MAXIMIZING SOCIAL RETURN ON INVESTMENT:
How North Carolina Can Revise Its Statutory Oversight Requirements to Facilitate Efficient Grant Making to Nonprofit Organizations

By:
Casselle Alyce Elisabeth Smith

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ABSTRACT:
North Carolina dedicates a portion of its annual budget to grants to nonprofit organizations. However, the state’s current statutory and regulatory scheme does not require measurement of social return on investment from grants to nonprofit organizations. This paper evaluates current statutes affecting oversight of state-funded nonprofits throughout the country and considers how the most effective elements from those statutes can be applied in North Carolina to facilitate more efficient grant making to nonprofits.
INTRODUCTION
North Carolina dedicates a portion of its annual budget to grants to nonprofit organizations. In order to guarantee the efficient allocation and utilization of state resources, state lawmakers must ensure that grants are only awarded to the most efficient nonprofit service providers. However, because such organizations are not profit driven, the value derived from their funding is not easily monetized through traditional econometric models. Many scholars and practitioners believe that social return on investment (SROI) analysis is one way to measure the social and socioeconomic value created by nonprofit organizations. However, the state’s current statutory oversight scheme does not require the type of reporting necessary to perform SROI analysis. This paper evaluates current statutes affecting oversight of state-funded nonprofits throughout the country and considers how the most effective elements from those statutes can be applied in North Carolina to facilitate more efficient grant making to nonprofits.

BACKGROUND
In recent years, North Carolina has distributed as much as $694 million per year in grants to nonprofit organizations. These grants are essential to the state because agencies alone cannot meet citizens’ service demands, and private providers often have specialized expertise that allows them to provide higher-quality services. Unfortunately, the state cannot ensure a maximum return from these grant allocations because there is no codified mechanism for evaluating grantee outcomes. Adopting legislation that requires grantees to report on the financial value their programs create is a potential solution for this gap in oversight. However, in the nonprofit sector, such evaluations are very complicated because outputs and outcomes are not easily monetized through standard return on investment models.

Businesses measure the value of their programs in three different ways – economic, social, and/or socioeconomic. Traditional econometric models (e.g., return on investment, debt/equity ratios, price/earnings, etc.) measure the economic value created by a given enterprise. Such measures are not sufficient to evaluate nonprofit organizations because, generally speaking, nonprofit organizations do not define their missions in terms of economic value creation. Instead, most nonprofits create social value by combining resources, inputs, and processes to generate improvements in the lives of individuals or society as a whole. Nonprofits create intangible products, and it is difficult to quantify the intrinsic worth of these products. For that reason, some scholars and practitioners suggest that government funders should be primarily interested in a grantee’s socioeconomic value – the ability to increase the value of inputs by decreasing public spending and increasing tax revenues (e.g., initiatives that transition public assistance recipients into private employment).

Much of the literature regarding performance evaluations of nonprofit organizations suggests that social and socioeconomic value can be measured using “social return on investment” (SROI) analysis. The SROI Network calculates social value using a principle-based SROI model. This approach focuses on engaging stakeholders, using financial proxies to capture values traditionally excluded from markets, and using performance measures (benchmarks, targets, and external standards) to establish outputs and outcomes. Meanwhile, in Social Return on Investment: Exploring Aspects of Value Creation in the Nonprofit Sector, authors Suzi Chun, Jed Emerson, and Jay Wachowicz, frame an SROI model focused on socioeconomic value. Their model identifies the direct, demonstrable governmental cost savings and revenue contributions resulting from a given initiative. Although they vary significantly, both types of SROI models require concrete input, output, and outcome data.

The North Carolina statutory and regulatory scheme does not require state-funded nonprofits to submit input, output, and outcome data. The governing statute obligates the Office of State Budget and Management to “adopt rules to ensure the uniform administration of state grants by all grantor state agencies and grantees.” Those rules focus on financial auditing and only require minimal programmatic reporting. As a result, agency practices are inconsistent, data collection is insufficient, and statewide accountability is inadequate.
RESEARCH QUESTION
This paper evaluates current statutes affecting state grantee oversight throughout the country and considers how the most effective elements from those statutes can be applied in North Carolina to facilitate more efficient distribution of grants to nonprofits.

