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Contracting with Nonprofits: Reaganomics Made Me Do It

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As managers, you and I are faced with ever-increasing demands on our ability to deliver high-quality services. Local government managers are the ones who are again being asked to implement Reaganomics, as interpreted by the first Bush presidency and revived, with new rhetoric, by the second. As you recall, the idea is to reduce the involvement of the federal government in solving social problems. The federal role would be to "empower" local governments and others to deliver services as needed.

This concept was designed to eliminate what has been called the cookie-cutter approach to providing social services. Local and state governments could develop programs designed to fit local needs. President Bush's "1,000 Points of Light" was an attempt to help all of us recognize the importance of social service and faith-community agencies that do good things on the local level.

The ultraconservative approach builds upon the foundation that all government is bad, with the corollary that the private sector is good; therefore, privatization seems to be the answer. At the same time, the Reinventing Government movement has turned us into "wannabe" entrepreneurs. This combination of the conservative concept that government is bad, with Osborne and Gaebler's "governmental entrepreneurs," has required that we rethink how local governments do business.

With these philosophical ideas as a foundation, local elected officials are still expected to deliver high-quality services to citizens. Among the areas of growing pressure is human services. In Sedgwick County, Kansas, we have been asked to take on more responsibility for mental health, developmental disabilities, aging, and juvenile crime prevention. In other states, local governments also are addressing child welfare and welfare-reform issues like job training and placement. We also are performing multiple roles as planner/coordinators, service producers, contracting agents, and quality assurance officers.

As managers, the practical solution requires us to call upon nonprofit social service agencies for assistance. Employing nonprofits to provide public social services is not, of course, a new concept. Managing them, however, always has been difficult. In 1914, Alexander Fleisher observed, "Of all the problems in social service policy, none is more harassing, more complex and perennial, than that of determining the proper relation of the state to privately managed charities within its borders.(1)

The trick now, as it was then, is knowing how to manage contracts with these agencies. The nature and the extent of contracting between government and nonprofit organizations are changing. Governments are contracting out more services to nonprofit organizations, and nonprofits are receiving larger amounts of their total revenues from governments. Until fairly recently, contracts were issued with few restrictions. But as governments have been called to greater accountability, so must be the nonprofit agencies with which we contract.

Nonprofits do good work. Their values are centered on helping the needy. All this is good. But, as government managers, we are faced with designing systems to assure that public dollars are spent appropriately. How are we to contract with, and hold accountable, these types of agencies?

Locally, several things have occurred simultaneously that have caused Sedgwick County to look more carefully at the issue of contracting with human service nonprofits:

1. A social service agency with which the county had contracted requested reimbursement for services it had provided but for which there was no contract. The agency defined the need, delivered the service, and then billed state and local governments.

2. A health care agency applied for a bailout grant of several hundred thousand dollars because it was "out of money, and the previous accountant made mistakes." When we requested financial statements and other documents, we were accused of being overbearing and were threatened: "If we go out of business, you will be in worse trouble."

3. Finally, an agency that provides services to the developmentally disabled failed for weeks to fix a hot-water heater in a group home at the same time that it was building a large fund balance. This balance could be transferred to an independent foundation that was accountable to neither federal, state, nor local governments.

These agencies have boards of directors composed of well-meaning citizens and administrators who care deeply about their clients. Yet they failed to provide adequate oversight and management. In our experience, the directors of many nonprofits lack management training.

Also, we often have seen board members leave the talents and traits that make them professionally successful at the door. Seldom are the tough questions asked in the boardroom about financial plans, budgets, long-term viability, and a continuous effort by the board to revisit the purpose of the agency.

Clearly, like local governments, a bad board can succeed with a good manager; however, a bad manager can devastate an agency led by a weak or uninterested board.

Some Work, Some Don't
Sedgwick County manages more than 650 contracts each year. Roughly 250 of these are for human services. Some of these relationships are extremely successful. For example, the county contracts with the zoological society to operate and maintain a world-class zoo. This arrangement is a classic one, with routine contact among board members, county commissioners, county manager, and staff. On the other hand, some relationships are difficult, and agencies have sued the county because of contract disputes.

When governments produce services directly, accountability to the public is assured through the electoral process and through the presence of a hierarchical bureaucracy that makes line workers answerable to supervisors and managers, who are in turn ultimately answerable to elected officials. When governments contract for services with for-profit firms, market competition enforces accountability for cost and service quality. Nonprofit organizations, however, lack both political and market feedback systems to ensure accountability. Increased contracting with government requires the development of additional methods.

In Sedgwick County, the incidents described in the first section of this article made it apparent that an independent study was needed to examine and identify which warning signs showed that agencies were in trouble, how to intervene appropriately when trouble occurred, and how to prevent poor behavior and performance. A partnership was developed between the Kansas Health Foundation, a public health philanthropy, and the county to contract with the Hugo Wall School of Urban and Public Affairs at Wichita State University to conduct such a study. In November 2000, the final report of the study was submitted.

The study used a variety of methods, including literature review, interviews, focus groups, reviews of the performance standards of several professional associations, and content analysis of human service contracts for several urban counties. It identified best practices in nonprofit governance, administration, and finance. It discussed three models of accountability: standards/ compliance, outcomes/performance, and capacity building.(2) It then made recommendations for incorporating best practices into the county's contracts to improve public accountability.

The resulting recommendations call for Sedgwick County to use a combination of the standards/compliance and the outcomes/performance accountability approaches in its contracting practices.

