



N.C. Center for Nonprofits

Government Contracts with Nonprofits: Solutions Emerging for a Broken System

New Results and Recommendations

Executive Summary

The Urban Institute conducted the first-ever national study of government contracting with nonprofits. Its 2010 report uncovered long-standing problems experienced by private nonprofits in North Carolina that provide public services through contracts with federal, state, and local governments. Following up on that report, the N.C. Center for Nonprofits has conducted two statewide surveys to see how nonprofits have fared in 2010 and 2011. Major new findings include:

1. The government contracting system has improved over the last two years, making nonprofits and state government more efficient. This is due to collaborative efforts between nonprofits and state agencies that were initiated by the N.C. Center for Nonprofits.
2. Late payments and underpayments of nonprofits are still major problems for nonprofits that contract with state government.
3. State budget cuts have hurt nonprofits and the people they serve. They have forced nonprofits to cut jobs and reduce essential services to North Carolinians in need.

The problems in government contracting hurt all North Carolinians by wasting money for both taxpayers and nonprofit, weakening the state's economy because nonprofits have to eliminate jobs, and damaging essential services to people in need.

The N.C. Center for Nonprofits recommends that these North Carolina policy makers take several specific steps to help solve these problems, including:

1. For the Governor:
 - Propose a state budget without disproportionate cuts in grants and contracts for nonprofits.
 - Designate nonprofit liaisons within each cabinet-level department and a nonprofit liaison within the Office of the Governor.
2. For the N.C. General Assembly:
 - Avoid burdensome, one-size-fits-all mandates and restrictions for private nonprofits, such as salary caps or administrative expense requirements.
 - Pass legislation to ensure prompt payment for nonprofit contractors.
 - Create a "Red Tape Review Commission" to eliminate redundant regulation of nonprofits.
 - Provide funding for audits, training, and accreditation required of nonprofits that receive state funds

- Provide adequate funding for indirect costs of nonprofits with state grants and contracts.
 - Make funding decisions based on nonprofit results and value for taxpayers rather than on arbitrary ratios.
 - Pass a state budget on time and without disproportionate cuts in nonprofit grants and contracts.
3. For the N.C. Office of State Budget and Management:
- Disclose to the public any departments and divisions that are late in their payments to private nonprofits.
 - Develop policies and procedures to minimize payment delays to nonprofits.
4. For all state agencies:
- Notify nonprofits as early as possible of any impending payment delays.
 - Where possible, use common terminology, questions, and performance measures for all grants and contracts within the agency.
 - Set up regular meetings between agency heads and nonprofits to exchange ideas to improve North Carolinians' lives.
 - Seek input from nonprofits about possible improvements to departmental policies and procedures.
5. For the N.C. Department of Health and Human Services (DHHS):
- Continue to include nonprofits in task forces and working groups aimed at improving DHHS operations
 - Look for ways to further reduce redundant reviews of nonprofits by DHHS divisions, accrediting bodies, and local management entities.

Government Contracts with Nonprofits: Solutions Emerging for a Broken System

The Urban Institute conducted the first-ever national study of government contracting with nonprofits. Its 2010 report uncovered long-standing problems experienced by private nonprofits in North Carolina that provide public services through contracts with federal, state, and local governments. At the same time, the National Council of Nonprofits published a special report showing how these government contracting problems hurt taxpayers, people in need, nonprofits, and the economy. The National Council's report provided several proposals for ways that nonprofits and state government could work together to solve the problems identified in the Urban Institute report.

Following up on those reports, the N.C. Center *for* Nonprofits has conducted two statewide surveys to see how nonprofits have fared since 2009. In 2010, 198 nonprofits responded to the Center's survey, and 326 responded in 2011.

