Accountability Gaps Limit State Oversight of $694 Million in Grants to Non-Profit Organizations

PROGRAM EVALUATION DIVISION
NORTH CAROLINA GENERAL ASSEMBLY

Final Report to the Joint Legislative Program Evaluation Oversight Committee

Report Number 2009-02

November 9, 2009

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The Program Evaluation Division 2009-2010 Work Plan, updated September 1, 2009, directed the Program Evaluation Division to review practices and policies regarding oversight of state grants to non-profit organizations. This study examined whether current oversight provides assurance that public resources are spent in the way intended by the state.

The statewide policy focus of this review required that we collect data from a wide range of state agencies. In particular, we would like to acknowledge the Office of the State Auditor, Office of State Budget and Management, Department of Health and Human Services, and staff from the numerous agencies interviewed for this report. I am pleased to report that all cooperated with us fully and were at all times courteous to our evaluators during the evaluation.

Sincerely,

John W. Turcotte
Director

PROGRAM EVALUATION DIVISION
NORTH CAROLINA GENERAL ASSEMBLY

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Accountability Gaps Limit State Oversight of $694 Million in Grants to Non-Profit Organizations

Summary

As directed by the North Carolina General Assembly's Joint Legislative Program Evaluation Oversight Committee, this policy review examines practices and policies regarding oversight of state grants to non-profit organizations. The specific focus of this investigation is whether current oversight provides assurance that public resources are spent in the way intended by the state.

Because statutes stipulate state funds include federal funds that flow through the State Treasury, the amount of money involved is considerable: $694 million was distributed to non-profits in Fiscal Year 2007-08.

Although grants to non-profits are covered by administrative rules and statutes that were intended to assure accountability for non-profit grants, findings from this review indicate persistent gaps that stand in the way of this goal. Statewide reporting requirements do not require sufficient documentation, do not adequately address program performance outcomes, fail to produce timely reporting, and lack sufficient enforcement. Contracts can provide a framework for establishing and tracking performance benchmarks, but current contract requirements often fail to do so because administrative rules are not consistently implemented. At the agency level, despite strong practices in some grant programs and agencies, inconsistent grants monitoring results in a lack of accountability statewide.

Based on these findings, the Program Evaluation Division developed four recommendations for action by the General Assembly:

- modify statutes to improve oversight of grants to non-profits by requiring performance-based contracting, program monitoring plans, and more timely and accurate reporting;
- emphasize competitive grant award processes and limit awards to legislatively named grantees;
- increase enforcement of reporting requirements by directing the Office of the State Controller to electronically stop payments to grantees that are ineligible to receive state funds; and
- enact legislation to give agencies the authority to withhold up to 2% of grant awards to fund oversight activities statewide and at the agency level.

Scope

As directed by the North Carolina General Assembly's Joint Legislative Program Evaluation Oversight Committee,[1] this policy review examines practices and policies regarding oversight of grants to non-profit organizations. The particular focus of this study is whether current oversight and management of state grants to non-profits provide assurance that public resources are spent in the way intended by the state.

This review addresses three central research questions:

1. To what extent and for what purposes do state agencies fund the activities of non-profit organizations?
2. What are best practices for tracking performance of non-profits?
3. How well does North Carolina track performance among non-profit grant recipients?

Data were collected from several sources, including

- the Grants Information Center database;
- Office of the State Auditor;
- surveys of agency staff responsible for grant oversight;
- interviews with agency staff including members of the Grants Management Oversight Committee;[2] and
- a review of grants-management policies and practices in foundations and other states.

Grants to private for-profits and government entities (local governments and the state university system) are mentioned but are not the focus of this review because they are not governed by policies that are the subject of this report. State funds disbursed through mechanisms other than grants (e.g., purchase of services) are also outside the project scope because they are subject to different oversight requirements.

Background

A central role of state government is to provide citizens with public services. Engaging non-government providers is essential to fulfilling this role because state agencies alone cannot meet the needs of citizens, outsourcing can be cost-effective and efficient, and private providers may provide higher-quality services where they possess needed expertise. In addition, outsourcing helps promote and sustain local non-government providers of goods and services. Grants are a key means to disburse funds to providers in North Carolina. This report focuses on policies that guide oversight of state grant funds disbursed to non-profit entities.

A grant is an agreement between the state and a private for-profit, non-profit, or governmental entity to carry out a program or provide services.[3] Grants are financial assistance arrangements, where the grantee receives state funds directly or pass-through funding from the federal government.

[1] The Joint Legislative Program Evaluation Oversight Committee establishes the Program Evaluation Division's work plan in accordance with N.C. Gen. Stat. § 120-36.13.

[2] The Committee was convened by the Office of State Budget and Management and includes representatives from the Office of State Budget and Management, Office of the State Auditor, Office of the State Controller, Attorney General's Office, and a representative of grantor agencies.

[3] Grants do not include payments made by Medicaid, the State Health Plan, or similar medical plans.

