

OPINION

Commentary and Letters

Charities Must Stand Up to States That Skimp on Payments for Services

By ALLEN PROCTOR

A HARD REALITY will soon confront the nonprofit world as the pressure to cut government spending gets more serious.

Nonprofits have long felt the tight pinch from state budget cuts, but they have masked much of the impact on people who rely on their services. That can't go on much longer.

A growing number of organizations that receive state aid will soon be forced to tell governments they cannot sign contracts that continue to offer such punitive terms. If state officials don't back down, nonprofits will face a tough choice: Deny services to some clients to help others or shut down and thereby deny aid to all clients.

This dilemma has been slowly building. State, federal, and local governments have been talking about spending cuts for years. Sometimes they have reduced spending and sometimes they have not. Either way, most taxpayers haven't seen any difference in their lives. They just see three issues: debt, deficits, tax increases. Who wouldn't want to eliminate or avoid all of them? Abolishing debt is good for the country, and it has no obvious personal impact. Erasing deficits also sounds good and is abstract enough for many individuals to anticipate little effect in their own lives. On the other hand, people can see that tax increases will come out of their own wallets.

Why is this myth that spending cuts don't affect real people so popularly ac-



MAX WHITTAKER/REUTERS/NEWSCOM

cepted and expansively broadcast by a wide swath of the political world?

Much of the answer lies with the behavior of nonprofit human-service organizations. In their devotion to helping serve community need no matter what, they have left many with the impression that government budget cuts make no meaningful difference.

Governments have been solving their budget problems by out-Wal-Mart-ing Wal-Mart. The discount retailer is famous for pressing its suppliers to lower their profit margins. Governments have been eliminating the profit margins of nonprofits.

They have done this in three ways documented by an Urban Institute survey of more than 32,000 nonprofits with government contracts:

- Skimping on payments. Sixty-eight

percent of nonprofits were paid less than the full cost of contracted services.

- Pushing costs to the nonprofits. For more than half of organizations, governments required nonprofits to match the government aid they received or absorb a portion of the government's cost.

- Paying late. More than half the nonprofits reported that the government reimburses them later than specified in the contract, typically 90 days later.

As a result, the majority of nonprofit service providers had to pay their bills when government payments weren't coming in, and when payments did arrive, they were less than the nonprofits' costs. This acquiescence has financially weakened nonprofit service providers.

PABLO EISENBERG

Fighting Fraud and Promoting Social Equity: a Nonprofit Agenda

AS THE 2012 elections focus debate on the nation's priorities, it's time for nonprofits to figure out how they can best serve a society increasingly divided over ideology, class, and financial scarcity.

The recent record has not been encouraging. Drastic cutbacks in government aid and the stagnant growth in foundation support have hurt many nonprofits, especially small and medium-size ones. Some groups have been forced to close their doors, while others are trimming programs to the bone. The largest and wealthiest nonprofits got richer, while small charities and grass-roots groups got poorer.

Many of the threats to nonprofits come from within. Fraud and embezzlement cost nonprofits billions of dollars, while compensation packages for CEOs of large organizations remain alarmingly large at a time when other workers face salary freezes and layoffs. Foundation performance has remained lackluster, as have the advocacy efforts of nonprofits in combating cuts in social safety-net programs.

If nonprofits are to play a more vital role in society, here are five things phi-

lanthropy and government must do together.

Eliminate theft, fraud, and other scandalous behavior. The prevalence of crime and ethically questionable behavior at nonprofits has eroded public confidence.

Bart Bevers, who regulated nonprofits as Attorney General of Texas, estimates that charities lose \$51-billion a year to thefts from employees and others. That represents a huge chunk of the nearly \$300-billion nonprofits collect annually from private donors.

Other experts have cited less explosive but still worrisome figures.

Nonprofit Imperative, a biweekly newsletter that collects information about nonprofit fraud, estimates that \$27-billion was stolen from nonprofits last year.

Much of the fraud goes unnoticed or is uncovered by journalists, not by the government agencies that should be on the lookout for trouble. That's because neither the Internal Revenue Service nor state attorneys general have been able to muster the resources or the will to oversee and police nonprofits aggressively.

It's time for Congress to take action and provide the regulators with the money and authority they need to crack down on nonprofit abuses. And nonprofits themselves must step up actions to protect their assets from abuse.

Make CEO pay more reasonable. Nonprofit chief executives continue to earn high sums, even at organizations that have had to cut their programs, lay off staff members, and scrap pay increases and benefits.