The studies found significant problems that undermine the ability of nonprofits to deliver essential public services through state government contracts, including:

- Excessive red tape for nonprofits applying for and reporting on government contracts. For example, some nonprofits that provide public services through contracts with the N.C. Department of Health and Human Services (DHHS) have been required to have multiple redundant reviews and audits by separate divisions of DHHS, local agencies, and providers of DHHS-required accreditation. These multiple reviews have taken valuable staff time away from providing services without bringing any additional value to the state or the people served by nonprofits.
- Unexpected changes to contract requirements made by the government after contracts have been signed. For example, state agencies have terminated three-year contracts after a single year of successful services, cut payment rates to nonprofits, and required nonprofits to provide additional services beyond what was set forth in their contracts.
- Contracts that do not cover the actual cost to provide the services required. For example, nonprofits have been hampered by unreasonable limits on the operating costs that are essential for good management and governance and by state agencies not paying for the very audits that they require.
- Late payments of contracts and grants. For example, state agencies have delayed their payments to nonprofits by weeks or months without providing prior notice to nonprofits. This has forced some nonprofits to take out unnecessary loans, reduce staff pay and benefits, lay off employees, and in some cases close their doors.

Nonprofits report that these problems affect the people of North Carolina in the following ways:

- **North Carolinians in need are not receiving essential services** that are undercut by these contracting problems.
- **North Carolina taxpayers are wasting public money**, because solving these problems could save state funds by allowing services to be delivered more efficiently.
- **North Carolina nonprofits are wasting private money**. Foundations, corporations, and individuals which support nonprofits are being asked to subsidize the true cost for essential human services that nonprofits provide on the state's behalf. This translates into less money

for other vital nonprofits, such as those in the arts, the environment, education, and other fields.

- **North Carolina's economy is weakened.** Nonprofits provide 400,000 jobs in North Carolina, about 10 percent of the state's workforce. By forcing nonprofits to cut staff and reduce salaries and benefits, these problems add to unemployment in North Carolina.

Nonprofits and State Government Collaborate To Improve Parts of the Government Contracting System

Following up on the Urban Institute report, the N.C. Center *for* Nonprofits has worked to fix these problems in state government's contracting with nonprofits. As a first step, the N.C. Center asked North Carolina nonprofits for more information about the problems found by the Urban Institute. Nonprofits' responses suggested that the two most significant issues were: (1) major problems with the state's online grants reporting system; and (2) red tape and redundant reviews by the N.C. Department of Health & Human Services (DHHS) that wasted tremendous time and money for nonprofits.

Online Reporting Problems

In response to the first issue, the N.C. Center sought input from nonprofits on the specific problems they were experiencing with the grants reporting system. This system was managed by the N.C. State Auditor until September 2009 and by the N.C. Office of State Budget and Management thereafter. Specific problems included:

- The inability to save changes as nonprofits entered their reports online, which required nonprofits to waste significant time re-entering their data;
- Data entry errors by the state agencies with which nonprofits have grants and contracts, making it impossible for some nonprofits to enter their reports in the online system; and
- Nonprofits erroneously being listed on the state's Noncompliance List and Suspension of Funding List.

The N.C. Center arranged meetings with nonprofits and the State Auditor and OSBM to address these issues. By the end of 2010, the changes recommended by nonprofits had been implemented.

Red Tape and Redundant Reviews

On the second issue, the N.C. Center arranged for 35 nonprofits to meet directly with DHHS Secretary Lanier Cansler in November 2010. As a result, the N.C. Center formed a DHHS/Nonprofit Task Force that identified solutions to 10 specific inefficiencies that nonprofits were experiencing in their contracts with DHHS. Specific concerns included:

- Inconsistencies in DHHS monitoring of nonprofits;
- Redundant audits and reviews by DHHS and local management entities (LMEs) that manage mental health, developmental disabilities, and substance abuse services;
- Inconsistencies between reporting and monitoring standards of different LMEs in the state;
- Delays in nonprofits' receipt of monitoring reports; and
- The requirement of additional reports that duplicated the standards of state-required accreditation.