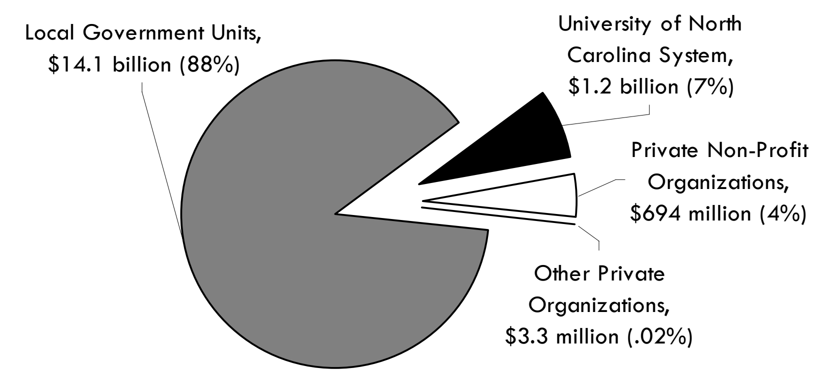
Once they are funded, grantees determine how best to deliver programs in accordance with contract terms established by state agencies.

As with any public expenditure, accountability information should document how—and how well—state grant funds are spent. By design, the grants mechanism distributes funds and responsibility for those funds across the state to multiple grantees. The resulting decentralization reduces the state's influence over the operation of grant programs, thereby increasing the importance of oversight to ensure appropriate use of public funds. Until recently, there was scant oversight of grants in North Carolina. Policymakers quickly recognized the need for stronger accountability rules due to the scandal involving former State Senator Frank Ballance and the John A. Hyman Memorial Youth Foundation. More recently, with over $1.7 billion in grants from the American Reinvestment and Recovery Act of 2009 coming to North Carolina, concerns over accountability have intensified.

N.C. Gen. Stat. § 143C-6-22(a) stipulates state funds include federal funds that flow through the State Treasury. As shown in Exhibit 1, the state disbursed a total of $15.9 billion in Fiscal Year 2007-08 to government and non-government entities. Most of this amount ($15.3 billion) was granted to government entities comprised of local government units and the University of North Carolina system. Agencies awarded the remaining 4% ($697.3 million) to non-government entities, most of which ($694 million) went to non-profit organizations.[4]

Exhibit 1

State Grant Funds to Private Entities and Government Units, Fiscal Year 2007-08



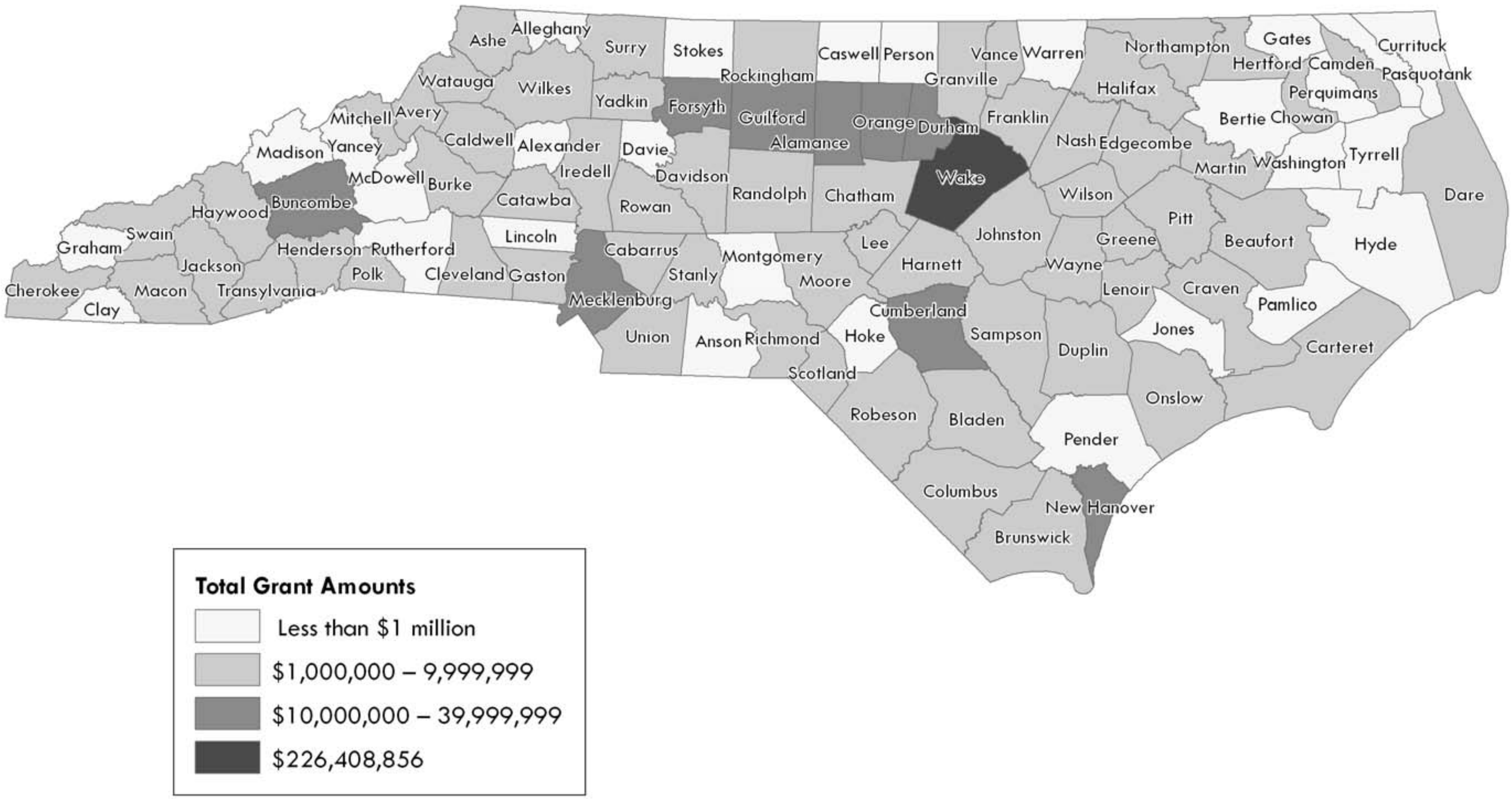
Note: Values do not add to 100% due to rounding.