METHODOLOGY
Using LexisNexis, I canvassed the statutory codes of all 50 states and the District of Columbia looking for statutes affecting grantee oversight. Because state statutory schemes vary so widely, I performed several searches within each state’s code. Each search focused on a different area of law: nonprofit grantees, procurement contracts, auditing, and government accountability. After collecting the statutes, I sorted them by oversight mechanisms. Next, I determined which mechanisms offered potentially effective systems for ensuring adequate data collection. Finally, I further analyzed the most effective statutes to tease out trends in the following areas: actors affected, data solicited, level of specificity, and enforcement mechanisms.

FINDINGS
There is no consistent model for statutory oversight of state-funded nonprofits. Only North Carolina and Georgia have statutes specifically designed to regulate state funding to nonprofits. In the remaining states, nonprofit oversight requirements stem from statutes located in more general sections of the code: auditing, procurement, executive agencies, budgeting, and accountability. In general, oversight mechanisms fit into the following categories: auditing, performance-based contracting, performance budgeting, and strategic planning.

In most states, auditing statutes are the only statutory mechanism in place to oversee state-funded nonprofits. In terms of collecting input, output, and outcome data for those nonprofits, these statutes are not at all effective. Auditing statutes offer no affirmative reporting requirements. At best, they encourage all contractors to maintain their own records that will be presented to the state only in the event of an actual audit. Moreover, the majority of auditing statutes only address an organization’s financial information. They do not mention program outputs or outcomes at all.

When drafted properly, the three remaining types of oversight mechanisms – performance-based contracting, performance budgeting, and strategic planning – can ensure that state collects input, output, and outcome data. The existing state statutes within each category do not conform to a uniform structure. Rather, they vary in terms of the actors affected, data collected, level of specificity, and enforcement mechanisms. That said, there are discernable trends within each category. Each of the three potentially effective oversight mechanisms is discussed below. Examples from the various states are examined with an eye toward potential gaps in the type of data solicited, interagency uniformity, and enforceability.

Performance-Based Contracts
Broadly defined, a performance-based contract (PBC) is a contract for services that allows the contracting governmental entity to hold the contracting nongovernmental entity accountable for mutually agreed upon service outcomes. In a PBC the contracting governmental entity defines the expected results, lists required performances measures, and – where appropriate – links such requirements to a portion of the service provider’s payment. In so doing, PBCs provide for more accountability than traditional service contract, which simply state the activities that the nongovernmental entity must provide. Arkansas, Colorado, and Connecticut have statutes requiring that all service agreements with nongovernmental organizations be executed through PBCs. The following statutory analysis demonstrates that simply requiring agencies to use PBCs is inadequate. However, the analysis also shows that lawmakers can bolster such legislation by specifically addressing the multiplicity of issues that may arise from the use of PBCs.

The Arkansas “Development and Use of Performance-Based Contracts” statute simply mandates that the State Procurement Director promulgate regulations mandating that “all state agencies, boards, commissions, and institutions of higher education shall use performance-based standards in professional
and consultant service contracts.” The accompanying statutory language clearly documents the legislature’s intent to use PBCs as means to increase government accountability. However, on its face, this statute does not ensure affirmative reporting, performance evaluations, or effective enforcement.\textsuperscript{x}