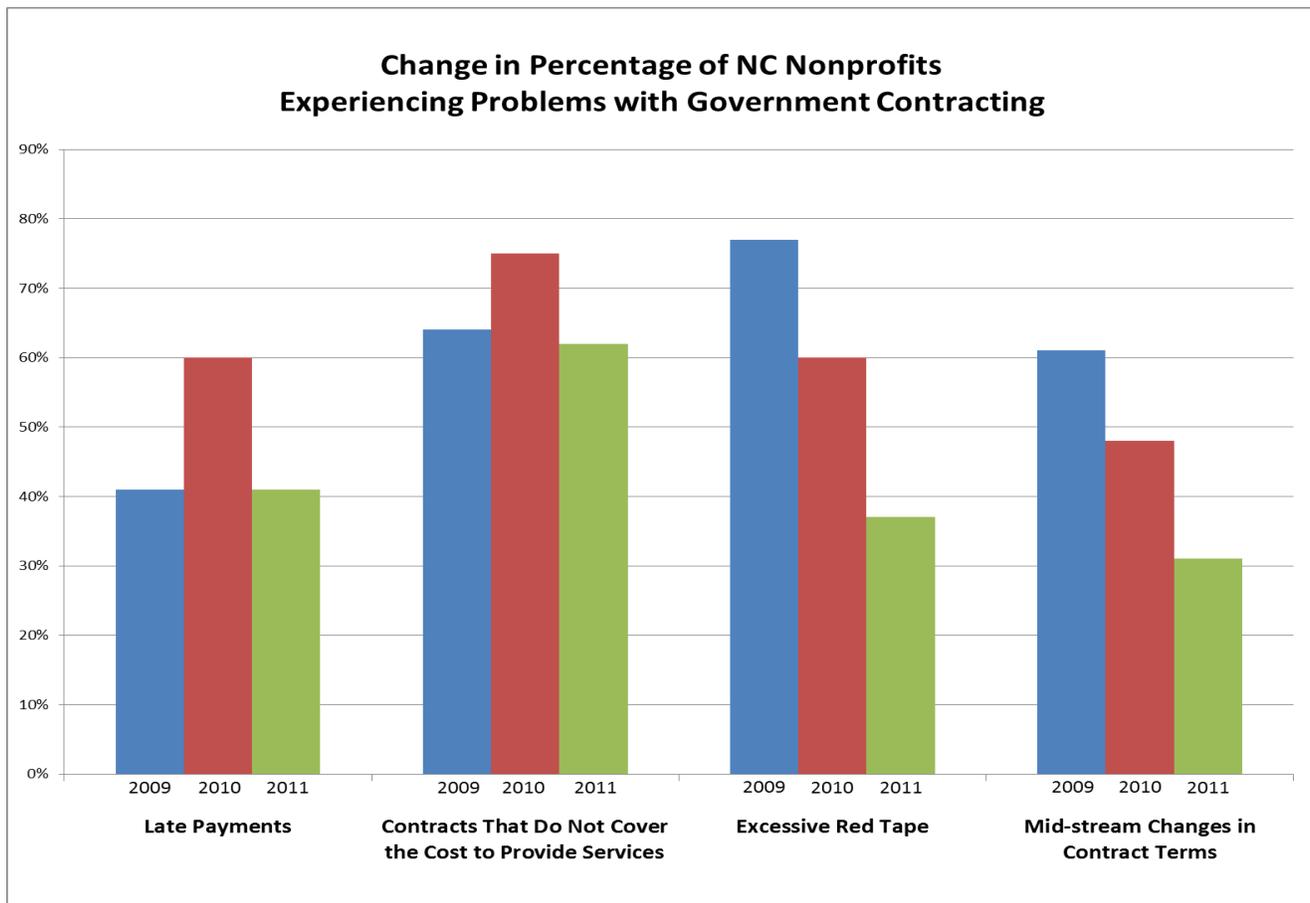
The Task Force, which included 10 nonprofit representatives and key DHHS staff, identified ways to improve each of these issues. The Task Force gave nonprofits a new opportunity to have a meaningful voice in many of the internal DHHS working groups and discussions about policies and procedures related to their concerns. At that time, DHHS had already started its DHHS Excels initiative to make the agency more customer-focused, anticipatory, collaborative, transparent, and results-based.

