken "system." We use the word "system" loosely because what exists is not really an integrated system intentionally or rationally designed to perform the important duties expected. Rather, it is an archaic, cobbled-together, patch-work arrangement that has evolved over many decades into such a fragmented and frail framework that the social safety net has now ripped and people who really need it are being hurt. Indeed, as this Special Report demonstrates, the broken "system" hurts everyone.

The size and scope of the problem has grown so significantly that we feel a moral obligation to draw your attention to this urgent yet silent national crisis. The contracting system must be fixed so people receive services when they need them, taxpayers receive full value for the programs they fund, and communities are strengthened through wise stewardship.

Without responsible solutions, our communities will suffer even more. The National Council of Nonprofits does not claim to have all the answers, because we don't. But this Special Report does offer specific action steps everyone can take to begin healing the broken system. Rather than requiring a big investment of money, most of the solutions can be achieved through intentional coordination and discipline in follow-through to make positive change. By working together, the American people, our governments, and our local nonprofits can turn this crisis around.

Tim Delaney  
President & CEO

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Board Chair

# *Special Report*

## **Costs, Complexification, and Crisis: Government's Human Services Contracting "System" Hurts Everyone**

October 7, 2010



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*Special Report*

**Costs, Complexification, and Crisis:  
Government’s Human Services Contracting “System” Hurts Everyone**

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For additional information and updates to this Special Report, please visit our dedicated web portal at [www.councilofnonprofits.org/govtcontracting](http://www.councilofnonprofits.org/govtcontracting)



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Multiple government reports, news accounts from across the country, and now hard data from the first comprehensive nationwide survey of problems nonprofits experience through government contracts all point to one inescapable conclusion: while governments rely extensively on nonprofits to deliver human services to their most vulnerable residents, governments do so using a contracting "system" that is so woefully broken that it now jeopardizes public health and safety.

The decisions to rely on nonprofits to provide services have sound policy, economic, and administrative justifications. Yet the convoluted, disjointed, and patch-worked laws and practices by which governments contract with nonprofits have led to nonpayment, underpayments, and late payments to nonprofits, in part because contracting and reporting processes have become excessively complex and irrational (through continual "complexification" as opposed to simplification).

The Urban Institute's new in-depth study, *Human Service Nonprofits and Government Collaboration: Findings from the 2010 National Survey of Nonprofit Government Contracting and Grants* ("Urban Institute Study"), provides the results of the first national survey documenting the serious and widespread problems experienced by nonprofit human service providers under contract with governments at the local, state, and federal levels.<sup>1</sup> Human service nonprofits include groups that provide essential needs such as food assistance, public safety, housing, child care, community and economic development, youth development, and more (but do not include other charitable nonprofits, such as arts and culture, education, or health care).

This related Special Report by the National Council of Nonprofits provides additional context to the Urban Institute's findings. This Report explains how the contracting problems affect everyone in America, not just nonprofits. It also identifies specific practices that contribute to the problems being experienced, and proposes solutions that nonprofits, government officials, funders, and citizens can adopt to improve services, restore value for taxpayers, and benefit communities.

This Special Report is dedicated to the many selfless government employees and officials who share the commitment of their nonprofit partners to improving the lives of their fellow citizens. The fact that millions of people receive the services they need through nonprofits is testimony to the dedication of these public servants in overcoming the system's many frustrating flaws.

## Executive Summary

### An Urgent Problem

For a variety of reasons, including to maximize efficiency and effectiveness, governments often contract with nonprofits to deliver particular services (such as food, shelter, and social services) to certain categories of people in need (such as children, the disabled, the sick, the elderly, or others). Yet recent government reports admit that governments have failed to honor their written agreements to pay nonprofits to deliver those government services:

- Illinois' Comptroller released a 50-page list of more than 2,000 nonprofits that the state has failed to pay almost half a billion dollars – *and that's for just the first half of this year*;<sup>2</sup>
- New York's Comptroller found that 92.5 percent of the state's contracts with nonprofits were late and the state had delayed paying numerous nonprofits for multiple years;<sup>3</sup>
- The U.S. Government Accountability Office found that – for a single federal program – some states pass all dollars to the nonprofits to pay for the services while other states take funds for themselves;<sup>4</sup> and
- The Congressional Research Service warned, "It appears that governments, especially state governments, may be contributing to the financial difficulties of nonprofit organizations, even to the point of not paying for contracted services."<sup>5</sup>

No one should accuse governments of acting with malice, intentionally trying to abuse the nonprofits delivering services and the individuals who are to receive services. Rather, over time this service-delivery "system" has evolved through happenstance, not design, and left nonprofit human service providers at the mercy of uncoordinated and often contradictory policies and practices of different federal, state, and local government departments, agencies, and offices. The consequences of neglecting this broken contracting system are staggering in scope, undermining the reliability of a "system" that is supposed to deliver vital human services.

### The Broken "System" Hurts Everyone in America

The Urban Institute's hard data now prove what has been known intuitively: that government contracting practices too often undercut delivery of the very services that governments are trying to provide through their contracts with nonprofits. The pain caused by the broken contracting "system" hurts more than the children, the elderly, the sick, the hungry, the homeless, and other individuals in need who cannot count on the programs to be there when the services are not funded, underfunded, or paid late. The new data show that governments using flawed contracting practices do so at the direct expense of nonprofit employees. Moreover, the misaligned policies and practice also harm taxpayers paying for the services, intrude on private philanthropy, divert funding away from nonprofits that do not have government contracts, and create a serious drag on the entire economy. Any policymakers expecting private philanthropy to fill the void are mistaken, because foundations and federated charities do not have enough assets to bridge the gap when governments do not honor their commitments. Statistically significant data show that reliable government contracting practices allow more services to be delivered to people in need – whereas negative contracting practices actually prevent needed services from being delivered.

### Government's Human Services Contracting "System" Is Woefully Broken

This research project began following an increased number of reports about governments failing to pay nonprofits on a timely basis as required by the terms of validly binding contracts. It turns out, however, that the late payment problem is just one of five major problems that human service nonprofits are experiencing:

1. Governments Failing to Pay the Full Costs

When governments do not pay the full costs of the services, nonprofits must divert time and resources trying to make up the difference, thus limiting attention on delivery of services to those in need. Governments pay less than it actually costs to deliver the services by, among other ways, denying or severely restricting indirect/overhead/administrative costs that are real, using outdated or artificially low reimbursement rates, requiring matching costs, and imposing unfunded mandates.

2. Governments Changing the Terms of Contracts Mid-Stream

When governments change the terms of their written agreement mid-way through performance, it hurts the people the programs are designed to help, weakens our communities by undercutting trust in government, and destabilizes the organizations that governments and taxpayers rely on to fulfill their obligations. Even when governments reduce payments, they often still demand full performance by the nonprofit, which is expected to produce the same outcomes with less funding.

3. Governments Paying Late

Failure by governments to pay their bills when they are due amounts to an unreasonable taking – essentially forcing nonprofits to involuntarily bankroll the government services they provide. This practice increases the cost of providing services, shortchanges the people who are most in need, and forces nonprofits to borrow or raise funds to fulfill the governments' legal obligations.

4. Complexification of Contracting Processes

Bidding burdens, needless red tape, and other government contracting policies and bidding practices routinely impose avoidable inefficiencies on nonprofits, thereby creating waste, eroding productivity by diverting staff time from serving individuals, and reducing the amount of services actually delivered to individuals and communities in need. Many of these complexities also add costs to taxpayers.

5. Complexification of Reporting Requirements

Reporting and oversight processes that once made sense can run amuck when needlessly duplicated, resulting in higher costs to taxpayers without adding value and diverting resources from delivery of needed services. Everyone needs to recognize that spending certain dollars chasing possible pennies is not cost effective for taxpayers.

### **Not a Hopeless Situation: The Solutions Are Fairly Simple**

Although the convoluted “system” is multi-jurisdictional, multi-layered, and excessively-complex, the solutions are fairly straightforward. Rather than requiring a big investment of money, most of the solutions can be achieved through intentional coordination and discipline in follow-through to make positive change for those being served, taxpayers, and the community at large. Importantly, this call to action is not issued solely by nonprofits. Earlier this year the U.S. Government Accountability Office issued a similar call, on behalf of government. These problems have built over years of neglect, so realistically they will not be solved overnight.

Importantly, the Urban Institute Study's findings also reveal that when governments have systems and practices in place that utilize smooth and fair contracting practices, those governments accomplish so much more with their investments. These governments have proven that a smooth, reliable, and fair system can exist.

## Background

*Government, at every level, provides few human service programs directly. Instead, government funds an array of services and programs, such as employment and training, health care, child care, foster care, food and nutrition programs, senior citizen centers, social services, and many others. ... In the social service field, policymakers routinely use the front-line service delivery capabilities of nonprofit organizations instead of developing new public bureaucracies.<sup>6</sup>*

The so-called “system” through which governments contract for the services on which they rely has evolved over decades through happenstance, improvisation, and frustration. Therefore, it is inappropriate to blame current government officials who inherited this broken system. The National Council recently published two Special Reports noting the nonprofit sector’s growing challenges in meeting increasing demands with decreasing revenue, and in both we have reached out to our colleagues in government in respectful ways to highlight the issues rather than point a blaming finger.<sup>7</sup> We will not attack government officials now, but neither will we simply look away pretending that this growing crisis does not exist. To advance the will of the people by providing services to those in need when they need it, while ensuring value to taxpayers, it is time to heal the broken “system.”

It also would be inappropriate to shrug off these contracting and payments problems as just symptoms of the Great Recession. The problems documented by this research project preceded the current economic times. As the Urban Institute Study observes, the recession has not created, but intensified “flaws in government contracting practices” and “exacerbate[d] this financial stress, placing additional pressure on stretched staff and resources.”<sup>8</sup> Indeed, in 1993 two leading scholars posed this question: “why do governments say they want our services, but do not want to pay us enough to do the job effectively?”<sup>9</sup>

Certainly the situation is more difficult on governments’ side, given their severe financial strains, which we acknowledge now as we did in our March 2010 Special Report, *State Budget Crises: Ripping the Safety Net Held by Nonprofits*. We recognize that the economy is imposing severe budget stresses on local, state, and federal governments, just as it is on the nonprofit sector. And the situation has only worsened since we issued that report. As chronicled in the New York Times in August 2010:

*Faced with the steepest and longest decline in tax collections on record, state, county and city governments have resorted to major life-changing cuts in core services like education, transportation and public safety that, not too long ago, would have been unthinkable. And services in many areas could get worse before they get better. The length of the downturn means that many places have used up all their budget gimmicks, cut services, raised taxes, spent their stimulus money — and remained in the hole.<sup>10</sup>*

But again, the worsening of the governmental budget crises is not an excuse for looking away from the growing problems; if anything, it demands prioritizing reform actions. It is time to come together to solve this joint problem.

**“Contract.** An agreement between two or more persons which creates an obligation to do or not to do a particular thing.”  
--Black’s Law Dictionary

## The Costs: How the Broken “System” Hurts Everyone

### The Tragic Costs to People in Need

The Urban Institute’s hard data now prove what has been known intuitively: that misaligned government contracting practices undercut delivery of the very services that governments are trying to provide through their contracts with nonprofits. For instance, nonprofits that reported problems caused by governments changing their written agreements mid-stream indicated they were forced to reduce the number of programs or services 10 percent more than nonprofits in situations where governments were honoring their contracts.<sup>11</sup> Similarly, nonprofits reporting governments’ late payment on contracts also reported they had to cut programs and services nine percent more often than nonprofits working with governments that paid their obligations on time.<sup>12</sup>

These statistically significant divergences show that reliable government contracting practices allow more services to be delivered to people in need – whereas negative contracting practices actually prevent needed services from being delivered.

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### The Senseless Costs to Taxpayers

A few enlightened government leaders are beginning to realize the tremendous opportunities to save taxpayers billions of dollars by making some rather simple changes. They see, for example, the tremendous waste – both to the nonprofits providing services and to governments – that occurs through excessive reporting and paperwork requirements. Appropriate reporting for oversight and accountability is imperative. But oversight processes that once made sense can run amuck when needlessly duplicated, resulting in higher costs to taxpayers without adding value. Consider the numerous examples of the “duplicative and cumbersome monitoring, contracting and oversight procedures” that one statewide official recently uncovered, such as multiple state agencies conducting overlapping audits of the same nonprofits and multiple state agencies operating separate fingerprinting operations, all duplicating efforts and costs to taxpayers.<sup>13</sup>

### The Needless Burdens on the Nonprofit Community

The pain caused by the broken contracting “system” hurts more than faceless organizations.

#### Nonprofit Employees

The Urban Institute Study shows (at Figures 9-13) that governments using flawed contracting practices do so at the direct expense of nonprofit employees. For example, 45 percent of nonprofit human service providers (or almost 15,000 employers nationwide) reporting that governments failed to pay the full costs of performing the contracts indicated they cut jobs last year. That stark figure is a 17 percent higher rate than nonprofits reporting that governments paid full costs. For the employees who retained their jobs, a fifth of their nonprofit employers were forced to freeze or reduce their salaries because the government contracts did not pay the full amount of what it took to serve the people in need. (See Table 1, below)

These are only a sampling of the troubling details disclosed in the following chart that demonstrate how government contracting problems hurt nonprofit employees. The third column illustrates that, when there were no reports of problems with government contracting, the recession still caused nonprofit boards and management to take some actions. But the fourth column reveals that nonprofit boards and management had to take even more severe actions when various components of the government

contracting system were broken. The fifth column demonstrates with hard data how governments using misaligned contracting practices (those in column four) significantly hurt nonprofit employees, compared to governments that used neutral contracting systems (column three). The bottom-line is clear: When government contracting systems are broken, nonprofit employees bear the brunt.