The Colorado statute is better but still flawed. It has a strong enforcement mechanism, but it does not specifically address the level of data that must be collected. The statute states that all contracts exceeding $100,000 must include performance measures, performance monitoring, and accountability sections. It also details the repercussions for contractor noncompliance (i.e., payment of damages and contractor disqualification). Per the statute, each contracting agency must designate an internal employee to be responsible for ensuring that all contracts comply with statutory requirements. The statute also establishes a centralized contract management system to ensure information sharing across agencies. While the statute does mandate the inclusion of performance evaluation measures and standards in each contract, it gives no guidance as to the required breadth or depth of the measures.\textsuperscript{xii} Therefore, a contract could comply with the statute by requiring contractors to report on activities performed (outputs) under the contract without addressing outcomes. This ambiguity leaves room for inconsistent agency practices. The Connecticut statute picks up where the Colorado statute left off by addressing both interagency uniformity and the need for outcome measures. The Connecticut statute establishes a State Contracting Standards Board that is obligated to assist state contracting agencies with “drafting contracts that achieve state goals of accountability, transparency, and results based outcomes.”\textsuperscript{xiii} It also mandates that the head of each agency appoint an agency procurement officer. The agency procurement officers must evaluate contractor performance, submit written evaluations to a central data repository, and create a project management plan with annual reports to the Board. Additionally, the agency procurement officer shall serve as a liaison between the agency and the state’s Chief Procurement Officer to ensure compliance with all statutory and regulatory provisions. In this way, the Connecticut statute guarantees that all state contracts require results-based outcomes and that contract performance is actually evaluated and reported. The State Contracting Standards Board and Chief Procurement Officer enforce uniform compliance, while agency procurement officers ensure that agency-specific needs are met.

Performance-based contracting statutes have the potential to be extremely valuable because of their ability to directly enforce grantee compliance. However, there is a considerable amount of disagreement among public administrators regarding what qualifies as a PBC.\textsuperscript{xiv} Therefore, simply stating that all agencies shall use PBCs does not ensure reporting on inputs, outputs, and outcomes. Statutes are most effective when they contain clear language requiring that all contracts include sections detailing performance measures (capturing the relationship between inputs, outputs, and outcomes), performance monitoring (requiring affirmative reporting by contractors), and accountability (repercussions for contractor noncompliance).

**Performance Budgeting**

In a performance budgeting system each government agency must furnish the legislature with a budget request that outlines what the agency plans to accomplish with the requested budget allocation. If properly drafted, performance budgeting statutes compel agency compliance by asserting that budget requests shall not be approved unless they meet certain criteria. This system allows state lawmakers to make funding decisions based on expected program outcomes. However, performance budgeting statutes are not as effective as performance-based contracting statutes because they do not directly require affirmative reporting by state-funded nonprofits. Delaware, the District of Columbia, and Florida each have a performance budgeting statute that requires agencies to describe what they plan to accomplish and the performance measures that they will use to evaluate their spending.

The Delaware Governmental Accountability Act mandates revisions to the budget document in an effort to increase government accountability, efficiency, and effective allocation and utilization of state resources.\textsuperscript{xv} The statute mandates the following revisions: the addition of a comprehensive mission statement, a performance measure for each internal program unit, an organizational chart for each department, details regarding each agency's background and accomplishments, and a description of the
link between the proposed allocation of services and what programs and/or services the agency will be able to accomplish. The District of Columbia’s “Budget and Financial Management” subchapter includes more detailed performance-measure specifications than the Delaware statute. The DC subchapter requires that the performance measures be able to assess “the efficiency with which the agency produces results, outputs, and services and meets the demands for activity by the agency.” Both Delaware and DC address agency outputs, but both stop short of specifically addressing program outcomes.

Florida’s statute reaches deeper to touch on outcomes. It explicitly states that agencies must “maintain a comprehensive performance accountability system containing, at a minimum, a list of performance measures and standards that are adopted by the Legislature.” The performance measures and standards must be drafted such that “outcomes are clearly delineated for each service or program, as appropriate, and outputs are aligned with activities.” The statute further stipulates that “output measures should be capable of being used to generate a unit cost for each activity resulting in a true accounting of what the state should spend on each activity it provides and what the state should expect to accomplish with those funds.”

