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INSIDE THIS ISSUE

- The recession has exacerbated problems faced by human service nonprofits that have government contracts and grants.
- Problems include late payments and contracts that do not cover the full cost of services or administration.
- Many nonprofits have already frozen salaries, drawn down reserves, and gone into deficits.

Contracts and Grants between Human Service Nonprofits and Governments

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Governments contract with human service nonprofit organizations to deliver pivotal services to individuals and communities, such as food assistance, housing, employment training, youth mentoring, child care, and many more. While these organizations derive their revenues from a mix of funding sources, many rely heavily on government grants and contracts. Despite the prevalence and importance of government contracting, there is little information on its scope and effectiveness. Recent anecdotal press reports, regional studies, and small surveys, however, portray a variety of problems related to government contracting, especially in the context of the current recession (Bureau of Contracts 2010; Deffley and Pratt 2009; DiNapoli 2010).

This brief summarizes results of a national study of human service nonprofits designed to document the extent of nonprofit-government contracting and related requirements and problems.¹ It also examines the impact of the recession on these organizations and the cutbacks they have made to keep their programs operating. While contracting problems are not new, many are exacerbated by the deep recession that has reduced government budgets and private contributions.

The findings reported here are based on a national random sample of human service organizations with more than \$100,000 in expenses in eight human service program

areas (table 1).² All estimates in this report are weighted to represent the entire U.S. human service nonprofit sector that had government contracts and grants in 2009. We explore the relationships between nonprofit and government contracting by type of human service provider, size of the organization, state, and level (federal, state, local) of government contracts.

Human Service Organizations with Government Grants and Contracts

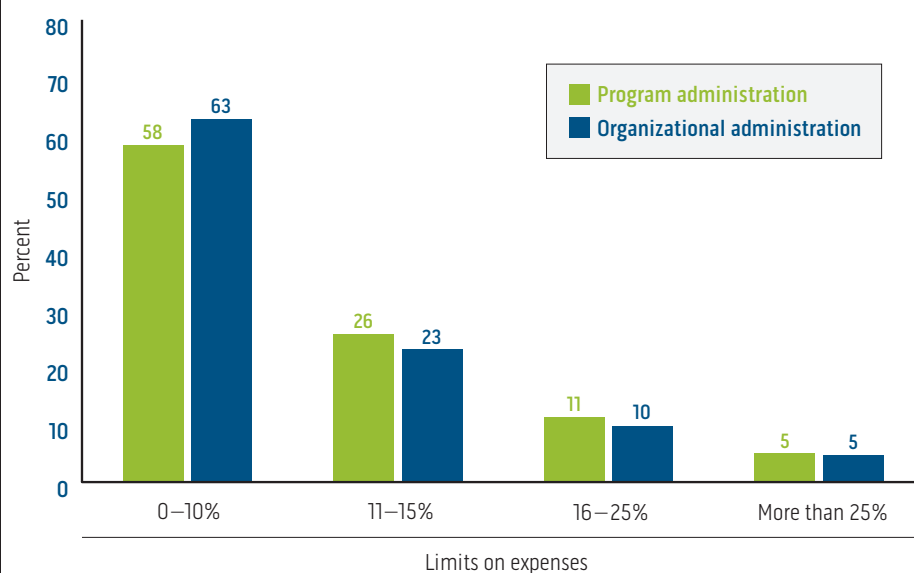
Government contracting is widespread among human service nonprofits. Nearly 33,000 have government contracts and grants, which provide the single largest source of revenue for 60

Our national survey documents the extent of nonprofit-government contracting and related problems and the cutbacks nonprofits have made to keep operating.

Table 1. Human Service Nonprofits with Government Contracts and Grants

TYPE OF ORGANIZATION	NUMBER	%
Human service: multipurpose	16,941	51.8
Housing and shelter	5,741	17.6
Crime and legal related	2,517	7.7
Community and economic development	2,401	7.3
Youth development	2,272	7.0
Employment	1,740	5.3
Food, agriculture, and nutrition	1,011	3.1
Public safety and disaster relief	70	0.2
Total	32,693	100.0

Source: The Urban Institute, National Survey of Nonprofit-Government Contracting and Grants (2010).