Also, in 2011, the N.C. General Assembly passed legislation (H.B. 618) that: (1) created an electronic document vault to streamline reporting by nonprofit contractors; and (2) requires DHHS to review annually policies of accrediting bodies and to ensure that DHHS policies and procedures do not duplicate these accreditation standards for accredited nonprofit service providers. DHHS has begun implementing these changes.

Positive Changes

As a result of the collaboration between the N.C. Center for Nonprofits, DHHS, OSBM, and the N.C. State Auditor, North Carolina nonprofits reported in 2011 that they have seen significant improvements in two of the major problem areas identified by the Urban Institute, including:

1. Far fewer nonprofits are reporting problems with excessive red tape with their government grants and contracts. Only 37% had overly-complex reporting requirements in 2011, down from 77% in 2009.
2. Likewise, government agencies are doing better at sticking to the terms of their contracts. Only 31% of nonprofits said that agencies made mid-stream changes to the contract terms in 2011, down from 61% in 2009.



Source: Statewide surveys conducted by The Urban Institute in 2009 and the N.C. Center for Nonprofits in 2010 and 2011.

Problems Remain in Fixing the Government Contracting System

While collaboration between nonprofits and government has led to improvements, nonprofits still report inefficiencies in the government contracting system. The N.C. Center's 2011 survey found that:

1. Late payments continue to be a major problem for North Carolina nonprofits. In 2011, 41% of state-funded nonprofits were paid late, the same as in 2009. Of these, 69% were paid late three or more times in 2011, and 71% said payments were delayed by at least one month. Nonprofits report that the majority of payment delays occur between July and October and that delays are typically longer when the General Assembly does not pass its budget until late summer. Insufficient notice about late payments has made it even tougher for nonprofits to respond to the resulting cash-flow issues.
2. Sixty-two percent of state-funded nonprofits report that their 2011 contracts did not cover the full cost of providing the services. For example, nonprofits again pointed to the unreasonable limits on indirect costs and to state agencies not helping to pay for the special audits that they require. Nonprofits confirmed this problem in the Nonprofit Finance Fund's annual State of the Sector Survey that was released in April 2012. In that survey, 73% of North Carolina nonprofits with federal grants or contracts said the federal government did not pay the full cost of providing services, and 65% of North Carolina nonprofits with state or local grants or contracts said these did not pay for the full cost of providing services.

State Budget Cuts Increase the Problems for Nonprofits and the North Carolinians They Serve

Over the past three years, North Carolina nonprofits have been hit particularly hard by state budget cuts.

- In 2009, 70% of N.C. nonprofits reported a decline in state grants, the fourth-highest rate in the nation. On top of this, 66% reported further cuts in revenue from state grants and contracts in 2010, and 62% had more cuts in 2011.
- The N.C. Budget & Tax Center found that total state grants to nonprofits dropped by 26% in FY 2009-2010, which was about 10 times greater than overall cuts to the state budget that year.
- Some examples of reductions to nonprofit funding in the FY 2011-2013 budget passed in 2011 (H.B. 200) include:
 - Cutting Smart Start funding by 20%;
 - \$5 million cut in grants and contracts to nonprofit health and human service providers (note: DHHS found one-time money to reduce this to a \$1 million cut in FY2011-2012);
 - 15-20% cuts for community economic development nonprofits;
 - Elimination of the Health and Wellness Trust Fund;
 - 87.5% cut in funding for the Clean Water Management Trust Fund; and
 - 15% cut in N.C. Arts Council grants.