**Table 1: How Broken Government Contracting Practices Hurt Employees**

SOURCE: Data from Urban Institute Study, Figures 9-13

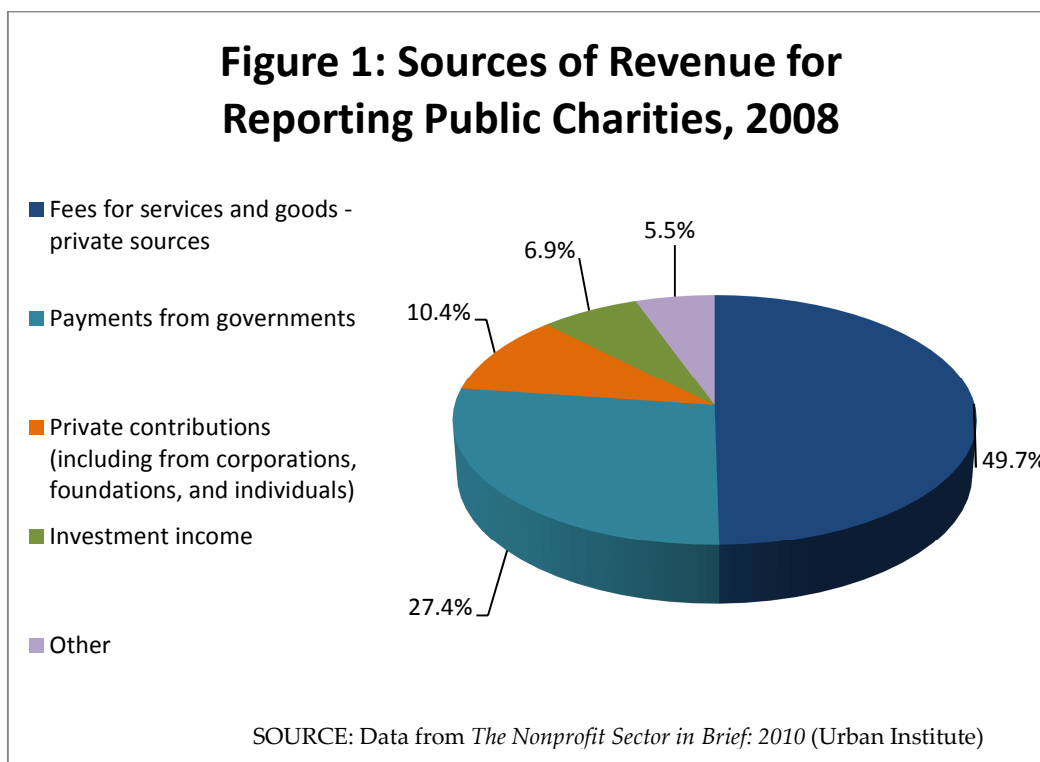
Issue	Direct Consequence to Nonprofit Employees	Recession's Impact	When Contracting Problems Exist	Significantly Worse
Government Does Not Pay Full Costs	Salaries frozen or reduced	38%	58%	20%
	Jobs eliminated	28%	45%	17%
	Employee benefits reduced	17%	28%	11%
Government Changes Contract Terms Mid-Stream	Salaries frozen or reduced	42%	58%	16%
	Jobs eliminated	31%	45%	14%
	Employee benefits reduced	18%	28%	10%
Government Pays Late	Salaries frozen or reduced	43%	58%	15%
	Jobs eliminated	34%	46%	12%
	Employee benefits reduced	18%	29%	11%
Burdensome Contracting	Salaries frozen or reduced	41%	55%	14%
	Jobs eliminated	32%	42%	10%
Excessive Reporting Reqts	Salaries frozen or reduced	42%	54%	12%
	Employee benefits reduced	15%	26%	11%

An otherwise “hidden” aspect of this Table merits emphasis. Some may read the data and see only that governments are hurting nonprofit employees. Yet that interpretation would be too broad. The data also reveal that when governments have systems and practices in place that utilize smooth and fair contracting practices, those governments accomplish so much more with their investments. These governments have proven that a smooth, reliable, and fair system can exist.

#### Private Philanthropy

The authors of this Special Report believe that most of the systemic problems relate to lack of attention – that the underlying system has been ignored for too long, allowing inefficiencies and uncoordinated layers of bureaucracy to corrode and weaken the service delivery system. However, there is a growing concern by many observers that government officials mistakenly believe that if government does not pay for human services, then foundations, federations, and other private giving will fill the void. Setting aside that such actions by government officials would amount to a taking of property – a hidden tax of sorts – it is fiscally impossible for foundations to fill that void.

According to the National Center for Charitable Statistics, in 2008 government funding accounted for 27.4% of all funding for the nonprofit sector, due to governments relying so heavily on nonprofits to deliver needed services in local communities.<sup>14</sup> By comparison, private donations accounted for only 10.4%, with foundations contributing only 1% of funding to the nonprofit sector as a whole. Put simply: foundations do not have the assets to fill the void when governments do not honor their contractual obligations. Neither do the invaluable federated charities that give so generously to human services.



#### Nonprofits That Do Not Contract with Government

When nonprofits with government contracts do not get paid, they have to raise additional funds to fill the void. This increases the competition for grants and donations from the philanthropic community, squeezing nonprofits that do not have government contracts. It also tends to limit the discretion of grant makers, leading some to shift their funding away from what they *want* to fund, to meet immediate human needs they feel they *must* fund instead.<sup>15</sup>

This shift happens in two ways. First, when foundations and individuals see unmet human needs, they often respond in an *ad hoc* manner, redirecting their planned donations away from arts, civil rights, conservation, education, research, and other important nonprofit groups to fill part of the gap in human services funding, effectively shortchanging some community needs while trying to rescue others. In the process, the community loses the benefit of programs and services that promote the public good, including cultural preservation, protection of civil and environmental rights, and much more. Second, an increasing number of foundations have been diverting their regular giving to create special funding and loan programs to keep human service nonprofits afloat while those nonprofits wait to receive their late payments from government contracts.<sup>16</sup> Yet other foundations have purposefully refused to do so, taking the longer-term view that they do not want to be enablers that effectively encourage government to delay payments and avoid reforms because it will only foster the misguided view that foundations will divert their money from elsewhere simply to bail out government obligations.

This “crowding out” effect is greater than most people realize. Data from other national surveys from last year and this year covering the entire nonprofit sector (not just human services organizations) reveal an even higher percentage of nonprofits that reported they have had to cut services, reduce employees’ hours and benefits, and lay off more employees than even the high numbers reported in the Urban Institute’s survey of human service nonprofits.<sup>17</sup>

### **The Broader Costs to the Economy**

This broken “system” creates serious drag on the rest of the economy in ways that many may not immediately recognize. For instance, as the Congressional Research Service recently reported, nonprofits employ more than the construction, finance, and insurance industries *combined*.<sup>18</sup> So when the broken contracting system forces nonprofits to eliminate jobs (*e.g.*, cut 17% more jobs because government fails to pay the full costs of services nonprofits deliver on behalf of government and cut 12% more jobs because governments failed to make timely payments under the written agreements), freeze or reduce salaries (*e.g.*, 20% more often when government does not pay full costs and 16% more often when government changes the terms of its binding agreements mid-stream), given the magnitude of the numbers it hurts everyone in the community, not just nonprofit employers and employees. (See Table 1, above)

There is a ripple effect that happens when fewer services get delivered to those in need. Consider, for example, what happens when the single mother cannot keep her job because the child-care center she relies upon has to shut down or limit the number of children because the government failed to pay on time. Or the employee whose absenteeism rate spikes at work, hurting his employer’s productivity, because his elderly mother gets bounced between senior centers as a result of government funding not coming through to nonprofit providers as promised under written agreements.

This negative ripple effect can amount to a tidal wave, when considering how much money nonprofits recycle through local communities. Nonprofits not only pay their employees who spend money for local housing, goods, and services, but also nonprofits collectively spend billions of dollars annually by paying rent on their office spaces, purchasing office equipment and supplies, and other goods and services from for-profit businesses that further fuels the economy; that is, unless governments do not pay their written agreements with nonprofits, in which case that money stops circulating through the local economy.

To put this in perspective, the Urban Institute Study notes (at page 5) that in 2009 American governments entered into \$100 billion worth of written agreements with nonprofits to deliver just human services for those governments. Now consider the size of that ripple effect when government fails to pay as agreed.

\* \* \*

The Overview Table on the next page further illustrates how the broken “system” benefits no one, and hurts everyone.

### Overview: The Broken “System” Benefits No One, and Hurts Everyone

<b>Individuals Who Need Services</b>	<p>Children, elderly, the sick, the hungry, the homeless, and other individuals in need cannot count on the programs to be there when the services that government has agreed to provide and pay nonprofits to deliver are not funded, underfunded, paid late, or lost in a broken system.</p> <p>With those in need relying on steady delivery of services, it is imperative that the government’s social safety net provided through contracted services operates smoothly.</p>
<b>Taxpayers Paying for Services</b>	<p>Taxpayers expect government services, whether delivered by governments or nonprofits, to be delivered effectively, efficiently, and in a cost-effective manner – not have their dollars squandered by duplicative practices such as having multiple state agencies paying for multiple in-house auditors each overseeing the same nonprofits separately.</p>
<b>People Who Vote &amp; Volunteer &amp; Work for Nonprofits</b>	<p>Voters lose faith in their government when policy decisions to provide services to needy individuals are not implemented due to needless duplications and complexity.</p> <p>Individuals who volunteer and make charitable contributions watch their efforts essentially erased by government policies and practices that build hurdles preventing nonprofits from using their services or donations to effectively serve communities.</p> <p>The data show that the first method of survival that nonprofits take when governments don’t pay hurts the nonprofit’s employees by reducing benefits, reducing hours, and laying off employees.</p>
<b>Governments</b>	<p><i>Legislative bodies</i> – The programs they created and funded to meet human needs cannot live up to their expectations due to bureaucratic burdens, failed implementation of policies, and unduly complex oversight that needlessly multiplies costs.</p> <p><i>Executive branch agencies</i> – Their hands are tied by rigid procedures and second-guessing, adding yet more expense to a burdened system.</p> <p><i>Elected officials</i> – They are held accountable by angry voters.</p>
<b>Nonprofits With Government Contracts</b>	<p>Nonprofits experiencing payment problems must divert scarce resources to juggle payments to employees, vendors, creditors, and others as they await government payments. The resulting erosion of organizational productivity inevitably impedes the delivery of services to those most in need, and deprives the nonprofit of valuable resources.</p>
<b>Nonprofits Without Government Contracts</b>	<p><i>Crowding Out Effect</i> – When government does not pay nonprofits for contracted services, those nonprofits then have no choice other than to try to find replacement money – which then increases competition with other nonprofits for an already dwindling pool of contributions</p>
<b>Private Philanthropy and Donors</b>	<p><i>Lose Discretion for Own Decisions</i> – by being forced to fill the gaps when governments fail to pay human service providers, many funders redirect their giving from arts, civil rights, environmental, and other causes to meet raw human needs, and lose investments already made in grantees that are unable to deliver on their missions.</p>

## The Problem: Where the “System” Is Broken

This project began following an increased number of reports about governments failing to pay nonprofits on a timely basis as required by the terms of validly binding contracts. It turns out, however, that the late payment problem is just one of five major problems that human service providers are facing as they try to deliver services to residents on behalf of governments.

### **1. Government’s Failure to Pay Full Costs**

The Urban Institute Study reports (at page 13 and Figure 7) that nationwide more than two out of three (68%) nonprofits with government contracts reported problems caused by the failure of governments to pay the full costs of contracted services. When governments do not pay the full costs, nonprofits must divert time and resources trying to make up the difference, thus limiting attention on delivery of services to those in need and subsidizing government.

#### **What Failure to Pay Full Costs Looks Like**

The problem of failing to pay nonprofits the full costs of what it takes to deliver services the government wants delivered manifests itself in a variety of ways. Unfortunately, those ways are not mutually exclusive, so nonprofits must expend efforts in multiple ways when performing services under a government contract.

##### **a. Artificially Limiting and Confusing Administrative/Indirect/Overhead Costs**

The Urban Institute data reveal (at pages 9-11 and Figure 6) that almost two-thirds (63%) of government contracts in 2009 limited reimbursement of overhead to 10% or less. This limitation is problematic for at least three significant reasons.

First, the substandard numerical limitation is significantly out of line with actual costs. “Overhead rates across for-profit industries vary, with the average rate falling around 25 percent of total expenses. And among service industries – a closer analog to nonprofits – none report average overhead rates below 20 percent.”<sup>19</sup> So capping the amount for nonprofits at between zero to 10% is an up-front acknowledgment that governments are unwilling to pay a fair and full price for human services.

Second, “underfunding overhead can have disastrous effects, [such as] nonfunctioning computers cannot track program outcomes and show what is working and what is not; poorly trained staff cannot deliver quality services to beneficiaries.”<sup>20</sup> By undercutting the real cost of what it takes to deliver the services, government is essentially eroding the capacity of the nonprofit service delivery system on which it relies so heavily.