Figure 1. Limits on Administrative Expenses for Government Contracts and Grants to Human Service Organizations

Source: The Urban Institute, National Survey of Nonprofit-Government Contracting and Grants (2010).

Note: The numbers are based on those that had contract limitations.

percent of these organizations. State government contracts are the single largest source of government funding for 41 percent of organizations. Just over a third receive the majority of their government funding directly from the federal government. A quarter rely mostly on local government contracts.³ Over half of these are multipurpose organizations that deliver a range of programs and services, including assistance for children, families, and the elderly. The second-largest group provides housing and shelter assistance.

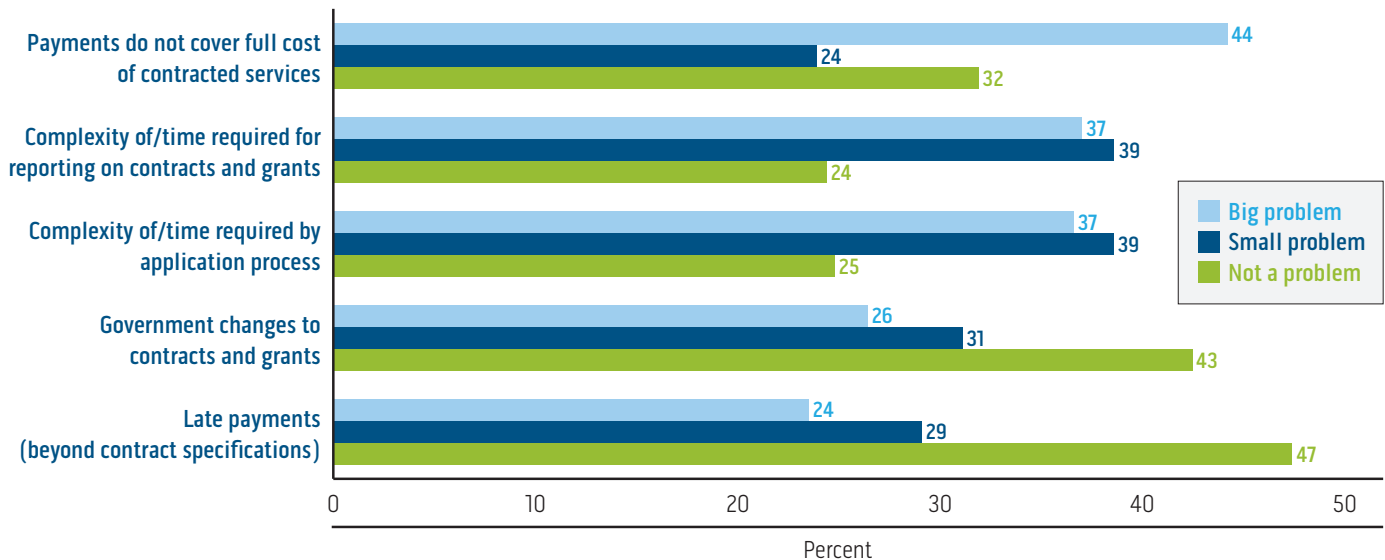
Nonprofits of all sizes, but especially larger organizations, contract with government; 40 percent of nonprofits contracting with government operate on \$1 million or more (large), and 39 percent, between \$250,000 and \$999,999 (medium). Just 21 percent have budgets between \$100,000 and \$249,999 (small).

In 2009, the total number of contracts between government and human service nonprofits was nearly 200,000. Nonprofits averaged about 6 government contracts and grants per organization, with large organizations averaging more contracts and grants per organization than smaller or mid-sized groups. The number of grants and contracts varied significantly by state, ranging from an average of 3 per organization in South Carolina to an average of 10 per organization in Arizona. Moreover, nonprofits are working with multiple government agencies to deliver services—76 percent had contracts and grants from two or more government agencies.

Characteristics of Government Contracts and Grants

A variety of payment methods apply to organizations' federal, state, or local government contracts and grants. These include cost reimbursement, fixed cost, cost per unit of time, unit cost per individual or family, and performance-based payments. Nationwide, about half of government contracts and grants were either cost reimbursement or fixed-cost

Figure 2. Key Problems Reported for Government Contracts and Grants



Source: The Urban Institute, National Survey of Nonprofit-Government Contracting and Grants (2010).