These state budget cuts have led to job loss in North Carolina. In 2011, 43% of nonprofits with state grants and contracts had to cut staff. Of these, 122 nonprofits told the N.C. Center *for* Nonprofits that they laid off a total of 872 employees due to reductions in state grants and contracts. This includes 628 full-time employees and 244 part-time employees. Nonprofits with state grants and contracts were three times more likely to lay off staff than nonprofits without state funds.

Cuts in state grants and contracts with nonprofits also mean that fewer North Carolinians are receiving essential services. In 2010 and 2011, 38% of nonprofits with state grants and contracts had to reduce their programs or services. Coupled with an increase in demand for nonprofits' services, this means that state and local governments are bearing a greater burden and that many North Carolinians – including seniors, low-income families, people with disabilities, and victims of domestic violence – are not having their basic needs met.

Some Solutions and Next Steps

The N.C. Center *for* Nonprofits will continue to bring together nonprofits and state government to develop collaborative solutions. The Center's objectives are to improve the state's contracting processes to provide high quality services for North Carolinians, to use taxpayer dollars more effectively, and to treat the state's nonprofit partners fairly. The N.C. Center encourages North Carolina policy makers to take these important steps:

1. **Protect the state's investment in the vital services provided by nonprofits.** State budget cuts in the last three years have left nonprofits with state grants and contracts that are inadequate to provide North Carolinians the essential services required in the funding agreements.
2. **Continue to develop fairer contracting processes for nonprofits.** This includes systems to ensure that government agencies pay nonprofits promptly and contracts that do not leave nonprofits with unfunded contractual obligations.
3. **Give nonprofits a seat at the table in policy discussions.** Other state agencies should follow the model of DHHS and include nonprofits in collaborative discussions about implementing contracting policies that will yield the most efficient and effective quality of service for North Carolinians.

The following are the N.C. Center's recommendations for specific policy makers:

For the Governor:

- Propose a budget without disproportionate cuts in grants and contracts for nonprofits.
- Designate nonprofit liaisons within each cabinet-level department. These liaisons do not need to be new positions, but rather can be existing staff who will serve as a point person for nonprofits that work with the department.
- Establish a liaison with nonprofits in the Office of the Governor.
- Participate in policy forums and discussions with nonprofits.

For the N.C. General Assembly:

- Avoid burdensome, one-size-fits-all mandates and restrictions for private nonprofits. Examples include unrealistic salary caps for nonprofit employees and requirements that nonprofits meet arbitrary ratios have proven to be misleading and ineffective. When appropriate, these provisions should be included in contracts between state agencies and nonprofits, not as special provisions in the state budget or in the N.C. General Statutes.
- Pass legislation that would require state agencies to honor the payment terms of their contracts with private nonprofits and that would reimburse nonprofit contractors for their actual costs of securing credit as they await late payment from the state.
- Provide adequate funding to pay for any mandates – such as financial audits, training, or accreditation – that are required for nonprofits that provide services on behalf of government through grants and contracts with state agencies.
- Provide adequate funding for indirect costs of nonprofits providing services on behalf of government through state grants and contracts.
- Create a “Red Tape Review Commission” to review state contracting processes with nonprofit service providers and to recommend the elimination of redundant and ineffective regulatory requirements.
- Pass a state budget without disproportionate cuts in grants and contracts for nonprofits.

- Pass a state budget by July 1 to minimize systemic payment delays.

For legislative appropriations committees and subcommittees:

- When making decisions about funding grants and contracts to nonprofits, carefully consider: the results that individual nonprofits achieve with state grants or contracts; the essential services that would be lost if nonprofits no longer provided public services; and the additional cost to the state if the government had to provide these services itself.
- Avoid sending boilerplate inquiries to all nonprofits with grants or contracts funded through a particular subcommittee, and avoid comparing nonprofit grantees solely on the basis of arbitrary ratios that do not measure results.
- In inquiries to nonprofit grantees, make clear the reason that specific questions are being asked and the meaning of terms such as “administrative expenses” that are not defined in the N.C. General Statutes.
- Recommend state appropriations without disproportionate cuts in grants and contracts for nonprofits.
- Provide sufficient funding for state agencies to reduce the likelihood that they will have inadequate financial resources to meet their contractual obligations to pay nonprofits on time.