Third, and perhaps most importantly, there is no common understanding of what constitutes overhead costs, so different standards get applied, further denying nonprofits the ability to recover their actual costs of delivering services. The U.S. Government Accountability Office (GAO) recently issued a report documenting an unsettling issue: that federal, state, and local governments all have different interpretations of what constitutes “indirect” costs that qualify for reimbursement and which costs are not reimbursable. For one federal program, implementing federal public policy and paid for with federal dollars, the GAO found:

- a nonprofit delivering the services in Wisconsin could be reimbursed up to 14 percent in overhead costs;
- a nonprofit in Louisiana delivering services under the same federal program could receive no more than 9.4 percent because the state kept the difference; and

- a nonprofit in Maryland delivering the same services under the same federal program using the same federal dollars would get reimbursed for no overhead costs – because the state kept the rest.<sup>21</sup>

This final issue occurs because of the many different definitions and interpretations of what constitutes “indirect costs,” “overhead costs,” “administrative costs,” and what is reimbursable and what is not. The terms are ambiguous at best, and capable of both manipulation and massage. According to the GAO:

*Understanding OMB guidance regarding the relationship between indirect and administrative costs is particularly challenging for state and local governments and nonprofits. ... Taken together, the OMB guidance can be viewed as ambiguous. Guidance is most useful when it is clear and well understood. ... When grants and grantees classify similar costs differently it can also result in the same cost activity being covered for some nonprofits but not others, and can increase the complexity of administering the grants. ... Even though the terms indirect costs and administrative costs are not synonymous, we found that some nonprofit, state, and local government officials we spoke with use them interchangeably. A national nonprofit association official made a similar observation, noting that terminology varies throughout the nonprofit sector. State and local government and nonprofit officials we spoke with also reported other terms, such as overhead, general operating expenses, or management and general expenses, synonymously with indirect and administrative costs.<sup>22</sup>*

Indirect costs must be paid in some way, even if state and local governments refuse to pay them. “GAO found that nonprofits ... to bridge the gap ... may reduce the population served or the scope of services offered, and may forgo or delay physical infrastructure and technology improvements and staffing needs. Because many nonprofits view cuts in clients served or services offered as unpalatable, they reported that they often compromise vital ‘back office’ functions, which over time can affect their ability to meet their missions. Further, nonprofits ... that experience delays in receiving their federal funding may be inhibited in their ability to bridge funding gaps. ... Collectively, these issues place stress on the nonprofit sector, diminishing its ability to continue to effectively partner with the federal government to provide services to vulnerable populations.”<sup>23</sup>

#### **b. Using Inaccurate and Outdated Rates**

Many government programs reimburse nonprofits using outdated rates that have not been revised in years. A federal court in California recently found that the state had allowed foster care reimbursement rates to fall behind actual costs by 32 percent.<sup>24</sup> In Connecticut, the average cost-of-living adjustment for purchase of service contracts performed by nonprofits stand at just 1 percent over the past 20 years, clearly failing to keep pace with inflation and the actual costs of providing services.<sup>25</sup> And officials in Massachusetts candidly acknowledged the failings of the rate-setting process in the Commonwealth:

*Rates in the [purchase of services] system are not based on the actual prices of the service. Instead, they are typically based on available budget divided by the desired volume of Services purchased. These rates frequently do not cover the full cost of providing services and do not support a fair wage for human service workers.<sup>26</sup>*

The use of artificially low rates shifts the burden of paying the difference onto the backs of nonprofits that then are forced to divert their already strained resources to try to raise the funds elsewhere.

### c. Requiring “Matching Funds”

The Urban Institute Study documents (at page 9) these startling facts:

- Three out of five nonprofits (60%) report that governments required them to raise – on average – at least 25 percent of matching funds to get a contract. In other words, a nonprofit essentially has to come up with a significant share of the costs in order to earn the right to perform the services.
- One of every four nonprofits (27%) reports having to raise – on average – at least half of the contract amount in matching funds in order to get a contract. Considering that the median size state government contract is \$200,000,<sup>27</sup> that means that a nonprofit delivering human services would have to raise \$100,000 in matching funds to perform the work on behalf of government.

The federal government does not require defense contractors to raise 25 percent of the costs for the privilege of building a fighter jet or submarine. State governments do not require highway construction companies to chip in 50 percent of the amount required to build a new highway or bridge. Local governments do not require technology companies to raise a quarter of the cost for new computer systems they install for the government. So why does government routinely (60% of nonprofit contracts) force nonprofits to go raise a significant amount of money to pay for the social safety net that is for the common good?<sup>28</sup>

### d. Diverting Funds from Delivery of Services via Unfair Payment Processes

Based on how governments decide to pay on their contracts, some governments actually *take money away from nonprofits*. For example, some governments pay nonprofits through credit cards – but that means that for the government’s convenience, nonprofits lose the two to three percent of the payment to banks, when the credit card company takes the interstate transaction fee (or “swipe fee”) from the money transfer. According to the National Association of State Procurement Officials, eight states mandate that contractors accept payments via government procurement credit cards (or, “p-cards”).<sup>29</sup> In North Carolina, for example, the state’s General Contract Terms and Conditions directs that the state is entitled to make payments by way of a “procurement card” and contractors are required to accept such payment if they also accept MasterCard or Visa from other customers.<sup>30</sup> Congress recently stood up to defend consumers against this fee, and Vermont recently stood up to defend its merchants from having to pay the swipe fee in certain circumstances.<sup>31</sup> So while some policymakers recognize the inherent unfairness, this unexamined practice of taking money from service delivery by lessening the amounts paid to nonprofits has not stopped.

### e. Imposing Unfunded Mandates

Governments impose a variety of unfunded mandates on nonprofits with contracts to deliver human services. Connecticut is in the process of implementing a new policy requiring nonprofit and other contractors to obtain cost-prohibitive proprietary data encryption software for providers’ desktops, laptops, and mobile devices that use certain state data. Despite the prohibitive costs, the state has not made provisions to reimburse the nonprofits, or even assist in group purchasing arrangements.<sup>32</sup> Nonprofits in different states have reported they often are required to send employees to mandated training, but the states do not reimburse the nonprofit for the costs of transportation, lodging, or meals for the employees who may have had to fly and stay overnight to take such training. Other instances of unfunded mandates include use of specified accounting or reporting software, and purchase of required equipment, such as computers.

## How Failure to Pay Full Costs Hurts

The Urban Institute’s Study (at page 20) demonstrates that while the recession has hurt nonprofits as a whole, this particular problem of governments failing to pay the full costs especially hurts certain

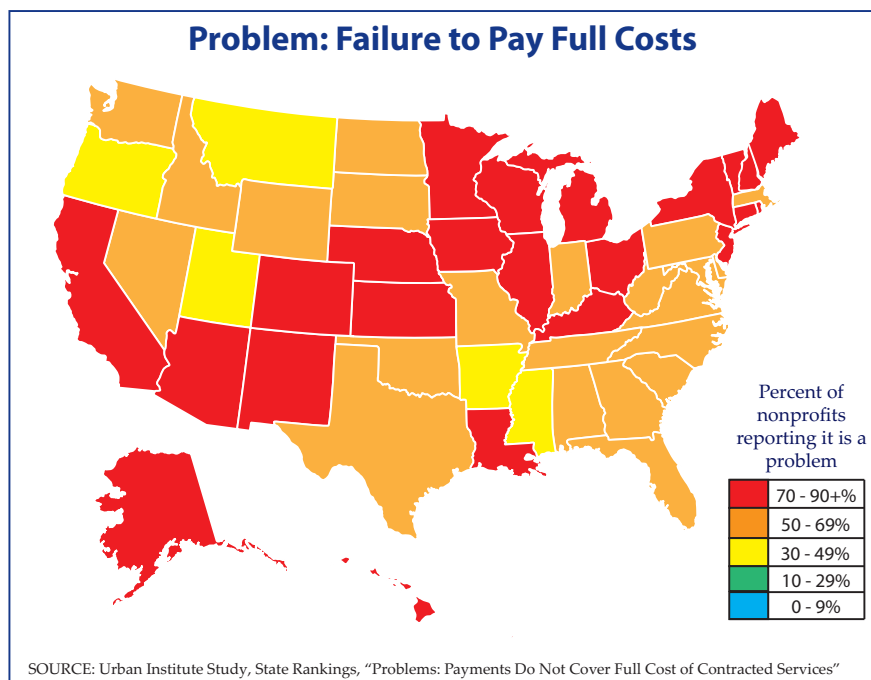
nonprofits. Twenty-seven percent of nonprofits not being fully paid by government for services delivered were forced to, among other actions, borrow funds or increase their lines of credit, as compared with only 12 percent of nonprofits without this problem.

### Comparing the State Rankings

The Urban Institute Study and related state profiles provide helpful comparisons between states to identify any significant trends or outliers. Relying solely on quick comparisons can be illusory, however. First, even if a state is ranked number 51 – making it arguably “the best in the country” – does not mean it is doing well. Montana, for instance, is ranked number 51 regarding governments (federal, state, and local) paying full costs in Montana. Yet one out of every three nonprofits in Montana listed this as a problem for their organization. So “best” by comparison is, in reality, simply the “least worst.” Second, simply because a state has a lower ranking by comparison does not necessarily mean it is providing the level of services that the public needs.

### Where Failure to Pay Full Costs Is Happening

According to the Urban Institute Study, 68 percent of human service nonprofits reported problems with government payments not covering the full cost of contracted services. The Study found that **more than half of the nonprofits in 46 states** indicated that governments’ failure to pay the full costs of providing services created a problem for them.<sup>33</sup> Even the “best” state (or, in reality, the “least worst” state) has a significant problem: **more than one out of every three** Montana human service nonprofits (36.7%) with government contracts reports that governments’ failure to cover the full costs of the services they provide on behalf of governments creates a challenge.



## 2. **Changing Contract Terms Mid-Stream**

Most Americans understand that a contract is legally binding. When individuals take out a mortgage to buy a house, they know they are obligated to honor the terms of the agreement and pay on time. When someone has a plumber fix some pipes, they know they must pay and cannot change their mind when the pipes are fixed. So most Americans likely will be startled to learn that governments frequently change the terms of their written agreements with nonprofits after the fact.

Nationwide, almost three out of every five (58%) nonprofits with a government contract reported that governments had created problems for them by changing the terms of the written agreement mid-way through performance. Regardless of the background reasoning – whether due to political impasses regarding budgets, funding shortfalls, or simply contracting practices by government agencies – contract changes hurt the people the programs are designed to help, weaken our communities by undercutting trust in government, and destabilize the organizations that governments and taxpayers rely on to fulfill their obligations.

Policymakers need to understand in advance that when they change contract terms mid-stream, they likely will be triggering job losses.

### What Changing Contract Terms Mid-Stream Looks Like

#### Cutting Payments

The experience of this contractor, reported by the Connecticut Association of Nonprofits this year, is representative of the ways that governments have responded to budget shortfalls by relying on their nonprofit partners to bail them out:

*One nonprofit provider was awarded a contract and later brought to the state agency to negotiate the final contract details. During negotiations, the state agency revealed that the amount of the contract would be ten percent (\$300,000) less than originally stated in the RFP, yet the state agency fully expected the nonprofit to provide the same level of service included in the original RFP.<sup>34</sup>*

Nonprofit contractors in a neighboring state expressed similar concerns in public meetings with a statewide official. According to one nonprofit leader, “Retroactive rate reductions ... break the ability for [a nonprofit] to plan and implement a program.” Another stated: “Retroactive cutting of contracts /amounts is devastating” to nonprofits.<sup>35</sup> Importantly, even when governments reduce payments, they still demand full performance by the nonprofit, which is expected to produce the same outcomes with less funding.

#### Cancelling the Contract

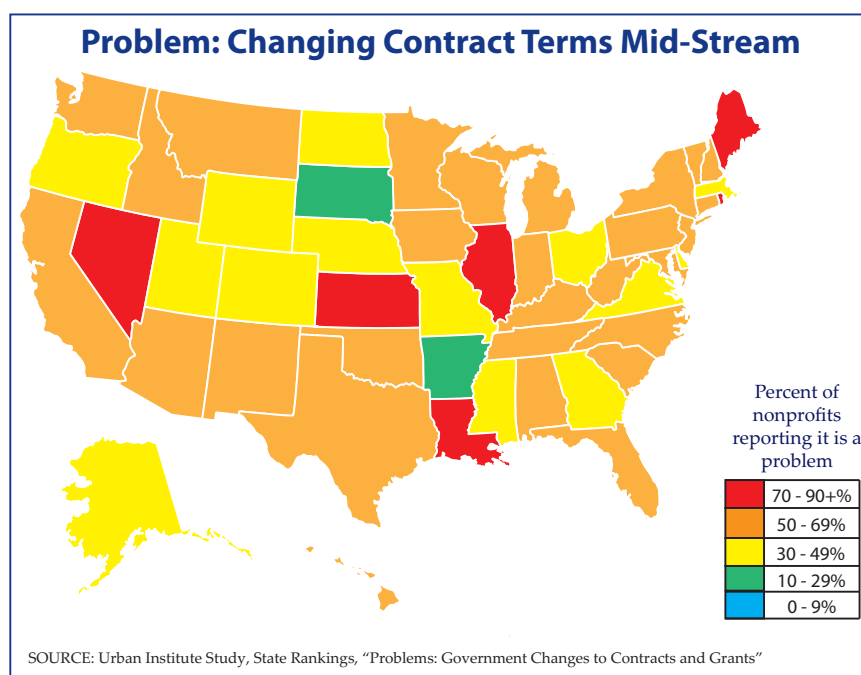
In North Carolina, several three-year contracts funded through the Children’s Trust Fund were terminated after the nonprofit contractors had hired staff and assumed other liabilities. Likewise, numerous nonprofit children’s rights centers in the state received letters in December 2009 alerting them that their funding to deliver needed services through contracts with the Division of Social Services would not be paid due to revenue shortfalls.<sup>36</sup>

### How Changing Terms Mid-Stream Hurts

According to the Urban Institute Study (at page 2, Figure 11), 45 percent of nonprofits suffering changes to government contracts mid-stream had to lay off employees, which is a significant 14 percentage points higher than nonprofits without this problem. Policymakers need to understand in advance that when they change contract terms mid-stream, they likely will be triggering job losses.