These performance budgeting statutes are not ideal for collecting adequate data from state-funded nonprofits. Each statute implicitly assumes that agencies will conduct performance evaluations; however, no statute explicitly mandates performance reporting to a single statewide entity. What is more, these statutes fail to address grants to nonprofits. Theoretically, to comply with the statute, an agency would have to require extensive reporting by grantees. However, actual data collection standards are most likely inconsistent across agencies because these statutes do not directly address affirmative reporting or grantee obligations.

**Strategic Planning**

During a strategic planning process, organizations set long-term goals and redesign their current operations to meet those goals. Ideally, a strategic plan aligns a government’s missions, goals, and tactics. California, the District of Columbia, Idaho, Kentucky, and Massachusetts each have strategic planning statutes. Ostensibly, each law was passed to increase government accountability and efficiency. However, the following analysis shows that strategic planning statutes do not always guarantee the same. The California and Massachusetts statutes appear vague and aspirational, at best. The remaining statutes lack adequate specificity and fail to address activity-level accountability. Therefore, none of these statutes guarantee that state-funded nonprofits will actively supply the state with outcome reports.

California’s Development of Strategic Plan statute mandates that agencies consult with stakeholders (employee organizations, the legislature, client groups served, suppliers, and contractors) to develop a strategic plan including performance measures and “identify the steps being taken to develop performance measures.” It was the intent of the legislature that such strategic plans “form the basis for conducting performance reviews pursuant to the [Strategic Planning and Performance Reviews statute] or for the implementation of performance budgeting systems.” Similarly, a Massachusetts statute creates an Office of Commonwealth Performance, Accountability, and Transparency charged with executing a performance management program throughout the executive department by “defining missions, creating measurable goals, establishing strategies for achieving those goals, and relating them to budget development.” However, both statutes stop there – offering no further implementation guidance, requirements, or oversight. Without more guidance, these statutes will not effect consistent reporting on outputs and outcomes.

Idaho and Kentucky have more comprehensive strategic planning statutes that require performance measures with benchmarks and performance targets. In both states, agencies must submit a report that states the progress made toward goal attainment as measured by the performance indicators set forth in their strategic plan. Additionally, per their statutes, both Idaho and Kentucky must provide training for the agency actors that will create the strategic plans. Only Idaho explicitly requires agencies to submit their performance report as part of their annual budget request.
Although they are much more comprehensive than California and Massachusetts, the Idaho and Kentucky statutes still fail to address state-funded nonprofits. Theoretically, in order to faithfully adhere to state statutes, state agencies in Idaho and Kentucky require nonprofit grantees to submit performance reports. However, a progress report may only discuss how each grant award demonstrates the agency’s effort to meet a specific goal without explicating the grantee’s actual outputs and outcomes.

Only the District of Columbia’s statute addresses the issue of government-funded nonprofits. It explicitly states that the mayor’s annual performance accountability plan shall include a statement of measurable, objective performance goals established for all significant activities of the government, including “activities funded in whole or in part by the District but performed in whole or in part by some other public or private entity.”

The purpose of strategic planning statutes is not to elicit input, output, and outcome reports from state-funded nonprofits; however, the statutes often lead to grantee reporting on this information. Additionally, they offer something that performance-based contracting and performance budgeting statutes do not: the opportunity to take a holistic view of government functions and effect alignment between missions, goals, and strategies.

**RECOMMENDATIONS**

North Carolina should revise its grantee oversight statute. The revised North Carolina statute should begin with a strategic planning framework. The statute should mandate that each agency develop a strategic plan that includes outcome measures with benchmarks and performance targets. Like Idaho and Kentucky, North Carolina should encourage best practices by obligating the Office of Management and Budget to develop and implement a training program for all individuals responsible for creating such strategic plans. To ensure compliance, the state should require agencies to submit progress reports as part of their annual budget request. This approach will force agencies to be thoughtful about how grant awards serve the goals of the contracting agency and how those goals relate more broadly to state policy initiatives.

