



State Grants to Nonprofit Organizations

State grants should be more consistently and effectively managed.

Major Findings:

- In 2005, the State of Minnesota made \$4.7 billion in payments to nonprofit organizations. Most of the money was paid directly to hospitals, health plans, and other large institutional service providers. Approximately \$1 billion was awarded in grants to almost 1,900 nonprofit organizations and administered by either a state or county agency.
- State grants to nonprofit organizations pay for a wide range of services—from environmental projects to employment training for the disabled.
- The state’s approach to managing grants to nonprofit organizations is fragmented and inconsistent, and does not provide adequate accountability.
- Many state agencies have grant-making policies and procedures, but they vary considerably in the degree to which they provide for oversight and accountability.
- Agency oversight of grant recipients is especially weak when the Legislature selects and names a recipient in law, rather than allowing the agency to select the recipient.

Key Recommendations:

- The state should establish a Grants Management Office in the executive branch to strengthen accountability and improve management of state grants.
- The Grants Management Office should have the authority to formalize and require agencies to follow the best practices discussed in this report.
- The Legislature should not name grant recipients in law but allow agencies to select recipients through a competitive process.

The full evaluation report, *State Grants to Nonprofit Organizations*, is available at 651-296-4708 or:

www.auditor.leg.state.mn.us/ped/2007/grants.htm

Report Summary

Minnesota state government uses nonprofit organizations to provide a wide range of services to citizens and communities.

Many of the services are provided by large nonprofit institutions (for example, hospitals and health plans). In addition, state agencies award individual grants to nonprofit organizations for services ranging from wetland protection to job training. In 2005, the state awarded almost \$1 billion in grants to approximately 1,900 nonprofit organizations. The grants were administered by a state or county agency.

Currently, the state does not have a consistent approach for managing grants. The Department of Administration has developed guidelines and a model grant agreement to help state agencies, but it does not monitor how well agencies adhere to them. In lieu of a state grant management system, state agencies have developed their own grant policies. As a result, the state has a fragmented system of grant management and oversight. We found that actual grant management practices vary considerably and oftentimes provide inadequate oversight of state grants.

The report suggests some solutions to the state's inadequate management of grants. Specifically, we recommend that the state create a Grants Management Office in the executive branch to establish, implement, and enforce grant management best practices.

Nonprofit organizations have come under increased scrutiny.

In recent years, there have been several reports nationally regarding the misuse of funds by nonprofit organizations. For example, the former chief of the Washington, D.C. chapter of the United Way pled guilty to stealing almost \$500,000 of United Way funds, and the New York chapter of the United Way learned through an internal investigation that its former leader had diverted over \$200,000 in charitable assets for personal use. These and other reports of misuse of funds by nonprofit organizations have been the focus of scrutiny by Congress.

In August 2006, Congress enacted legislation to reform the laws applying to nonprofit organizations. Included among the many reforms were provisions to (1) increase the penalties imposed on directors and officers who use their relationship with an organization for personal benefit, and (2) extend annual IRS reporting requirements to smaller nonprofit organizations.

Reports issued by our office over the past few years have also found problems with some Minnesota nonprofit organizations that received state funds. These investigations identified inadequate financial controls and inappropriate spending of state funds by some grantees. In addition, these reports highlighted inadequate oversight of state grants by several state agencies.

One-half of the state payments to nonprofit organizations in 2005 were for health- and education-related services.

Minnesota state government obtains goods and services from the private sector—both for-profit and nonprofit—in three basic ways: purchase orders, contracts, and grants. When state agencies use private sector organizations to obtain services for citizens or communities (not for state government itself), the payments are categorized as grants.

State payments to nonprofit organizations for all purposes, including grants and contracts, totaled \$4.7 billion in 2005. For the purposes of this evaluation, we excluded nonprofit organizations that were more “institutional” in nature, such as health plans and hospitals. The services the state purchases from these organizations are closely regulated and payments are made directly through the state's centralized payment systems. The remaining nonprofit organizations are the focus of this report. In 2005, they received almost \$1 billion through state grants administered by either a state or county agency.

Ten state agencies accounted for over 95 percent of the state funds paid to nonprofit organizations in 2005. The Department of Human Services alone accounted for almost two-thirds of the state funds paid to nonprofit organizations. Collectively, the

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departments of Human Services (DHS), Education (MDE), and Employment and Economic Development (DEED) accounted for almost 80 percent of expenditures made to nonprofit organizations in 2005. In contrast, 40 state agencies spent less than \$10,000 in 2005 on services delivered by nonprofit organizations.

State funding to nonprofit organizations is heavily concentrated in a relatively small number of organizations. Of the 3,178 nonprofit organizations that received state funds in 2005, 229 (7 percent) received 75 percent of the state funding paid to nonprofit organizations.