### Where Changing Contract Terms Mid-Stream Is Happening

According to the Urban Institute Study, more than a third of the human service nonprofits in 49 of the 51 jurisdictions (all except Arkansas and South Dakota) identified governments' changing of contract terms mid-way through the contract as a problem they endure – and it is a problem shared by almost half of the nonprofits in 39 states.



### 3. Paying Late

Nationally, two out of every five nonprofits (41%) report that governments paid them late at least once in 2009.<sup>37</sup> The dollar amounts are significant: on average the federal government owed \$97,635 on each contract, state governments owed \$117,679, and local governments owed \$38,937.<sup>38</sup>

Failure by governments to pay their bills when they are due amounts to an unreasonable taking – essentially forcing nonprofits to involuntarily bankroll the government services they provide. This practice increases the cost of providing services, shortchanges the people who are most in need, and forces nonprofits to borrow or raise funds to fulfill the governments' legal obligations. Some states owe individual nonprofits hundreds of thousands of dollars for contracted services already provided, and reports indicate that nonprofits are being forced to wait increasingly longer – sometimes a year or more – to receive payments from governments for services the nonprofits already have provided.

By withholding payments to nonprofits, governments effectively use that money as free financing. This practice unfairly takes money from nonprofits, which are essentially strong-armed into providing interest-free loans to governments. To add an ironic twist, nonprofits that do not receive payments on time from government often have to secure "bridge loans" to fill the void until governments pay what they owe. But nonprofits fortunate enough to find a bank willing to loan them money for this purpose then get stuck with paying the interest because governments will not reimburse those costs – costs incurred because governments failed to honor their written contracts. This has the effect of diverting more money from actual delivery of services to those in need.

## What Governments Paying Late Looks Like

### Late Payments

Government officials, the media, and now the Urban Institute Study all chronicle the major problems that human service nonprofits are experiencing as a result of governments failing to pay on their contractual obligations. The scale of late payments is frightening when one considers the extent to which our nation's human service delivery system depends on reliable and consistent access to needed services.

- In Illinois, the Comptroller issued a response to a Freedom of Information Act request listing the 2,000-plus nonprofits that the state owed more than half a billion dollars for the first six months of this year alone.<sup>39</sup> The Comptroller, Daniel W. Hines, took the unusual step of posting on his website an open letter to nonprofit human service providers acknowledging the severity of the problems caused by the state's delinquent payments:

*I remain impressed as always by the important work you do to ensure that our most vulnerable citizens are cared for and protected. Moreover, **your ongoing commitment to continue working in good faith as business partners with the State of Illinois is truly commendable given the fact that the State has been anything but a good business partner in return.** ... [I]t is time for our [State's] leaders to recognize that the public service community and its hundreds of thousands of employees is not just an essential purveyor of critically needed services to our most at risk population but is a significant element of our state's economy.<sup>40</sup>*

- Recently, California, Pennsylvania, and New York were unable to pass their budgets by the start of their fiscal year.<sup>41</sup> For each state, this was a continuation of the economic and political impasse that has created significant challenges for nonprofits in the past.
  - The budget impasse in California in 2009 led to the state paying some of its bills with I.O.U.s. Nonprofit with contracts with the state struggled to maintain operations, but suffered additionally under a unique quirk in California law, which states, "No nonprofit public benefit corporation shall be eligible for a late payment penalty if a state agency fails to make timely payment because no Budget Act has been enacted."<sup>42</sup>
  - Pennsylvania's historic budget crisis of 2009 caused untold disruptions in services. In Allegheny County, for instance, the Department of Human Services notified its service providers that the office was unable to make payments for advances, pre-payments or services rendered for the 2009-10 service and vendor contracts until the passage of the budget, which faced a \$3.25 billion shortfall.<sup>43</sup>
  - A recent survey conducted by the New York Council of Nonprofits found that 66 percent of nonprofits said they had been forced to take out a line of credit due to late payments from government agencies.<sup>44</sup>
- In Tennessee, a nonprofit responding to a recent survey by the Alliance for Nonprofit Excellence in Memphis described waiting "eight to nine months on the county... At one time we were owed \$500,000." Another survey participant, in describing how a contract that was supposed to begin in July took until October to get signed, observed: "we're financing the government."<sup>45</sup>

### Late Contracts

Last year, New York's Comptroller investigated state agencies to see how promptly they were approving contracts. His report found that state agencies in New York were processing contracts late about 92.5% of

the time, which then delays payments to nonprofits.<sup>46</sup> In the interim, nonprofits are put in the precarious position of having been awarded a contract and instructed to begin performing, yet technically they do not have a signed contract in hand. Moreover, without a signed contract, they cannot get paid. So when the state sits on the contracting paperwork, it means the nonprofit is expending its own resources hoping that the state will act in good faith and pay it.

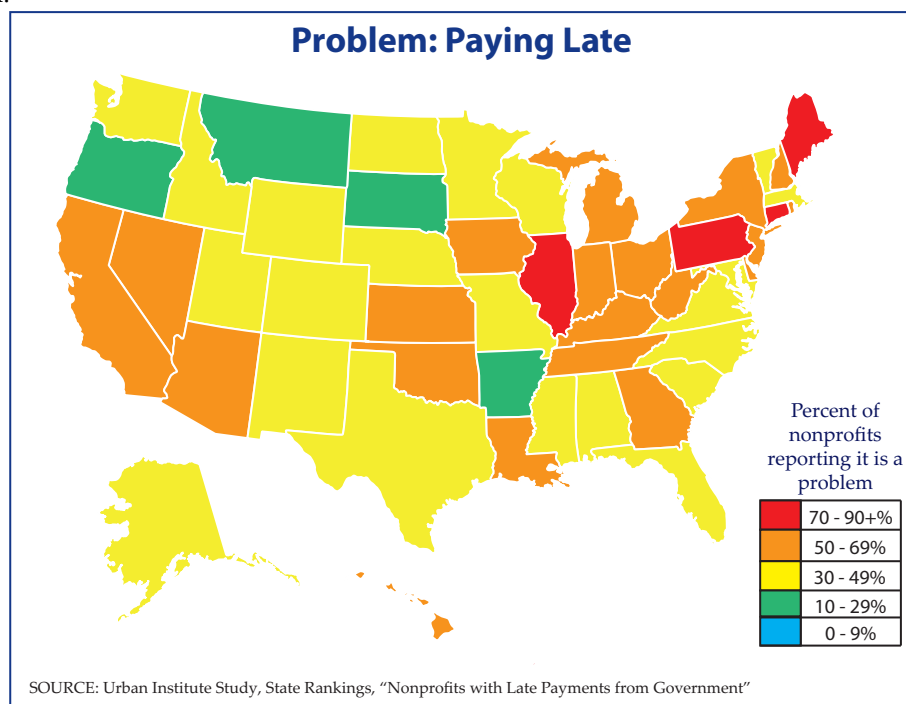
### How Governments Paying Late Hurts

Nationwide, nonprofits experiencing late payments from governments were 17% more likely to have to freeze or reduce their employees' salaries than nonprofits without this problem. (See Table 1)

- In Tennessee, as in many places, the impact of the payment problems is so great that nonprofits have to make painful decisions to stay afloat. A homeless prevention program in Tennessee recently reported “a fairly large number” of local residents had been evicted from emergency housing due to delays processing federal grants.<sup>47</sup>
- A Louisiana human services nonprofit official stated the problem succinctly: “It is critical that federal, state and local government agencies make payments in a timely matter. Delays in payments cause programs to suffer and severely hamper the efficacy of the funding in the first place. Everyone (funder, agency, and client) loses when payments are delayed.”<sup>48</sup>
- In New York, the Comptroller issued a report indicating these resulting burdens on nonprofits:
  - Missed payroll
  - Employees laid off
  - Reduction/elimination of service
  - Taking out loans<sup>49</sup>

### Where Governments Paying Late Is Happening

Nonprofits in Illinois reported this occurring the most, with more than eight out of 10 (83%) nonprofits there reporting that receiving late payments was a problem. About seven out of ten nonprofits in Maine, Connecticut, the District of Columbia, and Pennsylvania also identified late payments from governments as a problem.



**Table 3: Where Nonprofits Report Government Paying Late as Being a Problem**

SOURCE: Urban Institute Study, State Reports

<b>Level of Government Paying Late</b>	<b>Payments late by at least: 30 days</b>	<b>Payments late by at least: 60 days</b>	<b>Payments late by at least: 90 days or more</b>
<b>Federal Government in:</b>	Colorado, Hawai'i, Missouri, North Carolina, Pennsylvania, Texas	Alaska, California, Delaware, Georgia, Illinois, Mississippi, New Jersey, North Dakota	Alabama, Florida, Indiana, Kansas, Maryland, Massachusetts, Michigan, New York, Rhode Island, West Virginia, Wyoming
<b>State Government in:</b>	Alaska, Connecticut, Kentucky, Minnesota, New Mexico, Washington, West Virginia, Wisconsin	Delaware, Georgia, Indiana, Massachusetts, Missouri, Oregon, Tennessee	Alabama, California, Hawai'i, Illinois, Kansas, Louisiana, Maryland, Michigan, New Hampshire, New York, North Dakota, Oklahoma, Pennsylvania, Rhode Island, Utah, Vermont, Wyoming
<b>Local Government in:</b>	Florida	California, Georgia, Illinois, New Mexico, Ohio, Tennessee	Alabama, Connecticut, Maryland, Michigan, Nebraska, Nevada, New York, Pennsylvania, Rhode Island, Virginia

### Who Is Making Late Payments

The reports on late payments relate to all governmental entities in a state – local, state, and federal – and not just state governments. Nonprofits in half the states report that the federal government pays its contracts late – and the federal government pays 60 days or later in 19 states. (Of course, if individuals are late paying their taxes to the government, the government imposes a penalty – yet there is no equivalent penalty in many places when governments fail to pay their nonprofit partners on time.)

Even worse, at least 30 state governments paid their nonprofit partners more than 30 days late, including 17 states that paid 90 days or later. Local governments in 18 states paid late, including 90 days or later in 10 states. Deeper review of the data reveals curious patterns. For instance, nonprofits in eight states (Alabama, California, Georgia, Illinois, Maryland, Michigan, New York, Rhode Island) reported late payments of 60 days or more from all three levels of government. (See Table 3 above)

#### **4. Complexification of Contracting Application Requirements**

According to three out of four (75%) nonprofits nationwide with a government contract, the time required by the governments' complex and time consuming application processes is a problem.<sup>50</sup> To put things in perspective, consider how the Human Services Council of New York City focused the City's attention on the underlying problem of contracting complexity when it published the pamphlet, "New York's Human Services Providers Deserve a Parade, Not an Obstacle Course."<sup>51</sup>

##### **What Excessively Complex Application Processes Look Like**

Nonprofits report that state agencies in Maryland frequently do not issue solicitations far enough in advance to complete the bidding and evaluation processes before existing contracts expire. The dysfunctional system leads to short-term extensions of contracts and interruptions in service delivery. At times during extensions, funding levels remain frozen despite increased provider costs. Few nonprofits have the ability to continue offering the same services at the same level for an extended period of time.

The problem is compounded when the state does not pay providers during temporary contract extensions. One rape crisis center provided testimony to the Maryland Legislature stressing that an unfunded contract extension made it "difficult to serve victims when we don't know the status of our contracts and when or if we will be reimbursed. In the end, it's the victims of rape, domestic violence and child abuse who suffer."<sup>52</sup>

Finally, delays and increased administrative costs result when government contracting officials lack the subject matter knowledge to promulgate contracting documents that are tailored to the work being performed. Inexperience has led to including out-of-date federal audit requirements, contradictory definitions of the deliverables and dates of service in solicitations. Once mistakes come to light, new notices of funding availability are issued, thus causing a repeat of the bidding process. Providers have been required to submit and resubmit bids to proposals that must be altered numerous times in the process, costing unnecessary duplication of effort by both government and bidders. At worst, the knowledge gaps of state contracting officials result in the delivery of services that do not match the needs of clients or the expectations of the state agency.<sup>53</sup>

In Connecticut, nonprofits report that requests for proposals and any subsequent contract require human service providers to submit several pieces of standard information, such as their agency's contact information, workforce analysis, affirmative action plans, etc.<sup>54</sup> The lack of uniformity and coordination within government agencies duplicates costs at both ends – to the provider and reviewing state official.

These problems in contract administration are not new. A 2007 report of the Office of Legislative Auditor in Minnesota found many of the system shortcomings that the nonprofit human service providers have identified. The report states, "We evaluated how state agencies award and administer grants to nonprofit organizations and found policies and practices that were inconsistent and inadequate to ensure accountability." Among their findings:

- "The state's approach to managing grants to nonprofit organizations is fragmented and inconsistent, and does not provide adequate accountability."
- "Many state agencies have grant-making policies and procedures, but they vary considerably in the degree to which they provide oversight and accountability."
- "Agency oversight of grant recipients is especially weak when the Legislature selects and names a recipient in law, rather than allowing the agency to select the recipient."<sup>55</sup>

To its credit – and to the benefit of taxpayers and the people served by nonprofits – the state did follow the recommendations of the Legislative Auditor and created a Grants Management Office within the executive branch with authority to formalize and require agencies to follow best practices.