Note: Missing or not applicable answers are excluded from the figures.

payments. Just 17 percent of nonprofits had performance-based contracts.

Primary payment modes varied considerably among the states. Seventy-seven percent of organizations in Delaware reported fixed-cost payments, 60 percent of nonprofits in Missouri had cost per time-unit payments, and 73 percent of organizations in Utah had cost-reimbursable payments.

Matching requirements. Government contracts and grants often require nonprofits to match government support with money raised from donations or other sources, or to explicitly share program costs. More than half of nonprofits have a government contract or grant that requires matching or sharing costs and a third have two or more contracts or grants with this requirement. The amount an organization is required to match

or share varies from contract to contract. Sixty percent had to match, on average, 25 percent or more of contracts and grants and 27 percent had to match, on average, 50 percent or more.

Program and organizational administrative-expense limits. A majority of nonprofits reported that their government contracts and grants excluded or limited administrative or overhead costs for both funded programs and services (i.e., program administration) and the organization itself (i.e., general administrative costs) (figure 1).⁴ For example, about three in five organizations could use no more than 10 percent for organizational or program administration.

Reporting requirements. Nine out of ten nonprofits have government contracts and grants that require the organizations to report

results or outcomes of their programs and services. Given the large variety of payment types and the number of different agencies with which nonprofits contract, many organizations are finding it difficult to manage the different reporting requirements. Eighty-one percent of nonprofits indicated problems with government agencies having different reporting formats, 76 percent with different financial categories, and 75 percent with different outcome-reporting requirements.

Contracting Problems

Despite the prevalence and importance of government contracting, organizations are facing growing problems and challenges. In 2009, most nonprofits experienced some problem with their government contracts and grants. Key problems include payments not

Table 2. Revenue Changes Reported by Human Service Nonprofits with Government Contracts and Grants, 2009

Source of revenue	Decrease(%)	Remain the same (%)	Increase(%)
Investment income	72	18	10
Corporate donations	59	28	13
State government agencies	56	30	14
Federated giving (e.g., United Way)	53	38	9
Private foundations	53	31	17
Individual donations	50	29	21
Local government agencies	49	40	11
Fees from self-paying participants	39	40	20
Fees from government as third-party payer (e.g., Medicaid)	34	47	19
Federal government agencies	31	39	30
Other	52	24	24

Source: The Urban Institute, National Survey of Nonprofit-Government Contracting and Grants (2010).

Notes: The "other" category includes royalties, church/congregation donations, unspecified contracts and grants, and earned income from events. Percentages may not sum to 100 because of rounding.

covering full program costs, complex and time-consuming applications and reporting, changes to contractual and grant agreements, and late payments (figure 2).

Full program costs not covered. More than two-thirds of human service nonprofits reported that government payments do not cover the full costs of contacted services (it was a big problem for 44 percent and a small problem for 24 percent).

Complexity of and time required for applications and reports. Three-quarters of nonprofits said that the complexity of applying for and reporting on government contracts and grants as well as the time they take are a problem. In each case, over a third of nonprofits indicated that this was a big problem.

Changes to contracts and grants.

Changes to contracts and grants include cancellation, cut payments, and postponement. About 58 percent of nonprofits regarded such changes as a problem; over a quarter characterized them as a big problem.

Late payments. Forty-one percent of nonprofits reported that government agencies made late payments (beyond contract specifications) in 2009. Late payments were regarded as a big problem by almost a quarter of organizations and as a small problem by an additional 29 percent. Larger nonprofits were more likely than smaller organizations to report late payments: 46 percent compared to 34 percent, respectively. Late payments were prevalent among all levels of government;

state agencies, however, were more likely than local or federal agencies to be over 90 days late in paying. Late payments were problematic for 83 percent of Illinois nonprofits and 80 percent of Maine organizations.