Standards/compliance asks questions such as: How many clients were served? What services did they receive? Are client records current and complete? Do employees possess appropriate professional credentials? This method has the advantage of being inexpensive and relatively easy to monitor. Its major disadvantage is that it does not guarantee effective services.

Outcomes/performance accountability addresses questions such as: Is the client improving? Have clients gained knowledge or changed behavior? Are clients and/or their families satisfied with the services received? The advantage of this accountability model is the focus on desired outcomes and performance. Its major disadvantage is that identifying and measuring appropriate outcomes often is difficult, and monitoring outcomes is much more expensive for agencies than counting services.

Developing Outcome Measures

Another problem exists with outcomes/performance. Because goals are hard to define, results hard to measure, and treatments uncertain, it becomes difficult to write meaningful quality specifications into requests for proposals and contracts. As a result, professional standards are often substituted. But the use of professional standards, like client/staff ratios, for quality measures can have the effect of forcing a local government to purchase a higher level of service than the public generally demands. Decisionmakers need to be able to distinguish a "Cadillac" from a "Chevy" in terms of service quality and to allocate resources with a knowledge of these distinctions. Despite these problems, considerable progress has been made toward identifying meaningful client outcomes.

Outcome/performance models hold considerably more promise for improving agency operations and client conditions than standards/compliance models used in isolation. Local governments should work with nonprofit agencies to develop meaningful outcome measures and to negotiate the costs of outcome design and of monitoring into contracts.

The present study, entitled Enhancing the Delivery of Public Services by Nonprofit Agencies, recommends that contractors document their implementation of strategic management principles: a current mission statement, annual operating goals, regular evaluation of programs, an annual budget that reflects mission and goals. Nonprofit managers are encouraged to know their costs and to price their services accordingly. The study also recommends that RFPs call for an agency to submit its entire budget, not just a project budget, when bidding. This gives the government knowledge of its share of the agency's operating budget and paints a better picture of agency costs and administrative overhead. Finally, the report recommends that the county, in partnership with other funders, offer annual workshops in management and financial management to assist the nonprofit agencies in gaining needed skills.

The study also recommends that agencies document their implementation of effective governance, that is, that the board of directors pays attention to strategic issues, that it hires and evaluates the executive director, that it approves an annual budget and operating goals, that it monitors program performance and financial condition, that it affords orientation sessions for new members. The county is also encouraged to work with other funders to maintain a roster of potential board members and to provide training for board members, which makes them more aware of their responsibilities to the community as well as to the organization.

It is recommended that county contract monitors keep a checklist of early warning signs, for instance, excess board or employee turnover, failure of the board to meet regularly and to keep accurate minutes, customer complaints, failure to meet reporting deadlines, late or inaccurate billing, the existence of pending lawsuits, negative trends in financial ratios. The existence of four or more warning signs should trigger a more intense contract review.

Contract Enforcement

One of our biggest challenges is identifying effective contract enforcement techniques. Applying sanctions can be extremely difficult when quality of care depends on continuity of care, or when there are no alternative providers. Sedgwick County plans to explore the possibility of rewarding good performance with reduced reporting requirements or increased flexibility. We will also consider financial rewards and penalties, like withholding 10 percent of payment if a contractor fails to meet specified outcomes or standards through mismanagement or misconduct, or giving a 5 percent bonus for meeting performance goals.

In addition to an emphasis on nonprofit performance, the new era of contracting holds major implications for how local government does business. Contracts do not manage themselves. We need workers who know how: to write clear and detailed specifications for RFPs and contracts, to solicit and evaluate bids, to negotiate contract details, to analyze costs, and to monitor for service quality and costs. These employees will need strong communication skills and sound judgment. If current employees lack these skills, a locality must provide training that helps them.

We all complain about the reporting requirements imposed on us by federal and state governments. This experience should guide the requirements we impose on others. We should work with state governments, United Ways, foundations, and other funders to ease the reporting burdens on nonprofits while ensuring accountability for public funds. We need to form partnerships that assist nonprofits in acquiring the management skills and information technology needed to meet our accountability demands.

This is the third major accountability model (after standards/compliance and outcomes/performance): capacity building. As a single funder, county government lacks the force to wield a major influence on nonprofit organizations, but in the long run the best results are likely to be achieved if agencies have the capacity to identify changing community needs; to adapt to shifting needs and operating environments; to build the information systems they need to accurately track finances and client outcomes; and to develop the managerial, financial, and technical skills for designing, funding, and implementing innovative programs.

An experienced researcher in this field suggests: "Government is no longer a buyer dealing at arm's length with a seller but a partner in a virtually seamless, mutually dependent relationship [emphasis added].(3) If there is an ounce of truth in this statement, then we as managers are required to rethink how we manage contracts with nonprofits. Our challenges are to find ways to hold nonprofits accountable without micromanaging them, and to work with other funders to build capacity in the nonprofit sector. I hope this study will help my colleagues begin this process.

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[1] Cited in Stephen Rathgeb Smith, "Government Financing of Nonprofit Activity," in Elizabeth T. Boris and C. Eugene Steuerle, Nonprofits and Government: Collaboration and Conflict (Washington, D.C.: Urban Institute Press, 1999), p. 186.
[2] Paul Light, Making Nonprofits Work (Washington, D.C.: Brookings Institution Press, 2000).
[3] Kettl, Donald F. Sharing Power (Washington, D.C.: Brookings Institution Press, 1993), p. 13.

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