Especially troubling are reports from New York, where state employees told nonprofits they had to waive their statutory right to prompt contracting or prompt pay from the state. Mission-driven nonprofits, eager to provide needed services in the community, face a dilemma: do they agree to waive the rights that the state legislature has declared they are entitled to, or do they refuse and watch the state employee then award the contract instead to a nonprofit willing to waive its statutory right? This, unfortunately, is not conjecture; as the New York Comptroller found: nonprofits “are afraid not to sign waivers ... that they will lose funding entirely.”<sup>56</sup> One nonprofit leader commented that state agencies “put in a waiver of interest as an automatic part of contract. You have to sign it, saying it was reasonably delayed. I refused last year and it delayed my contract even more. The fear is always you make too much of a stink and they’re not going to contract with you.”<sup>57</sup> Once the state agency gets a nonprofit to waive its right by threatening to take away the contract, the state agency then gets to use the nonprofit’s money for a longer period of time than provided by elected policymakers.

In its recent report, GAO found, “The high costs of grant administration sometimes discourage nonprofits from applying for grant funds. Three nonprofits we interviewed reported that they do not seek additional government grants or may not reapply for grants they currently receive for this reason. ... Over half of the nonprofits in our study said that administrative reporting requirements make it challenging to administer grants they receive.”<sup>58</sup>

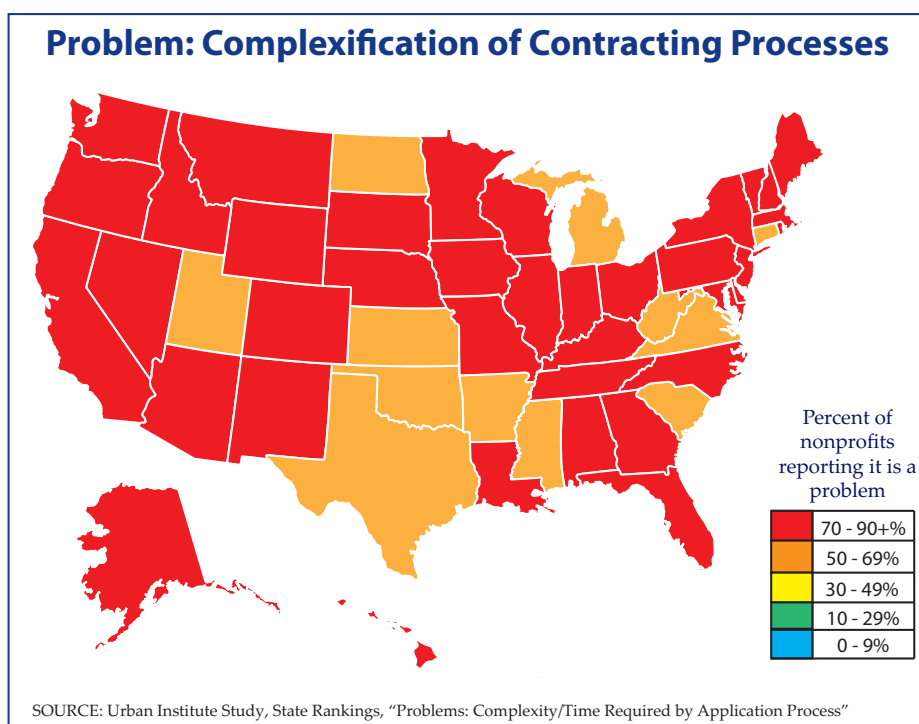
### How Excessively Complex Application Processes Hurt

Bidding burdens, needless red tape, and other government contracting policies and bidding practices routinely impose avoidable inefficiencies on nonprofits, thereby creating waste, eroding productivity by diverting staff time from serving individuals, and reducing the amount of services actually delivered to individuals and communities in need. Many of these complexities also add costs to taxpayers.

Streamlining the system of government contracting will restore taxpayer value by improving efficiency and lowering the costs for providing higher quality services to the people who need them most. But it will take a refocusing of priorities away from filling out paperwork in favor of producing results for people.

### Where Excessively Complex Application Processes Is Happening

The following map reveals how serious and pervasive this problem is, with more than one out of two nonprofits in *all* states reporting it is a problem. Indeed, even the “best” state (or “least worst” state) has a significant problem: **more than half** of Arkansas’s nonprofits (57.7%) report that governments’ processes in Arkansas for applying for grants and contracts create challenges.



## 5. Complexification of Contract Reporting Requirements

Three out of four nonprofits (76%) nationwide with a government contract reported that the complexity and time government imposed on them to report on contracts created problems. No nonprofit disputes the need for effective oversight and scrupulous accountability. Indeed, the nonprofit community as a whole succeeds only to the extent it earns and maintains public trust every day. However, when the contract reporting and oversight requirements become as extensive, duplicative, and inordinately costly as they are now – to the individuals being served, to taxpayers, and to the community as a whole – then something is seriously askew.

### What Excessively Burdensome Reporting Requirements Look Like

While determining whether a reporting requirement is “excessive” is generally a subjective exercise, some practices simply cannot stand up. Consider the following:

- One constant impediment is that different government agencies (and indeed, sometimes different offices within agencies) use inconsistent budget categories, meaning that financial records must be kept and reported in different ways to different agencies, diverting valuable resources to pure bureaucratic paperwork. Indeed, 76 percent of nonprofits reported this to be a problem when responding to the Urban Institute Study (at page 13).
- In 2009, Hawai’i stopped using an electronic billing system through which providers sent their invoices for services, and switched to an antiquated, offline billing system that requires organizations to use a modem. That change reportedly requires nonprofits to add the unreimbursed cost of hiring new billing staff to accommodate this out-of-date system, thus increasing costs and diverting resources away from program services.
- Nonprofits in Washington State have pointed out that most of the government agencies contracting with nonprofits each have separate databases. This has forced the nonprofits to divert staff time to re-enter the same data multiple times.

- Similarly, a multi-service provider in Illinois stated, “[I wish] we could consolidate databases to create efficiency.... We have to enter meals for child care into different systems for different funders even though it’s the same variable.”<sup>59</sup>
- In New York, employees of nonprofits have been fingerprinted multiple times by different departments.<sup>60</sup>

A persistent, but correctable, problem occurs in the area of financial audits of nonprofit organizations providing services on behalf of governments. Nonprofit contractors in Jacksonville, Florida report that city offices do not accept independent audits, and a single nonprofit contractor may have its financial records audited by multiple City auditors from different departments. This lack of coordination has not resulted in commensurate savings. At a certain point, everyone needs to recognize that spending certain dollars chasing possible pennies is not cost effective for taxpayers.

Reporting and oversight are essential. But at a certain point, everyone needs to recognize that spending certain dollars chasing possible pennies is not cost effective for taxpayers.

The New York Comptroller’s statewide meetings with nonprofits uncovered numerous examples of what can only be considered auditing overkill. One nonprofit official remarked: “Wave after wave of auditors on site is very disruptive to program operations. State agencies need to maximize and coordinate their oversight efforts and reduce the volume of these activities.” Another reported, “Different State agencies have literally audited the same patient chart in our agency.” And perhaps most instructive, “Whenever there is a funding crisis, government automatically takes an approach that there needs to be more accountability for reduced resources.”<sup>61</sup>

### How Excessively Burdensome Reporting Requirements Hurts

All of the practices discussed above divert resources (time and dollars) away from mission and towards the “empty calories” of excessive administrative activities. The diversion does not occur in a vacuum, however; services suffer and taxpayer expectations are dashed.

To illustrate, when one nonprofit added up the hours that staff members spent on reporting requirements for a particular government grant, the organization found that it was spending about 31 percent of the value of the grant on its administration. The government agency, however, would agree to reimburse the nonprofit for only 13 percent of the program’s indirect costs.<sup>62</sup>

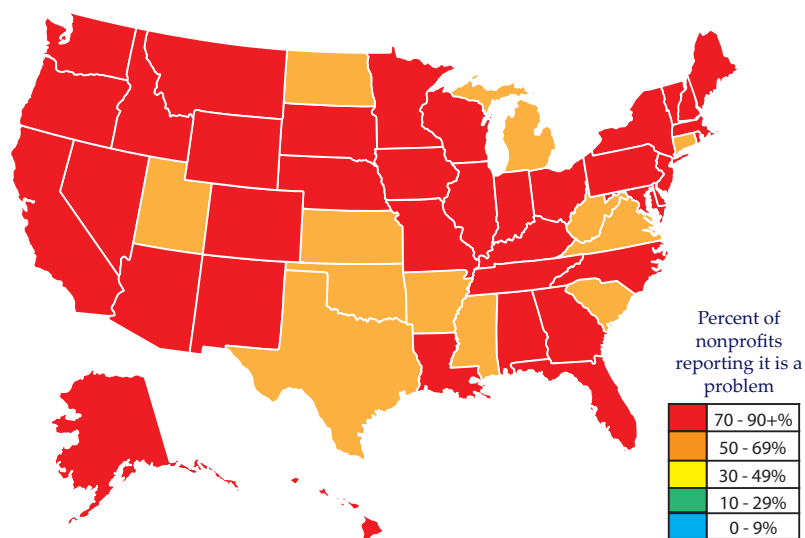
An alternative approach is necessary. Consider the well-reasoned views expressed in the “Partnership Principles for a Sustainable Human Services System” developed by the Donors Fund in Illinois:

*The emphasis should be on service quality and consumer outcomes. Government should direct more attention toward meeting the human service needs of consumers, rather than on managing service providers. Service providers should spend more resources and attention on meeting the human service needs of consumers rather than on paperwork.*<sup>63</sup>

### Where Excessively Burdensome Reporting Is Happening

The overwhelming red in the following map tells the real story: more than 7 out of every 10 nonprofits in 41 states and DC regard excessively burdensome reporting as a problem, and more than half the nonprofits in all states see this as a problem – for the nonprofits, those they serve, and taxpayers. Again, even the “best” state by comparison (or least worst) has a significant problem: **more than half** of Arkansas’s nonprofits (52%) report that governments’ processes in Arkansas for reporting on grants and contracts create problems.

### Problem: Complexification of Reporting Requirements



SOURCE: Urban Institute Study, State Rankings, "Problems: Complexity/Time Required for Reporting on Grants/Contracts"

### The Solutions: Getting to Win-Win-Win for Everyone

Although the convoluted "system" is multi-jurisdictional, multi-layered, and excessively complex, the solutions are fairly straightforward. Rather than requiring a big investment of money, most of the solutions can be achieved through intentional coordination and discipline in follow-through to make positive change for those being served, for taxpayers, and for the community at large.

Importantly, this call to action is not issued solely by nonprofits. Earlier this year the U.S. Government Accountability Office issued a similar call, on behalf of government:

*As the federal government increasingly relies on the nonprofit sector to provide services, it is important to better understand the implications of reported funding gaps, such as compromised quality of important administrative functions, including information technology, human resources, legal, and accounting operations. ... Collectively, these challenges potentially limit the sector's ability to effectively partner with the federal government, can lead to nonprofits providing fewer and lower-quality federal services, and, over the long-term, could risk the viability of the sector.<sup>64</sup>*

### Step One: Engage in Collaborative Dialogue for Solutions

To solve a problem, first there must be recognition that a problem exists, then a defining of the nature, scope, and scale of the problem, and finally development of a coordinated plan for corrective action. The first positive step should be creation of a mechanism for meaningful dialogue between governments and nonprofits, which are natural partners given that we serve the same communities and same constituents. Just as the best solutions will vary from jurisdiction to jurisdiction, no single approach exists. Currently, efforts are underway in various places that could serve as models elsewhere. Here are a few such collaborative efforts:

- **Connecticut:** In 2010 Connecticut passed a law establishing the Commission on Nonprofit Health and Human Services that brings together legislators, state commissioners, and nonprofit executives to “examine the funding provided to nonprofit providers of health and human services under purchase of service contracts.”<sup>65</sup> The Commission, which includes representatives of nonprofits, will collect and analyze data and issue a preliminary report on findings and recommendations to the General Assembly by January 1, 2011, and a final report by April 1, 2011.
- **Illinois:** The Donors Forum in Illinois (with support from the Wallace Foundation) has developed *Fair and Accountable: Partnership Principles for a Sustainable Human Services System*, which “recommends practices that should be followed when the City of Chicago or State of Illinois contract with nonprofits to provide human services ... to help ensure that Illinois residents have access to high-quality human services that meet their needs.”<sup>66</sup> As the Donors Forum states in its report, “Many of the concepts could be well applied to other nonprofit services and programs that receive government funding, including – but not limited to – the arts, economic development, health care, and programs that promote volunteerism and community service.”<sup>67</sup>
- **Maine:** The Maine Association of Nonprofits (with support from the JTG Foundation) recently created an environment for human service providers, funders, government staff, and elected and appointed officials to come together to build common ground and share values around mission and service. Their first convening on September 22, 2010, was designed to develop stronger partnerships and a long-term strategy for adapting the systems for providing services to Maine’s most vulnerable populations.
- **New York City:** Mayor Bloomberg’s Administration has stepped forward with an innovative Nonprofit Initiative to address the challenges of increased demand for services and declining resources. The Nonprofit Initiative focuses on “reducing the fixed costs of nonprofit organizations, enhancing the responsiveness and efficiency of City contracting procedures and facilitating a new partnership for stronger nonprofit management and governance.” This comprehensive effort to streamline contracting with nonprofits arose out of a smaller (and successful) effort to wring costs out of the system so New York City could afford cost of living adjustments for nonprofit providers.<sup>68</sup>

### Specific Action Steps to Achieve “Win-Win-Win” Solutions

Before turning to specific action steps, it is important to remember not to get pulled into the normal “blame game” of pointing fingers at government to accuse current office holders or administrations, at any level of government, of being responsible for the problems. These problems have been brewing for decades. The pertinent issue is not “who” got us here, but “who” has the courage to help lead us out of the mess and “how” do we change the system so it performs smoothly.