Changes in Experiences with Contracting

Problems associated with government contracts and grants are not new and are becoming a growing concern for many nonprofit organizations. In 2009, 31 percent reported that their experience with government contracting was worse than in prior years. Sixty-four percent of nonprofits had a similar experience with government contracting compared to prior years, and about 90 percent of these organizations reported one or more contracting problems.

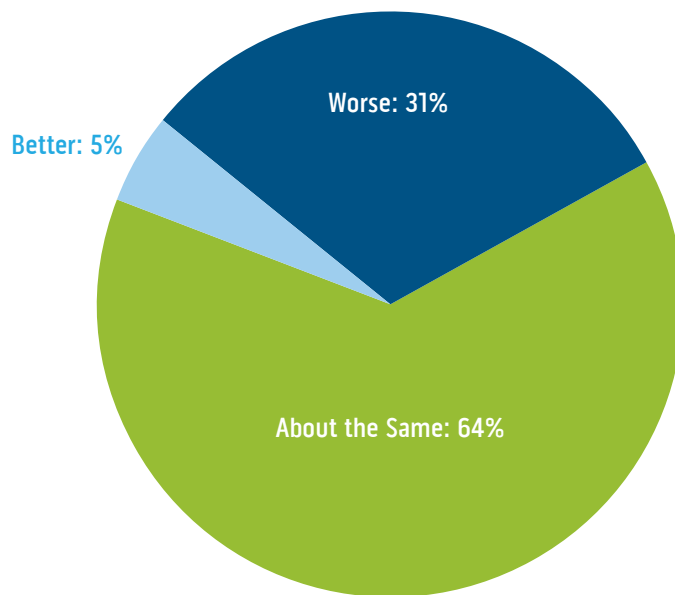
Contracting experiences varied greatly by state. Fifty-seven percent of organizations in Illinois and 56 percent in Hawaii said their experience was worse in 2009 than in prior years, but only 11 percent of organizations in North Dakota and 6 percent in Arkansas had worse experiences.

Impact of the Recession on Nonprofit Revenues

In 2009, the recession increased demands for many basic human services and at the same time nonprofit revenues were severely cut. Payments from government agencies fell; donations from individuals, corporations, and private foundations decreased; and investment returns and fee income declined (table 2). In addition, some government agencies imposed additional fees to shore up their budgets. Over 40 percent of nonprofits faced a deficit in 2009.

Government funding. The recession has significantly decreased sales, personal income, and corporate income tax revenues for local, state, and federal governments. These financial shortfalls have led state and local governments to cut budgets in all major services, such as

Figure 3. 2009 Nonprofit-Government Contracting Experience Compared to Prior Years



Source: The Urban Institute, National Survey of Nonprofit-Government Contracting and Grants (2010).
Note: Missing or not applicable answers are excluded.

health care, services to the elderly and disabled, and education (Husch 2010; Johnson, Oliff, and Williams 2010). Governments at every level reduced their funding for human service nonprofit organizations. Fifty-six percent of organizations reported less revenue from state agencies, 49 percent from local agencies, and 31 percent from federal agencies (table 2).⁵ As the size of an organization increased, it was more likely to report reduced funding from local and state government agencies.

Donations. Nonprofit budgets were further strapped by drops in contributions from foundations, corporations, and individuals. With the exception of federated giving, smaller nonprofits experienced larger declines in contributions than larger organizations.

Investment income. While 72 percent of organizations experienced declines in savings, investment income accounts for a small portion of nonprofit revenue each year.

Actions Taken by Nonprofits to Cope with Reduced Revenues

Human service organizations undertook substantive actions to cope with the financial strain incurred from reduced revenues. In 2009, 82 percent of human service providers had to scale back their operations—with most organizations resorting to two or more cutbacks. Half of organizations froze or reduced salaries, 39 percent drew on financial reserves, and 38 percent reduced their number of employees (figure 4).

“If government payments and private donations fail to recover in the next year or so, human service nonprofits straining to balance reduced revenues along with increased needs for their services could reach the breaking point. Many have already drawn down their reserves and ended 2009 with deficits.”

Figure 4. Cutbacks by Human Service Nonprofits in 2009

Source: The Urban Institute, National Survey of Nonprofit-Government Contracting and Grants (2010).