A typical private-college leader made 3.7 times as much as the average full professor on his or her campus in 2009, according to *The Chronicle of Higher Education*, and more than three dozen chief executives made more than \$1-million.

This comes at a time when tuition is high and a paucity of scholarship aid makes it impossible for many young people to afford higher education.

Nonprofit hospitals also pay their executives extraordinarily well at a time when they do little to provide care for the poor. Local studies by newspapers have identified scores of hospital chief executives who make \$1-million or more.

Nonprofits have allowed themselves to be taken advantage of in a manner that businesses would not tolerate. A for-profit company would never sign a government contract that didn't cover its costs, would insist on a profit, and would add a significant interest penalty for late payments.

Nonprofits may also be encouraging the situation by penalizing themselves and their employees rather than exposing the public to any reduction in services because of government cuts. Half of the nonprofits in the Urban Institute survey froze or reduced staff salaries, and more than 40 percent reduced staff benefits and tapped their reserves. But nationally only one-fifth made any reductions in services, and in 27 states the proportion of nonprofits that reduced services was even less than one-fifth. The upshot is that nonprofits have used their own cash and put their employees' financial welfare in jeopardy to maintain government services, thereby leaving many taxpayers with the impression that tax increases are not needed to preserve services.

It would be a grave mistake to assume that philanthropy can solve this problem. Private donations provide only 22 percent of nonprofit revenue, and the share has not exceeded 24 percent since 1985. The only way the next wave of government budget cuts will occur with no impact on government services is if nonprofits spend more from their reserves, assuming

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The same excessive compensation characterizes large foundations, health charities, and big social-service organizations.

Such high salaries are in part the fault of the IRS, which has been too vague about what level of pay is acceptable and too unwilling to penalize organizations that pay overly generous salaries. States have shown some interest in cracking down, and bills have been floated in several places to cap nonprofit salaries.

But this is not just the responsibility of government. Nonprofit boards need to stop approving such high pay at a time when money is so scarce and seek greater equity in pay among all workers.

Encourage donors to do more for the needy. Despite the desperate need by nonprofits to attract private aid to make up for the loss of government funds, foundations have not responded.

Wealthy individuals are not doing much better. As *The Chronicle of Philanthropy's* ranking of the 50 top donors of 2011 showed, most of the super-rich give to colleges, hospitals, and the arts.

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Nonprofits Need Leadership to Motivate Workers and Advocate for Change

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leaving very little for other nonprofits.

The giving patterns of both foundations and wealthy individual donors will continue to widen the gap between small grass-roots groups and big wealthy organizations. Witness the closing this winter of the venerable Hull House in Chicago, which was founded more than a century ago by Jane

Few White House staff members understand the needs of nonprofits.

Addams. Not one of the city's wealthiest residents came to the rescue of this vital institution when it faced dire financial problems.

Nonprofit coalitions like Independent Sector and the National Council of Nonprofits should devote more energy to putting pressure on foundations and other donors to give more to organizations that serve people hit by hard financial times.

Strengthen White House support. The Obama administration has given lip service to the importance of nonprofits in a shrinking economy, but it

has done no better than to hold a few meaningless conferences and establish a \$50-million innovation fund that has proved neither innovative nor productive.

A major part of the problem is that few White House staff members understand the needs of nonprofits. Their primary focus has been on entrepreneurial programs that form only a tiny segment of the nonprofit world.

One of the purposes of the Social Innovation Fund was to persuade more foundations to invest in promising nonprofit programs.

If the administration had really wanted to boost philanthropic giving, it should have used its bully pulpit to encourage foundations to spend more and urged Congress to force greater giving by increasing the minimum share of assets grant makers must distribute.

The recent appointment of Cecilia Munoz, former vice president for the National Council of La Raza, as director of the White House Domestic Policy Council is an encouraging sign of change. Putting a person who understands grass-roots and advocacy groups in a role of power is a big step forward for the Obama administration.

Invigorate nonprofit advocacy. Nonprofit coalitions have been fighting hard to protect

the charitable deduction despite little evidence that more than a billion dollars might be lost by the changes President Obama has proposed.

By contrast, leading nonprofit groups have done little or nothing to protect vital social and economic programs that have been put at great risk as Congress grapples with ways to rein in the deficit. Many nonprofit coalitions seemed more concerned with their narrow self-interest and greed than in the national interest.

Progressive groups must especially take steps to be more forceful in holding the Obama administration accountable for its social and economic policies, but programs that help low-income people should be a priority for all major social-service, health, environmental, and social-justice organizations.