Also, we invite readers to (a) go to [www.councilofnonprofits.org/govtcontracting](http://www.councilofnonprofits.org/govtcontracting) to review additional recommendations and (b) send us your ideas for solutions so we can develop a centralized resource for governments and nonprofits across America to help them streamline their processes so they can more efficiently and effectively serve those in need.

## Solutions the Federal Government Can Focus On

### What Congress Can Do

- **Enact the *Nonprofit Sector and Community Solutions Act*.** Enacting the bipartisan H.R.5533 would create for the first time in American history a central place for the nonprofit community to raise important issues that cut across many federal departments and establish a forum within the federal government to review these important issues. With nonprofit employees comprising almost 10% of America's workforce, it is well past time for federal (as well as state and local) policymakers to recognize that government – which relies so heavily on the nonprofit sector – should be concerned about the health and well-being of the nonprofit sector.
- **Mandate that federal pass-through dollars actually pass through fully to the deliverer of services.** The revelation in the recent Government Accountability Office report (GAO-10-477) that state governments take a slice of federal dollars designated for federal programs underscores the lack of coordination of federal funding for vital programs: nonprofits in Wisconsin can get 14% for indirect costs they incur to run the federal program, while nonprofits in Louisiana running the same federal program can receive only 9% because the state takes money for itself, whereas a nonprofit in Maryland gets absolutely nothing for the indirect costs it incurs because of Maryland's internal practices.<sup>69</sup> Congress should prevent federal resources from being siphoned away from delivery of the actual services.

### What the Office of Management and Budget Can Do

- **Clarify Recoverable Costs.** Follow up forcefully to the GAO's recommendation issued last May by doing more than simply convene a meeting "to clarify and improve understanding of how nonprofit's indirect costs should be treated." The problem is rooted in widespread confusion over terminology. As one respected study notes, there needs to be "a standard definition of the term overhead. Currently organizations have to report their overhead differently for nearly every grant that they receive. Standardization would allow funders [government and private alike] to compare apples to apples."<sup>70</sup> The solution will not rest in simply repeating the words to people, because of the various conflicting definitions and interpretations of "administrative costs," "indirect costs," and "overhead costs." Given the enormity of the dollars involved, OMB should commit to developing uniform standards that all recipients of federal funds – state and local governments and their nonprofit partners – must follow.

### What the White House Can Do

- **Establish a Commission on Cross-Sector Solutions.** The initial version of the Serve America Act called for creation of a Commission on Cross-Sector Solutions to America's Problems that would identify problematic processes, procedures, and practices to free up resources (funds and organizational time) for governments, businesses, and nonprofits. One such way would be a simultaneous examination of federal regulation and reporting regimens, many of which are unnecessary, duplicative, and at times even contradictory. Times like this call for reexamination and transformation of existing arrangements so they produce meaningful outputs. By eliminating counter-productive and the least-productive elements of government conditions attached to contracts with nonprofits, the Commission can promote wise stewardship of limited resources.

## Solutions That State Governments Can Focus On

### What the Executive Branch in Each State Can Do

- **Provide Leadership.** The residents of each state deserve a government that is held to the highest standards of accountability, efficiency, and compliance with the laws. The Governor and all of the state's constitutional officers should commit to providing the leadership necessary to comply with the contracting laws already on the books, including prompt payment requirements, and to hold agency heads accountable for improving the performance and efficiency of their agencies.<sup>71</sup>
  - Compared to other states, New York has the best package of laws on the books concerning prompt contracting and prompt payments to nonprofit contractors. Yet the state's record in complying with its own laws is abysmal: the state's own Comptroller has issued reports documenting how the state's contracts were completed late almost 92.5% of the time, and even detailed instances when government agencies paid years late, forcing nonprofits to effectively bankroll government operations.<sup>72</sup> So just having good laws on the books is not enough; there must be commitment from Governors and constitutional officers to honor and strictly enforce the state's obligations under written agreements.
- **Provide an Integrated Procurement System.** Replace the broken happenstance "system" with one that has been designed purposefully. States should consolidate the contracting, oversight, and payment functions into an integrated procurement system. Designed correctly, an integrated system would enhance public transparency, cost effectiveness, and time efficiency, helping those receiving services and taxpayers paying for the system. An advanced model of a highly integrated system is being developed in Florida ([MyFloridaMarketPlace](#)) that automates the state's order, approval, invoicing, and payment process. Other models showing some success exist in Virginia ([eVA](#)) and Wisconsin ([VendorNet](#)). Likewise, in cooperation with the nonprofit human services community, New York City is developing the [Health and Human Services Accelerator](#) that aims to centralize document management, speed the selection process, standardize contracts, and regulate post-award actions.
- **Use a Document Vault.** States should eliminate redundancy in the application and reporting processes by creating an electronic "file cabinet" to centrally house all documents relevant to bids for contracts, and to which each contracting agency would have access. New York City is pioneering the [document vault](#) approach. The creation of a document vault would lessen the administrative burden of multiple document requests because nonprofits would have to submit only once their organizational, integrity, and fiscal documents, such as their IRS tax-exemption determination letter and Form 990, and the unified, online filing and retrieval system would ease the burden of various state agencies that could call up the information as needed rather than have to maintain their own duplicative receipt, cataloguing, filing, and retrieval processes.
- **Streamline Auditing Requirements.** Governmental agencies should coordinate their efforts by designating a lead agency for conducting audits in order to avoid repeated and unnecessary audits, and to reduce interruptions in nonprofit program services. Governmental agencies should also share the results of audits with each other, both to enhance understanding of the work of the nonprofits, as well as to strengthen intergovernmental communications and efficiency.
- **Offer Electronic Fund Transfers.** Governmental entities should offer payments to their nonprofit contractors through electronic fund transfers (EFT) instead of credit cards that take money from

nonprofits and those they serve via the interstate transaction swipe fee. Moreover, governments should not charge a set-up or administrative fee for implementing this cost-saving measure.

- **Utilize an Ombudsman Program.** Each state should explore with the nonprofit State Association the creation of an ombudsman for government contracting who will serve as an intermediary and advocate for contractors. The ombudsman position could be created as a state official (as in Florida)<sup>73</sup> or a State Association employee (as in New York).<sup>74</sup>

### What the Legislative Branch in Each State Can Do

- **Reform Prompt Payment Penalties.** Each Legislature should require state and local governments to reimburse nonprofit contractors for a statutory substantial late-payment interest penalty or their actual costs of securing credit as they await payments from the government, whichever is greater, and provide mechanisms so these laws can be strictly enforced.
- **Extend State Prompt Payment Laws to Counties and Cities.** Legislatures should extend state prompt payment laws to the counties and cities to ensure that the state and its political subdivisions all honor their written commitments and treat nonprofit contractors fairly. These laws also should be strictly enforced.
- **Stop Taxing Tax-Exempts.** States should refrain from imposing administrative fees and other assessments and practices against tax-exempt contractors in recognition of the reality that the nonprofits are, by definition, not earning a profit on the contract and are performing services that otherwise would be the responsibility of government. Several states impose an administrative fee that all contractors must pay to fund oversight and contract administration. The concept of an administrative fee is particularly onerous in the area of human services because the governments typically dictate the reimbursement rates, limit indirect costs, and do not allow profits from which the fee could be drawn. Likewise, the mandatory procurement card payment practices of North Carolina, Virginia, and other states forces nonprofits to pay interchange or “swipe” fees of 2% to 3% to banks for the privilege of being paid by credit card. In both cases, money diverted to fees is taken out of program services, thus shortchanging the people the contracts are intended to serve.

### Solutions That Nonprofits Can Focus On

#### What Individual Nonprofits at the Local Level Can Do

- **Act Responsibly.** Although the vast majority of nonprofits do their very best to comply with government requirements, all nonprofits must make renewed efforts to ensure we all are complying with contract requirements.
- **Just Say No.** Nonprofits must learn to refuse contracts that are not manageable or cost effective.
- **Stand Up for Those You Serve.** Successful advocacy does not always have to be confrontational. Nonprofits need to recognize that policymakers frequently are willing to engage them in crafting solutions. Consider this recent development at the local level: When Tucson nonprofit leaders expressed concern about how proposed budget cuts would harm the people they serve, the City Manager asked the nonprofit community to suggest an alternative way for the city to consider human services funding in light of reduced revenues. Working together, community nonprofits and the city developed a three-tiered plan to prioritize resource allocation.<sup>75</sup> On the flip side, however, many have observed that for too long, too many nonprofits have sat quietly on the

sidelines, adopting a mentality of “don’t bite the hand that feeds you” – even if that hand is not feeding you and may be hurting you. Nonprofits need to understand that accepting bad contracting practices is a form of enabling the shortchanging of those you serve. Few nonprofits would consider filing a lawsuit against the government, and the National Council of Nonprofits is not encouraging lawsuits as a standard practice. But nonprofits need to recognize that they have enforceable rights, too, and they may need to turn to the courts to stop the most egregious practices.

- **Speak Up for Your Government Partners with Whom You Serve.** Fortunately, many government officials and employees understand the challenge and have taken personal action to honor written agreements and ensure prompt payment. Unfortunately, these faithful public servants rarely receive the positive recognition they deserve for doing their jobs fairly and with integrity. Rather than pointing an accusing finger towards government, we all should look for opportunities to reach out, privately and publicly, to express our gratitude for those who do their jobs well.
- **Share Your Stories and Ideas.** If you have had a positive or negative experience with government-nonprofit contracting, or if you have ideas for solutions, please share them with us by sending them to [www.councilofnonprofits.org/share-your-story](http://www.councilofnonprofits.org/share-your-story) or [www.govtcontracting.org/share-your-story](http://www.govtcontracting.org/share-your-story)
- **Join for Collective Protection and Voice.** All nonprofits are invited to join their nonprofit State Association,<sup>76</sup> because the more voices we have around our collective policy table in each state, the better we can amplify our collective concerns and solutions. By joining other nonprofits in your state through your State Association you can participate in tracking trends, developing strategies, coordinating activities, and whenever possible working in partnership with government to change counterproductive policies and practices and implement solutions that best serve the people and communities in your state.

#### What State and Local Nonprofit Associations Can Do

- **Establish Partnerships.** Nonprofit State Associations and other nonprofit organizations should continue to reach out to governments to establish cooperative relationships through which the parties, as partners, work through practical, procedural, and fiscal problems and together develop solutions that ensure people get the services they need when they need them, taxpayers receive full value for the programs they are funding, and communities are strengthened. Donors Forum in Illinois pioneered an excellent model for collaboration and problem solving by the public and private sectors, which has culminated in the highly endorsed [Partnership Principles for a Sustainable Human Services System](#). Successful partnerships have also been established in Connecticut, Maine, and New York City.

#### What National Nonprofits Can Do

- **Best Practices Task Force.** The National Council of Nonprofits and other nonprofit partners will establish a Task Force to review and report on practices initiated by nonprofits and governments that promote the three interrelated values of ensuring that services are available to those who need them when needed, of streamlining government so that taxpayers receive the full value of the programs they are funding, and of strengthening communities as a result.
- **Promote Ongoing Research.** The nonprofit and philanthropic community as a whole should commit to identifying and funding research into the problems that nonprofits are experiencing in

contracting with governments and solutions or best practices that have proven records of success in expanding quality services, saving taxpayer money, and strengthening communities through a vibrant nonprofit sector. While the Urban Institute's prodigious efforts have resulted in a deeper understanding of governmental contracting problems, this initial research focused exclusively on human service nonprofits. Reports from government, the media, and the National Council's own research suggests that these problems are also prevalent in other subsectors.

### Solutions That Funders Can Focus On

- **Support Needed Research.** The research conducted to date, while raising awareness about what is wrong with current practices in government contracting with nonprofits, does not go far enough. To leverage philanthropic giving, invest in research to help governments and nonprofits understand the scope of the problem and find solutions. We do not currently have data to know whether, for instance, arts and cultural groups, environmental groups, or nonprofits providing health care face similar or different challenges from those reported in the first national study conducted by the Urban Institute.
- **Encourage Grantees First to Understand, and Then to Report to Their Funders the Full Cost of Providing Services to Local Communities.** Many nonprofits do not have the capacity needed to determine the full cost of service delivery. Help build the capacity of your grantees to calculate the true cost of service delivery so that they can be informed when they negotiate with their government partners for the cost of delivering programs in local communities.
- **Understand Your Grantees' Plight.** Until governments pay the full cost of service delivery, your grantees will have shortfalls in their impact and their budgets. Grantees will require assistance with business planning and capacity building so that they can sustain the delivery of needed services in local communities – and your investment in them can bear fruit.
- **Provide Direct Support for Infrastructure Groups.** Help State Associations work to find solutions to these challenges that affect your grantees in their states and in their local communities.

### Solutions That Citizens Can Focus On

- **Lift Your Voice.** Ask the individuals running for Governor and the legislature what meaningful actions they will take if elected to correct this long-standing problem.
- **Express Your Expectations.** Ask them why your state does not have a cabinet-level official or a legislative committee focused on the health of the nonprofit sector, which employs about 10 percent of America's workforce.