For legislative leadership:

- Participate in policy forums and discussions with nonprofits.
- Encourage members of the General Assembly to visit nonprofits in their districts, including nonprofits that provide public services through state grants and contracts.

For the N.C. Office of State Budget and Management:

- Disclose to the public any departments and divisions that are late in their payments to private nonprofits. This transparency would help nonprofits make better budgeting decisions when they apply for state grants and contracts.
- Develop policies and procedures to minimize payment delays to nonprofits. These could include a time schedule for initial payments after grant decisions and a process for partial payments to nonprofits at the beginning of the fiscal year to cover operating costs until full payments are made.
- Continue to seek input from nonprofits about the online grants reporting system.

For the N.C. Department of Health and Human Services:

- Continue to include nonprofits in task forces and working groups that are part of the DHHS Excels initiative.
- Work with the N.C. Center *for* Nonprofits to establish an annual meeting between the DHHS Secretary and nonprofit leaders to exchange ideas.
- Continue to review accreditation standards and to eliminate monitoring and reporting requirements that duplicate these standards for accredited nonprofits. Where appropriate, recommend to the General Assembly specific areas where nonprofit service providers can be deemed to be compliant if they maintain current accreditation.
- Work with local management entities (LMEs) to coordinate reviews of nonprofit service providers by DHHS and LMEs and eliminate redundancies.

- Use an electronic document vault to enable nonprofit service providers to file application information and financial and performance documents one time for review by multiple DHHS divisions and/or LMEs.

For all state agencies:

- Notify nonprofits as early as possible of any impending payment delays. This would help nonprofits make contingency plans that minimize job loss and reductions in services.
- Where possible, use common terminology, questions, and performance measures for all grants and contracts within the agency.
- Use electronic document vaults to enable nonprofit service providers to file application information and finance and performance documents one time for review by multiple divisions or agencies.
- Where appropriate, implement multi-year contracts with nonprofits.
- Seek input from nonprofits about possible improvements to departmental policies and procedures.

For members of the Council of State:

- Designate nonprofit liaisons within their departments. As with cabinet department nonprofit liaisons, these do not need to be new positions, but rather can be existing staff who will serve as a point person for nonprofits that work with the department.
- Work with the N.C. Center *for* Nonprofits to set up meetings to exchange ideas with nonprofit leaders experienced in the fields with which their departments work.

For cabinet secretaries:

- Work with the N.C. Center *for* Nonprofits to set up meetings to exchange ideas with nonprofit leaders experienced in the fields with which their departments work.

By taking these steps, policy makers can promote job growth, improve the availability of quality services throughout the state, and lessen the burdens on state government. The N.C. Center for Nonprofits is interested in working with policy makers on each of these proposed next steps.

For More Information

- N.C. Center *for* Nonprofits:
<http://www.ncnonprofits.org>
- Urban Institute report:
<http://www.govtcontracting.org/sites/default/files/Full%20Report.pdf>
- Urban Institute snapshot of government contracting in North Carolina:
<http://www.govtcontracting.org/sites/all/files/govt/NC.pdf>
- National Council for Nonprofits web portal on government contracting:
<http://www.govtcontracting.org>
- National Council of Nonprofits special report on government contracting problems:
<http://www.govtcontracting.org/sites/default/files/Costs%20Complexification%20and%20Crisis.pdf>
- N.C. Budget and Tax Center “BTC Brief” on state grants to nonprofits:
<http://www.ncjustice.org/sites/default/files/BTC%20BRIEF%20-%20state%20grants%20to%20non-profits-WEB.pdf>

For more, contact David Heinen, Director of Public Policy and Advocacy, N.C. Center *for* Nonprofits, dheinen@ncnonprofits.org or 919-790-1555, ext. 111.