Next, the oversight statute should include a section mandating that all contracts governing grant awards be performance-based. This is the most effective way to directly attach an enforceable reporting requirement to all grantees. To encourage best practices, North Carolina may consider including a clause that obligates the Division of Purchase and Contract to assist state agencies with contract drafting. However, that clause notwithstanding, the statute should unequivocally outline minimum contract standards to ensure interagency uniformity.

The performance-based contract standards should explicitly include the following: an affirmative reporting requirement, concrete output and outcome benchmarks, monitoring programs that describe how performance will be measured, and an accountability section outlining repercussions for nonperformance. Failure to report and/or failure to meet output and outcome benchmarks should be considered a breach of the terms of the grant contract. Such breach should nullify the contract and disqualify the grantee from receiving state funds for a period of twelve months. If the grantee wishes to reapply after the twelve-month period lapses, it must explain its previous failure to comply and show why it is nonetheless the most qualified service provider.

**CONCLUSION**

By incorporating the strongest elements from legislation around the country, North Carolina can craft a statute that ensures input, output, and outcome reporting by state-funded nonprofits. This will enable the General Assembly to use SROI analysis to evaluate the social and/or socioeconomic value created by grants to nonprofits. In so doing, the state will be taking the first step toward more efficient distribution of state grant funds. What is more, by incorporating strategic planning, lawmakers can use such legislation to ensure a unified understanding of the mission, goals, and performance expectations of each state agency.
An SROI analysis does the following:

1. Examines a social service activity over a given time frame (referred to as “Time Zero”) using a net present value and/or economic value of those costs in real dollar terms; (2) calculates the amount of "investment" required to support that activity and articulate all the values, objectives and stakeholders of the organization before agreeing which aspects of the organization are to be included in the scope; and determine what must be included in the account in order that stakeholders can make reasonable decisions; (3) value the things that matter: use financial proxies for indicators in order to include the values of those excluded from markets in same terms as used in markets; (4) only include what is material: how activities create change and evaluate this through the evidence gathered; (5) do not over-claim: make comparisons of performance and impact using appropriate benchmarks, targets and external standards; (6) be transparent: demonstrate the basis on which the findings may be considered accurate and honest; and showing that they will be reported to and discussed with stakeholders; (7) verify the result: ensure appropriate independent verification of the account.


“A SROI analysis does the following: (1) Examines a social service activity over a given time frame (usually five to 10 years); (2) calculates the amount of "investment" required to support that activity and analyzes the capital structure of the non-profit that is in place to support that activity; (3) identifies the various cost savings, reductions in spending and related benefits that accrue as a result of that social service activity; (4) monetizes those cost savings and related benefits (that is to say, calculates the economic value of those costs in real dollar terms); (5) discounts those savings back to the beginning of the investment timeframe (referred to as "Time Zero") using a net present value and/or discounted cash flow analysis; and (6) then presents the Socio-Economic Value created during the investment time frame, expressing that value in terms of net present value and Social Return on Investment rates and ratios.”

Required Reporting - Grants Information Center (included actual worksheet in appendix)

Program Evaluation Division, supra note 1, at 12

See Appendix A for Official Code of Georgia §50-20-3 and North Carolina General Statutes §143C-6-23, respectively.


Appendix B, Arkansas Code §19-11-1010(c)

Appendix B, Arkansas Code §19-11-1010(a)

See Appendix B, Colorado Revised Statutes 24-103.5-101

Appendix B, General Statutes of Connecticut at §4e-4(f)(3)
xiv Id.
xv Appendix C, Delaware Code Title 29 §10502(b)
xvi See Appendix C, Delaware Code Title 29 §10502(d)
xvii Appendix C, The District of Columbia Code §47-308.01(a)(3B)(D)
xviii Appendix C, The 2012 Florida Statutes §216.1827(1)
xix Appendix C, The 2012 Florida Statute §216.1826
xx Id.
xxi Appendix D, California Government Code § 11816
xxii Appendix D, California Government Code § 11817
xxiii Appendix D, Massachusetts General Laws Chapter 7 §4A(e)
xxiv Appendix D, The District of Columbia Code §1-204.56a(b)(1)