### **Conclusion: Drift Aimlessly or Drive Purposefully?**

Alarmingly, the Urban Institute Study reveals that the social safety net upon which so many Americans rely right now is deteriorating rapidly, as the problems are growing worse, not better. On a nationwide basis only 5 percent said things were better in 2009, 64 percent indicated nothing had changed, and 31% reported that things were actually worse than in years past.<sup>77</sup> Nonprofits in all states reported absolutely no improvements at any level of government (Alabama, Delaware, D.C., Hawai'i, Iowa, Kentucky, Nevada, Oregon, Utah, Virginia, and West Virginia).<sup>78</sup> Perhaps most distressing, however, is that nonprofits in seven states reported that conditions are more than 40% worse than in the past:

- Illinois: 57% worse than in prior years
- Hawai'i: 56% worse
- Iowa: 45% worse
- Pennsylvania: 45% worse
- Kansas: 43% worse
- Nevada: 41% worse
- North Carolina: 41% worse

With the availability of this new data, the question presented to the American people – and our policymakers – is whether we want to continue drifting aimlessly as the broken “system” continues to erode in ways that hurts everyone – the people who need services, taxpayers paying for services, funders, nonprofits both with and without government contracts, private businesses in the economy, and the public at large that wants its public institutions to live up to their written agreements. Or will we roll up our sleeves and purposefully drive reform to correct the system? The choice is ours, collectively.

\* \* \*

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The National Council of Nonprofits, the nation's largest nonprofit network, works through its member State Associations to amplify the voices of America's local community-based nonprofit organizations, help them engage in critical policy issues affecting the sector, manage and lead more effectively, collaborate and exchange solutions, and achieve greater impact in their communities. Visit our website at [www.councilofnonprofits.org](http://www.councilofnonprofits.org).

To comment on this report or share any government actions and policies that are affecting your nonprofit, positively or negatively, please go to our dedicated web portal on this topic, at [www.councilofnonprofits.org/govtcontracting](http://www.councilofnonprofits.org/govtcontracting)

## Endnotes

- <sup>1</sup>Elizabeth T. Boris, Erwin de Leon, Katie Roeger, Milena Nikolova, *Human Service Nonprofits and Government Collaboration: Findings from the 2010 National Survey of Nonprofit Government Contracting and Grants* (Urban Institute Center on Nonprofits and Philanthropy) (2010) (hereinafter “Urban Institute Study”); <http://www.govtcontracting.org/sites/default/files/Full%20Report.pdf>. See also Urban Institute Briefing <http://www.govtcontracting.org/sites/default/files/Brief.pdf> and State Profiles <http://www.govtcontracting.org/sites/default/files/State%20Profiles.pdf>
- <sup>2</sup> Illinois Office of the Comptroller, Daniel W. Hynes, via Freedom of Information Act Request submitted by Heartland Alliance for Human Needs & Human Rights; <http://www.illinoispartners.org/sites/default/files/Tax%20Exempt%20Orgs%20Awaiting%20Payment%20as%20of%20July%202012%2010.pdf>
- <sup>3</sup> Office of the State Comptroller, State of New York, *Prompt Contracting Annual Report Calendar Year 2009* [http://www.osc.state.ny.us/reports/fiscal/contract\\_annualreport10.pdf](http://www.osc.state.ny.us/reports/fiscal/contract_annualreport10.pdf)
- <sup>4</sup> U.S. Government Accountability Office, *Treatment and Reimbursement of Indirect Costs Vary Among Grants, and Depend Significantly on Federal, State and Local Government Practice*, GAO 10-477 (May 2010) at pages 10-12. <http://www.gao.gov/new.items/d10477.pdf>
- <sup>5</sup> Sherlock and Gravelle, *An Overview of the Nonprofit and Charitable Sector* (November 17, 2009) at page 35; <http://www.councilofnonprofits.org/sites/default/files/CRS%2011.17.09%20report%20An%20Overview%20of%20the%20Nonprofit%20and%20Charitable%20Sector.pdf>
- <sup>6</sup> Carol J. De Vita and Eric C. Twombly, “Nonprofits and Federalism,” chapter 7 in *Nonprofits & Government: Collaboration & Conflict*, edited by Elizabeth T. Boris and C. Eugene Steurle (2<sup>nd</sup> ed. 2003; Urban Institute) at 259(emphasis added); see also Steve Rathgeb Smith, Michael Lipsky, *Nonprofits for Hire: The Welfare State in the Age of Contracting* (Harvard University Press 1993) (“Although government funding of nonprofit service organizations dates to the colonial period, only in the last 25 years did this government-nonprofit strategy emerge as a widespread and favored tool of public service delivery”) at page 11.
- <sup>7</sup> See [A Respectful Warning Call to Our Partners in Government: The Economic Crisis Is Unraveling the Social Safety Net Faster Than Most Realize](#) (National Council of Nonprofits, August 2009), and [State Budget Crises: Ripping the Safety Net Held by Nonprofits](#) (National Council of Nonprofits, March 2010).
- <sup>8</sup> Urban Institute Study at page 10, Figure 6.
- <sup>9</sup> Smith and Lipsky, *Nonprofits for Hire*, at pages i and ii. The authors proved prescient with some of their questions, including this one (at page 13):
- [E]conomic downturns at the state or federal levels may result in cutbacks and the subsequent demise of nonprofit agencies as they fail to replace large parts of their program [funding]. During the Great Depression many nonprofits experienced severe difficulties because of the loss of income and increased demand. We should inquire whether the increased dependence of nonprofits on contracting poses similar concerns.*
- <sup>10</sup> Michael Cooper, [“Governments Go to Extremes as the Downturn Wears On,”](#) *New York Times* (August 6, 2010); see also U.S. Government Accountability Office, *State and Local Governments: Fiscal Pressure Could*

*Have Implications for Future Delivery of Intergovernmental Programs*, GAO-10-899 (August 2010) (“closing the fiscal gap over the next 50 years would require action ... equivalent to a 12.3 percent” increase in revenue or reduction in expenditures); Mary Williams Walsh, “[Cities in Debt Turn to States, Adding Strain](#),” *New York Times* (October 5, 2010) (“Across the country, a growing number of towns, cities and other local governments are seeking refuge in [distressed cities programs] as alternatives to federal bankruptcy court”); Paul Krugman, “[America Goes Dark](#),” *New York Times* (August 9, 2010); editorial, “[Latest Bailout to States Doesn’t Begin to Address Multiple Fiscal Nightmares](#),” *The Columbus Dispatch* (Ohio; August 15, 2010). Additional looming government budget stressors include:

- *Federal: deficit, Medicare, and Social Security.*
- *State & local underfunded public pension plans; see, e.g.,* Ron Lieber, “[Battle Looms Over Huge Costs of Public Pensions](#),” *New York Times* (August 6, 2010) (the “seemingly guaranteed and ever-escalating monthly pension benefits” of state and municipal retirees “are breaking budgets nationwide,” at a projected amount of at least one trillion dollars); Mary Williams Walsh, “[Pension Fraud by New Jersey Is Cited by S.E.C.](#)” *New York Times* (August 19, 2010) (in its first action ever against a state, the S.E.C. – to “send a message to other states or local governments” – charged New Jersey with securities fraud for claiming it had funded public pension plans properly when it had in fact failed to do so); GAO Report 10-899 (“state and local governments experienced a decline in pension asset values of 27.6 percent” from the end of 2007 to the end of 2008) at page 30; Jeannette Neumann, Michael Corkery, Marcus Walker, “[Stressed States Are Forcing Workers to Retire Later](#),” *Wall Street Journal* (August 2, 2010); [The Trillion Dollar Gap: Underfunded State Retirement Systems and the Road to Reform](#), Pew Center on the States (February 2010)
- *States’ underfunded unemployment trust accounts; see, e.g.,* Joey Peters, “[A Growing Pile of Debt for State Unemployment Insurance Programs](#),” Stateline (The Pew Center on the States; August 4, 2010) (reporting that 31 states have borrowed more than \$40 billion from the federal government because their unemployment trust funds are depleted, which further mires those states in debt and deficit modes)
- *State and local unrepaid and inadequate public infrastructure for basic utilities (e.g., water and sewage) and safe transportation (e.g., bridges, highways, and public transit systems); see, e.g.,* Ezra Klein, “It’s the Perfect Time to Invest in ... Infrastructure,” *Washington Post* (October 3, 2010) at G-1 (“The society of Civil Engineers gave your infrastructure a D grade and estimated that you need to make more than \$2 trillion in repairs and upgrades”; Slate, “[One Quarter of America’s Bridges Declared Unsafe or Obsolete](#)” (July 19, 2010) (“Of the more than 600,000 bridges around the United States, more than 25 percent, or 151,394 of them, have been declared either ‘structurally deficient’ or ‘functionally obsolete’ by the U.S. Department of Transportation,” and it will cost an estimated \$650 billion to fix them) and Jeremy Herb, “[150,000 U.S. Bridges Still Rated ‘Deficient’](#),” *Minneapolis Star-Tribune* (July 21, 2010); GAO-10-899 (“Estimates of the costs to repair, replace, or upgrade aging infrastructure so that it can safely, efficiently, and reliably meet current demands, as well as expand capacity to meet increasing demands, top hundreds of billions of dollars. Addressing these challenges is complicated by breadth of the nation’s physical infrastructure – including aviation, highway, transit, rail, water, and dam infrastructure”) at page 30.

<sup>11</sup> Urban Institute Study, Figure 11: Nonprofits reporting problems with governments altering existing written agreements reduced their programs or services 26 percent of the time, compared to the 16 percent reduction rate by nonprofits reporting no contract change problems.

<sup>12</sup> Urban Institute Study, Figure 10: Nonprofits reporting late government payments as a problem reduced their programs or services 25 percent of the time, compared to the 16 percent reduction rate by nonprofits reporting no late payment problems caused by government.

<sup>13</sup> Elliot Pagliaccio, Assistant Comptroller of New York, “Summary of Notes Taken from Statewide NFP Forums,” (June 14, 2010) (hereinafter “Pagliaccio”) at page 4. The New York Comptroller’s Office conducted field research and documented the following insights from nonprofits:

- Several different state agencies contracting with the same nonprofit send their own audit teams out to audit the same nonprofits, often reviewing the same paperwork, instead of having one state agency assigned as the lead and sharing its audit results with other state agencies.
  - “Multi-funded [nonprofits] should get coordinated monitoring and auditing by State agencies and/or a lead State agency should be designated. [It’s a] waste of State resources to look at the same thing multiple times.”
  - “Different State agencies have literally audited the same patient chart” of nonprofits.
  - “Wave after wave of auditors on site is very disruptive to program operation. State agencies need to maximize and coordinate their oversight efforts and reduce the volume of these activities.”
- Several different state agencies contracting with nonprofits maintain their own fingerprinting program with separate systems, paperwork, employees, management, storage, retrieval, oversight, and other components then each taking, checking, recording, storing, and otherwise dealing with the same nonprofit employee, rather than having one lead state agency sharing the data with other state agencies.
  - “We have been fingerprinted multiple times by different State agencies. Can this be done once and shared by State agencies?”
- Each of several different state agencies – and too often each bureau, office, and subcomponent of the same state agency – draw up its own contracts that then have to be reviewed, revised, and approved by one or more government lawyers, instead of having one master contract that addresses the base elements on a consistent basis.
  - “It seems that every [state agency] funding ‘silo’ has its own infrastructure of attorneys and contract managers. Each contract seems to go through multiple levels of review and in many instances, requests for information for the contract duplicate and triplicate information already provided through funding or grant requests. There does not appear to be set standards for contract development/review – each attorney or contract manager seems to be able to assert individual bias into the process.

<sup>14</sup> Kennard T. Ward, Katie L. Roeger, Thomas H. Pollak, *The Nonprofit Sector in Brief: 2010* (Urban Institute), Figure 2, page 3. Although the terms “contracts” and “grants” can have technical differences in each jurisdiction, both really provide a way for governments to pay nonprofits to do certain work on behalf of the government. A government “grant” is not a free gift for nonprofits to spend as they wish. Rather, it remains a contractual obligation to do certain things. Indeed, in many ways government contracts and grants is a subset of the way nonprofits are paid fees-for-services provided.

<sup>15</sup> See, e.g., The Virginia G. Piper Charitable Trust: “11 Arizona Funders contribute more than \$1 million for second year of basic needs funding,” March 23, 2010 (regarding special fund created to help meet critical emergency housing and food needs in Maricopa County; normally, the Piper Trust focuses on healthcare and medical research, children, older adults, arts and culture, education, and religious organizations.) <http://www.pipertrust.org/enewsletter/articles/Mar2010BasicNeedsFunding.html>; see also “The Economic

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Health and Impact of Nonprofits in Connecticut: How a strong partnership between nonprofits and the state creates a better Connecticut” (Connecticut Association of Nonprofits 2010) (in Connecticut, a recent survey found that 12 percent of nonprofits reported losing funding opportunities because a funder had a “shift in giving priorities/other causes seen as more important”) at page 3.

<sup>16</sup> See, e.g., The Community Foundation of Greater Atlanta [Nonprofit Loan Fund](#), Denver Foundation’s [Colorado Nonprofit Loan Fund](#), Nonprofit Finance Fund [Working Capital Loan Fund](#), and Northern California Grantmakers [Emergency Loan Fund](#).