Larger organizations were more likely to cut salaries, reduce benefits, and decrease staff size than smaller or mid-sized organizations. Three out of five crime- and legal-related nonprofits and youth development groups froze or reduced salaries.

Geographically, cutbacks differ greatly. Three out of five of human service organizations in Connecticut, Illinois, and Minnesota reduced salaries, compared to a quarter of those in North Dakota and Arkansas. Organizations in Illinois were most likely to borrow funds or increase their lines of credit (42 percent), while groups in Montana were least likely to do so (3 percent).

Contracting Experiences and Cutbacks

Cutbacks are also associated with problems with and alterations of contracts. Organizations that reported changes in government contracts

and grants or late payments were significantly more likely to undertake cutbacks than organizations without changes or problems.

- Organizations with altered contracts were more likely to reduce or freeze salaries, reduce employee benefits, reduce their number of employees, and draw on reserves compared to those with no changes in contracts.
- Human service organizations that reported late payments were more likely to freeze or reduce salaries, reduce their number of employees, and draw on reserves compared to those without late payments.
- Nonprofits that had problems (whether large or small) with payments not covering the full costs of services were significantly more likely to freeze or reduce salaries,

decrease their staff size, and draw on reserves, compared to nonprofits for which insufficient payments were not a problem.

Conclusion

This study illustrates serious and widespread issues faced by human service nonprofits that work with government. The sheer scale and variety of formal funding relationships with federal, state, and local governments is not widely recognized. Government processes differ from agency to agency and often from contract to contract, which exacts a heavy toll on nonprofit providers. Furthermore, the recession intensified problems for organizations and many ended 2009 with deficits. Freezing salaries and dipping into reserves, where available, were classic survival steps.

While the recession might be easing, state budget shortfalls projected for fiscal years

2011 and 2012 are estimated to reach \$300 billion (Husch 2010; Johnson et al. 2010). If, in addition, donations and investment income fail to recover in the next year or so, the strain on human service organizations will likely become critical. Human service nonprofits trying to balance reduced revenues with increasing demand for services may reach the breaking point. Of greater concern is the hollowing of organizational capacity that may take years, if ever, to rebuild. The implications of a weakened nonprofit human services sector are not on the public policy agenda.

But there are bright spots in the findings that could provide models for improving nonprofit-government funding relationships. In particular, nonprofits report fewer problems in some states than in others. Follow-up analysis of practices in those states is a prior-

ity. The National Council of Nonprofits, our collaborator on this project, has begun collecting these data.

Nonprofits and government agencies at all levels must work together to identify and implement workable solutions to the problems documented here. This study marks the first step, understanding the dimensions of the problems and the types of nonprofits most affected. The next steps will require concerted efforts to craft and test solutions and to promote their implementation.

Methodology

The survey was based on a random stratified sample (by state, type, and size of nonprofit) of 501(c)(3) human service nonprofit organizations from all 50 states and the District of Columbia drawn from the Urban Institute's National Center for Charitable Statistics

(NCCS) databases. The sample was limited to organizations with more than \$100,000 in expenditures that are required to file the Form 990 with the U.S. Internal Revenue Service. Nine thousand organizations were surveyed and more than 3,500 responded, of which 2,153 had government contracts and grants. Responses were weighted to enable estimates for sectorwide, national, and state-level analyses.

Acknowledgments

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Notes

A copy of the full report is available on the Urban Institute web site at <http://www.urban.org/url.cfm?ID=412159>.

1. The definitions of government contracts and grants often overlap and are not standard across jurisdictions. Both are payments for services that governments agree to underwrite.
2. Human service organizations comprise one of the major categories of nonprofit organizations under the National Taxonomy of Exempt Entities. The recreation and sports category was excluded from the study. See methodology section for sampling information.
3. Reported level of government implementing the contract or grant; actual finding source may be federal block grants or other government programs that provide funds to be used by states, counties, and local governments.

4. Program administrative costs might include computer use, copying, rent, and telephone use. General administrative (or overhead) costs are those that cannot easily be allocated to individual programs. Such costs might include utility payments, receptionists, and finance, accounting, marketing, and contracting staff.
5. State and local government revenues may originate with the federal government; nonprofits report agencies that process their contracts and grants.

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