In 2005, almost 60 percent of state funds awarded to nonprofit organizations was given to organizations providing services in one of the following three categories: (1) health services and related activities (30 percent of funds), (2) education and related services (19 percent), and (3) other activities directed to individuals (10 percent). A large number of cultural and business organizations also received state funds, although organizations in each of these categories received less than 1 percent of the state funds paid to all nonprofit organizations.

Minnesota state government has a fragmented approach to grant management that lacks oversight and accountability.

Unlike oversight of other state contracts, such as professional/technical and service contracts, Minnesota does not have a consistent approach to grant management. State statutes require the Department of Administration to approve most other contracts but allow the department to choose whether to approve grant contracts. Currently, the department does not approve other agencies' grant contracts or oversee them in any manner.

State statutes and the Department of Administration's contract policies provide some broad standards for grant management, but the policies are not enforced. One section in the Department of Administration's contract manual specifically addresses grants. While Administration staff told us these policies should be considered "directives" rather than suggestions, staff also acknowledged

that they do not review agencies' practices to ensure that these policies are being implemented.

Despite having less consistent oversight, agencies manage significantly more funds through grants than through professional/technical contracts. As noted earlier, state agencies spent about \$1 billion on grants to nonprofit organizations in 2005. Agencies also make grants to other entities, such as for-profit and government organizations, that are not included in this figure. In contrast, state agencies spent just over \$354 million on all professional/technical contracts during the same time period.

In 2005, Governor Pawlenty's Drive to Excellence included a grants initiative that focused on the lack of a consistent statewide grant management process. The initiative found that: "There are no statewide standards in grants management policies, practices and supportive systems. This lack of consistency causes inefficiency in the administration of grants programs. . . ."¹

Minnesota state agencies have their own grant management policies, which vary widely and provide for limited oversight and accountability.

We reviewed grant policies for six state agencies: MDE, DEED, DHS, and the departments of Health, Natural Resources (DNR), and Public Safety (DPS). These agencies ranged from having no agency-wide grant management policy (DNR) to detailed grant policies (MDE, DHS, and DPS).

None of the agencies we reviewed have grant policies that reflect all of the grant management evaluation criteria presented in the report. Most of the agencies that we reviewed do not have policies that require specific levels of monitoring, such as conducting formal site visits of grantees or reconciling requests for payment with financial documentation.

¹ State of Minnesota's Drive to Excellence, *Annual Report to the Governor* (St. Paul, December 2005), 41.

No single agency in the executive branch ensures that state grants are appropriately managed.

We reviewed 50 grants and found significant problems.

Minnesota state agencies provide inconsistent and sometimes inadequate oversight of grants.

To evaluate agency practices, we selected 50 grants made to nonprofit organizations. We selected a variety of nonprofit organizations for our review, including those that had received state funding for several years and those that were awarded new grants, those that received large payments from the state and some that received relatively small payments, and some that were specifically named in statute.

Our file review evaluated all phases of the grant management process—from grantee selection to grant closeout. In almost all of these phases, we found that state agencies differ in their management of grants. Moreover, we often found that units within state agencies differ in how they manage grants.

When we compared the grant management practices we observed through our file review to the evaluation criteria (best practices) outlined in the report, we found that the state’s management of grants was often inadequate. For example, less than half of the grants we reviewed were competitively awarded. In only one-third of these grants, grant application reviewers were required to sign forms asserting that they did not have a conflict of interest. For less than one-quarter of the grants competitively awarded, grant applicants were required to submit financial information regarding the health of their organization.

Agencies varied widely in the level of monitoring they provided for their grants. In contrast to the evaluation criteria, agency staff conducted formal site visits in less than half of the grants we reviewed. Similarly, in 35 of the grants we reviewed, grant managers did not compare grant payment requests to grantees’ financial records in order to verify that grantees used state grant funds as intended.

In general, state agencies provide less oversight of legislatively-mandated grant recipients than other grantee organizations.

The Legislature sometimes names or describes in law the organization that is to receive a state grant. Agency staff said that, because legislatively-mandated grantees are awarded funds by law, the agencies’ enforcement authority over these grantees is unclear.

Ten of the grants we reviewed involved legislatively-mandated grantees. We found that agencies were in fact less likely to require work plans or interim reports and more likely to provide payments to these grantees in advance of work being performed. Grant managers were also less likely to conduct site visits for legislatively-mandated grantees than for grants to other organizations.

For many of the grants we reviewed, agency staff did not verify that grant funds were used as intended.

Summary of Agency Response

In a letter dated December 12, 2006, Public Safety Deputy Commissioner Mary Ellison, who is also Team Leader of Governor Pawlenty’s Drive to Excellence Grants Management Steering Committee, wrote that she was “pleased to note that the recommendations of [the OLA] report are consistent with those of the Drive to Excellence Grants Management Steering Committee.” She further commented that she “look[s] forward to working with [OLA] and the legislature in furthering the goal of consistent professional management of grants to Minnesota nonprofit organizations.”