<sup>17</sup> See, e.g., 2009 studies by Bridgespan Group, Guidestar, and the Johns Hopkins University Listening Post, as reported in our Special Report Number 9, “[Strategies Being Used by Nonprofit Leaders to Cope with the Nation’s Economic Crisis](#)” (National Council of Nonprofits; August 2009). Also, consider the state-specific studies cited in our Special Report Number 8, “[A Respectful Warning Call to Our Partners in Government: The Economic Crisis Is Unraveling the Social Safety Net Faster Than Most Realize](#)” (August 2009), showing that the crowding out factor was having a significantly worse impact on the sector as a whole: Colorado (arts and cultural nonprofits experienced more financial challenges than other nonprofits); Idaho (24% of nonprofits reported reducing their programs and services, and 23% reported reducing their staff); Louisiana (35% were cutting staff, and 26% were cutting programs); Michigan (56% of nonprofits reported reducing the number of their employees); Minnesota (34% of nonprofits had reduced programs, and 27% had reduced full-staff staff and another 18% had reduced part-time staff); and New Jersey (34% had cut staff or planned to do so).

<sup>18</sup> *An Overview of the Nonprofit and Charitable Sector*, Congressional Research Service (November 17, 2009) at pages 19-2; <http://www.fas.org/sgp/crs/misc/R40919.pdf>.

<sup>19</sup> Ann Goggins Gregory and Don Howard, “The Nonprofit Starvation Cycle,” *Stanford Social Innovation Review* (Fall 2009) at 50.

<sup>20</sup> *Id.* at 49-50 (“Organizations that build robust infrastructure – which includes sturdy information technology systems, skills training, fundraising processes, and other essential overhead – are more likely to succeed than those that do not. This is not news, and nonprofits are no exception to the rule”).

<sup>21</sup> Government Accountability Office, *Nonprofit Sector: Treatment and Reimbursement of Indirect Costs Vary among Grants, and Depend Significantly on Federal, State, and Local Government Practices*, Report GAO-10-447 (May 2010) (“GAO found differences in the rate in which state and local government reimburse nonprofits for indirect costs. These differences, including whether nonprofits are reimbursed at all, largely depend on the policies and practices of the state and local governments that award federal grants to nonprofits. ... [S]ome state and local governments do not reimburse these costs at all. ... As a result, GAO found that variations in indirect cost reimbursement exist ... within the same grant across different states.”) at page i.

<sup>22</sup> *Id.* at page 7.

<sup>23</sup> *Id.* at page i.

<sup>24</sup> *California Alliance of Children and Family Services v. Allenby* (No. C-06-4095-MHP\*2)(Feb. 23, 2010), available at <http://www.cacfs.org/materials/Final%20Judgment%202-24-10.pdf>

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<sup>25</sup> “The Economic Health and Impact of Nonprofits in Connecticut: How a strong partnership between nonprofits and the state creates a better Connecticut” (Connecticut Association of Nonprofits 2010) (Connecticut Report) at page 7.

<sup>26</sup> EOHHS Report to Administration and Finance: Recommendations for Reforming the Purchase of Service System, Executive Office of Health and Human Services, Commonwealth of Massachusetts (January 2008).

<sup>27</sup> Urban Institute Study, Table 3.

<sup>28</sup> This issue of requiring nonprofits to go out to raise even more money to subsidize government operations becomes even more pertinent as different jurisdictions eye creative ways to tax nonprofits, be it through attempts to repeal tax exempt status altogether, impose PILOTS (Payments-In-Lieu-Of –Taxes), or exact new fees designed to evade tax exemptions guaranteed in state constitutions, such as light pole fees. See, e.g., *Nonprofits object to Minneapolis’ streetlight fees, feeling ‘death by a thousand cuts,’* MinnPost.com (October 29, 2009)

[http://www.minnpost.com/stories/2009/10/29/12959/nonprofits\\_object\\_to\\_minneapolis\\_streetlight\\_fees\\_feeling\\_death\\_by\\_a\\_thousand\\_cuts](http://www.minnpost.com/stories/2009/10/29/12959/nonprofits_object_to_minneapolis_streetlight_fees_feeling_death_by_a_thousand_cuts)

<sup>29</sup> National Association of State Procurement Officials, *State and Local Government Procurement*, 2008.

<sup>30</sup> North Carolina General Contract Terms and Conditions, available at

[http://www.wcu.edu/WebFiles/WordDocs/NC\\_General\\_Contract\\_Terms\\_and\\_Conditions.doc](http://www.wcu.edu/WebFiles/WordDocs/NC_General_Contract_Terms_and_Conditions.doc)

To avoid losing so much money from the mandatory p-card swipe fee, a nonprofit in another state reported that it stopped taking credit card payments, which meant that it had to relinquish its ability to accept contributions via the internet.

<sup>31</sup> Tina Trenkner, “[Taking a Swipe at Card-Swiping Fees](#),” *Governing* (August 2010) (Vermont Legislature unanimously passed law to give the state’s retailers more options; Wall Street collected \$48 billion from these ‘interchange’ or ‘swipe’ fees).

<sup>32</sup> Connecticut Report at pages 6-7.

<sup>33</sup> Urban Institute Study, State Rankings, “Problems: Payments Do Not Cover Full Cost of Contracted Services.”

<sup>34</sup> Connecticut Report at page 5.

<sup>35</sup> Pagliaccio, at page 5.

<sup>36</sup> Information based on interviews conducted by the North Carolina Center for Nonprofits with North Carolina nonprofits that provide services on behalf of the state.

<sup>37</sup> Urban Institute Study at page 15.

<sup>38</sup> *Id.*, at Table 8.

<sup>39</sup> Illinois Council of Human Service website: [Tax Exempt Orgs Awaiting Payment as of July 12 10.pdf](#)

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<sup>40</sup> Open Letter to Service Providers, Illinois Comptroller Daniel W. Hynes (emphasis added) <http://www.ioc.state.il.us/news/isp.cfm>.

<sup>41</sup> National Conference of State Legislatures, "Late State Budgets," August 27, 2010, <http://www.ncsl.org/default.aspx?tabid=17823>.

<sup>42</sup> [California Government Code Section 927.11\(b\)](#).

<sup>43</sup> [Pa. budget crisis leaves state-dependent agencies cash-strapped - Pittsburgh Business Times](#) (July 31, 2009).

<sup>44</sup> New York Council of Nonprofits, *Comptroller Questions, Nonprofits Respond* (January 19, 2010) <http://www.nycon.org/news/newsDetails.asp?newsid=266>.

<sup>45</sup> Alliance for Nonprofit Excellence, "Downstream and In Demand: Another Look at Mid-South Nonprofits and the Economic Crisis," (August 30, 2010) <http://www.npexcellence.org/Downstream2010.pdf>.

<sup>46</sup> Office of the State Comptroller, State of New York, *Prompt Contracting Annual Report Calendar Year 2008*, (May 29, 2009) [http://www.osc.state.ny.us/reports/fiscal/contract\\_annualreport.pdf](http://www.osc.state.ny.us/reports/fiscal/contract_annualreport.pdf).

<sup>47</sup> *Late federal funding to homeless program results in evictions*, Johnson City Press (February 4, 2010) <http://www.johnsoncitypress.com/News/article.php?ID=73720>.

<sup>48</sup> Louisiana Nonprofit Sector Fiscal Health Survey, Louisiana Association of Nonprofit Organizations, June 2010, page 19; see also this observation from another survey respondent: "Expecting nonprofits to carry state expenses while waiting for contract approval is not realistic -- cash flow is an incredible problem."

<sup>49</sup> Office of the State Comptroller, State of New York, "New York State's Not-for-Profit Sector," 2010, <http://www.osc.state.ny.us/reports/economic/nfp2010.pdf>.

<sup>50</sup> Urban Institute Study at pages 13-14. We suspect that the number might have been even higher if nonprofits with budgets less than \$100,000 had been included in the survey. These nonprofits often are almost automatically kept out of the bidding process because of the complexities and endless requirements. Indeed, as the Urban Institute Study notes (at page 9), "The cost of raising matching funds seems to limit such contracts to organizations with strong finances."

<sup>51</sup> Human Services Council of New York brochure, 2009.

<sup>52</sup> Testimony of Michele Hughes, Executive Director, Life Crisis Center, Salisbury, Maryland, in support of House Bill 527, Study of State Procurement of Health and Social Services, 2008.

<sup>53</sup> Analysis based on interviews conducted by the Maryland Association of Nonprofit Organizations with Maryland nonprofits that provide services on behalf of the state.

<sup>54</sup> Connecticut Report at 5.

<sup>55</sup> Office of the Legislative Auditor, State of Minnesota, "State Grants to Nonprofit Organizations" (Report January 2007), [www.auditor.leg.state.mn.us/ped/2007/grants.htm](http://www.auditor.leg.state.mn.us/ped/2007/grants.htm).

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<sup>56</sup> Pagliaccio, at page 3.

<sup>57</sup> *Id.*

<sup>58</sup> GAO-10-447 at page 20.

<sup>59</sup> Donors Forum Partnership Principles, at page 11.

<sup>60</sup> Pagliaccio, at page 5.

<sup>61</sup> *Id.* at pages 5-6.

<sup>62</sup> Nonprofit Starvation Cycle at 50.

<sup>63</sup> Donors Forum Partnership Principles, at page 11.

<sup>64</sup> Report GAO-10-447 at page 22.

<sup>65</sup> Connecticut Laws 2010, Chapter 10-5 ; <http://www.cga.ct.gov/2010/ACT/sa/pdf/2010SA-00005-R00SB-00316-SA.pdf> ; see also website of the Connecticut Association of Nonprofits. <http://www.ctnonprofits.org/policy/commission>

<sup>66</sup> Donors Forum, "Fair and Accountable: partnership Principles for a Sustainable Human Services System," (January 2010) [http://www.donorsforum.org/s\\_donorsforum/bin.asp?CID=14836&DID=33993&DOC=FILE.PDF](http://www.donorsforum.org/s_donorsforum/bin.asp?CID=14836&DID=33993&DOC=FILE.PDF)

<sup>68</sup> Mayor's Nonprofit Initiative, <http://www.nyc.gov/html/nonprofit/html/initiatives/initiatives.shtml#strength>

<sup>69</sup> GAO-10-447 ("Federal, state, and local governments rely on nonprofit organizations as key partners in implementing programs and providing services to the public, such as health care, human services, and housing-related services. ... [V]arying reimbursement practices by state and local governments that award federal funds affect the rate at which indirect costs are covered. Absent a clear understanding among federal, state, local, and nonprofit officials about how to interpret OMB's indirect cost guidance and consistently classify activities typically thought of as indirect costs, nonprofits will likely continue to struggle with accurately and consistently reporting on their indirect and administrative costs of doing business, and a clear picture of the true gap between actual and reimbursed indirect costs will remain elusive.") at page 22.

<sup>70</sup> Nonprofit Starvation Cycle at 52.

<sup>71</sup> See recommendations from New York Comptroller Thomas DiNapoli: "In order for there to be meaningful change there must be an empowered body in the Executive Branch that reviews regulations and policies for consistency between state offices. Those that are administrative in nature should be reviewed for consistency across State agencies."

<sup>72</sup> Office of the State Comptroller, State of New York "Prompt Contracting Annual Report, Calendar Year 2009," (May 31, 2010), [http://www.osc.state.ny.us/reports/fiscal/contract\\_annualreport10.pdf](http://www.osc.state.ny.us/reports/fiscal/contract_annualreport10.pdf)

<sup>73</sup> See Florida Statute 215.422 (7). The Florida Vendor Ombudsman website states: "A Vendor Ombudsman, whose duties include acting as an advocate for vendors who may be experiencing

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problems in obtaining timely payment(s) from a state agency, may be contacted at (850) 413-5516, or by calling the Department of Financial Services Consumer Hotline at 1-800-342-2762.”

[http://dms.myflorida.com/business\\_operations/state\\_purchasing/documents\\_forms\\_references\\_resources/vendor\\_ombudsman](http://dms.myflorida.com/business_operations/state_purchasing/documents_forms_references_resources/vendor_ombudsman);

<sup>74</sup> New York Council of Nonprofit Organizations (NYCON), “New Program Helps Navigate State Payments,” (October 4, 2010), <http://www.nycon.org/news/newsDetails.asp?newsid=304> (“Working in conjunction with the New York State Comptroller, NYCON is now taking [online inquiries](#) from members regarding their unresolved contracting and/or payment issues with New York State. NYCON will be working closely with the Comptroller’s Office and other State agencies to help members get the information and answers they need regarding the contracting and payment process, the location of their particular contract or payment within that process, and the actions that need to be taken for the contract or payment to be executed.”).

<sup>75</sup> [http://azstarnet.com/news/opinion/editorial/pdf\\_65c01590-1dea-11df-861b-001cc4c03286.html](http://azstarnet.com/news/opinion/editorial/pdf_65c01590-1dea-11df-861b-001cc4c03286.html);  
[http://bloximages.chicago2.vip.townnews.com/azstarnet.com/content/tncms/assets/editorial/6/5c/015/65c01590-1dea-11df-861b-001cc4c03286.pdf.pdf?\\_dc=1266647845](http://bloximages.chicago2.vip.townnews.com/azstarnet.com/content/tncms/assets/editorial/6/5c/015/65c01590-1dea-11df-861b-001cc4c03286.pdf.pdf?_dc=1266647845)

<sup>76</sup> To find your State Association, visit our website at <http://www.councilofnonprofits.org/find-your-sa>

<sup>77</sup> Urban Institute Study, at page 22, Figure 14.

<sup>78</sup> *Id.* at State Profiles. Even within the eight states where some nonprofits reported double-digit improvements, those gains were offset by a greater number of nonprofits reporting things had actually gotten worse for them in those same states (Massachusetts – 14% better, but 26% worse; Michigan – 11% better, but 40% worse; Mississippi – 11% better, but 21% worse; Missouri – 11% better, but 20% worse; South Dakota – 13% better, but 26% worse; Tennessee – 10% better, but 17% worse).