Issues of poverty cannot be separated from cancer or heart disease, from housing or urban development, from environmental problems or questions of education. They are all related. Defense of the social safety net, if it is to be successful, can only

be achieved by broad coalitions working on national issues beyond the narrow missions of their member groups.

To meet these big challenges, nonprofits need leadership.

Now that Gara LaMarche has left as chief executive of Atlantic Philanthropies and Paul Brest has announced his retirement as head of the William and Flora Hewlett Foun-

Defense of the safety net can be achieved only by broad coalitions working on national issues.

datation, the foundation world has no visible leaders who can speak to the values and needs of its institutions. The same void in leadership can also be found at big nonprofits. Few heads of nonprofits seem to have a vision and commitment beyond the self-interests of their own organizations.

The shaky state of the economy and lack of funds have un-

settled nonprofit workers. A recent survey by *The Chronicle* found that a large majority of nonprofit employees were unhappy with their jobs, eager to leave them to seek new employment opportunities. As Paul Light, a scholar at New York University put it, "there is an anxiety in the sector that is palpable. This is a beleaguered work force. They are wondering what the future is going to look like, and they're right to wonder."

To meet the challenges ahead, the nonprofit world must develop the leadership that can calm and energize its work force, forcefully lead its advocacy and coalition activities, clean up the scandals, and hold government and politicians accountable.

Nonprofits have the potential to meet these challenges. The big question is whether they have the will.

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Social-Service Groups Must Negotiate Better Deals With Government or Risk Financial Ruin

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they have any, or their employees can survive with even lower salaries and benefits. When the next round of government cuts comes through, nonprofits will find they can ask no more of their hard-pressed employees, and their bank accounts will offer little help. Lower government payments will simply mean fewer services.

What will the taxpayers say when services disappear? It would be ironic if they blame the nonprofits for service cuts. But nonprofits have only three options, all of which point to eventual reduction in services. They can:

Continue doing what they have been doing. If salaries or benefits go much lower, many of their employees will have to seek work elsewhere. Losing employees, or alternatively laying them off, means reduced services. If nonprofits don't cut workers or services, they will operate until they can't make payroll or pay their bills. When nonprofits announce these changes, taxpayers will probably blame them for inefficiency or poor management rather than blaming the government's inadequate payments.

Play hardball. They can refuse to sign contracts that don't cover the full cost of providing services for government agencies. This is a no-win situation. They can survive by not taking government contracts and shift their clients to another "more caring" nonprofit,

or take the contract and join the race to the bottom. If a nonprofit quits providing services, the public will criticize it for not caring, and governments will probably blame reductions in service on the refusal of nonprofits to "help" the government provide services. If a nonprofit takes the contract without getting a fair payment, it will fail and nonprofit inefficiency will be blamed when needy people lose services.

Join together and demand better contract terms. Nonprofits can go to government with one voice and mount a clear public-relations campaign that lays out the financial reality of nonprofit survival in terms that business executives understand. The message could be something like: "Paying less than the cost is a sure formula for bankruptcy—and nonprofits aren't loading a profit margin on top." Nonprofits have never done this, and they have little practice in showing a unified front. Some may refuse to collaborate, charging their colleagues with trying to better themselves at the expense of larger government deficits and leaving their clients in the lurch.

None of these are good options, and all have the potential for nonprofits to take all the blame. Nevertheless, moving cautiously ahead with all of these approaches may provide the best way for Americans to get realistic.

Nonprofits must make sure they know what services are

key to this mission and which ones might be provided by other nonprofits. They must ensure that the key mission services are the ones they continue to provide even under money-losing contracts. They can concentrate their layoffs or wage reductions on the other programs they offer.

At the same time, every nonprofit should set a goal for the next year to reject at least one money-losing contract, however small, in the next six months. That could start a more productive discussion of the key role nonprofits play in the supply chain of government services.

Nonprofits must also join local associations or create new ones so they can share their financial challenges. Together they can make a concerted push to tell elected officials how much they lose on their government contracts and the impracticality of expecting philanthropy to surge to fill the gap.

Little steps on all fronts will draw some criticism. The alternative for many nonprofits, however, would ultimately be bankruptcy. In either case, taxpayers may finally see that government budget cuts usually mean fewer of the services that citizens believe they have every right to expect.

Allen Proctor is a consultant to nonprofits. He previously served as a chief financial officer at Harvard University and deputy budget director for New York City.

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