Source: Program Evaluation Division based on data from the Sponsored Program and Research Council (University of North Carolina), Grants Information Center (non-profit and other private organizations), and Office of the State Auditor (local government units).

In Fiscal Year 2007-08, state agencies disbursed grant funds to non-profits with main offices in all of North Carolina's 100 counties (see Exhibit 2; some non-profits provide services in counties other than where their main offices are located). As shown, non-profits located in major metropolitan areas garnered the highest grant dollars; organizations headquartered in Wake County received the most of all counties ($226,408,856).

[4] The $694 million consists of grant funds from state ($452.3 million; 65%), federal ($172.8 million; 25%), state/federal combined ($55.7 million; 8%), and other ($13.2 million; 2%) sources.

Exhibit 2: Total Non-Profit Grant Amounts, Fiscal Year 2007-08



Notes: An additional $602,945 was awarded to grantees with no home office listed in the Grants Information Center. Another $10.4 million was awarded to grantees with home offices located outside of North Carolina (e.g., Johnson & Wales University has a campus in Charlotte but is headquartered in Rhode Island).

Source: Program Evaluation Division based on information from the Grants Information Center.

Grants to non-profits support a wide array of services in North Carolina. Exhibit 3 summarizes the 10 service classifications that received the largest amounts of grants to private non-profit organizations in Fiscal Year 2007-08. As shown, economic development garnered the largest proportion of funds.[5]

Exhibit 3

Services Funded with State Grants to Non-Profit Grantees: 10 Highest-Funded Classifications, Fiscal Year 2007-08

Service Classification	Total Grant Amount (Millions)
Economic Development Corporations	$ 168.8
Private Universities / Colleges	108.3
Child Care Centers / Adult Care Centers	70.7
Children's and Youth Services	63.6
Hospitals / Health Services Organizations	56.9
Housing / Community Development	45.3
Conservational Development	44.3
Biofuels Technology & Research	20.6
Family Violence Shelters and Services	19.7
Educational Development Services	19.4
Total 10 Highest Funded Classifications	**$ 617.6**
Total Grants to Non-Profits	**$ 694.0**

Note: Amounts include awards and positive or negative adjustments to awards during the fiscal year.

Source: Program Evaluation Division based on data from the Grants Information Center.

Administrative rules and statutes guide the oversight of grants to non-profits in North Carolina. Whereas government entities that receive state grant funds are not subject to reporting requirements, non-government entities, including non-profits, are subject to recently updated statutes and administrative rules (see Appendix A). N.C. Gen. Stat. § 143C-6-23(d) requires the Office of State Budget and Management to adopt rules that ensure the uniform administration of state grants by all grantor state agencies and grantees. In the North Carolina Administrative Code, the Uniform Administration of State Grants establishes policies and procedures for disbursements of state grants and for state agency oversight, monitoring, and evaluation of grantees. Grantees that receive grants from federal sources are also required to follow standards set by the United States Office of Management and Budget.[6]

[5] The Program Evaluation Division has issued two reports on economic development entities that identified the need for improved accountability: *Improving Regional Economic Development through Structural Changes and Performance Measurement Incentives* (May, 2008) and *North Carolina's Water and Wastewater Infrastructure Funding Lacks Strategic Focus and Coordination* (January, 2009).

[6] Circular A-133 sets standards for audits of states, local governments, and non-profit entities that receive federal funds; Circular A-122 establishes cost principles for federal grants to non-profits.

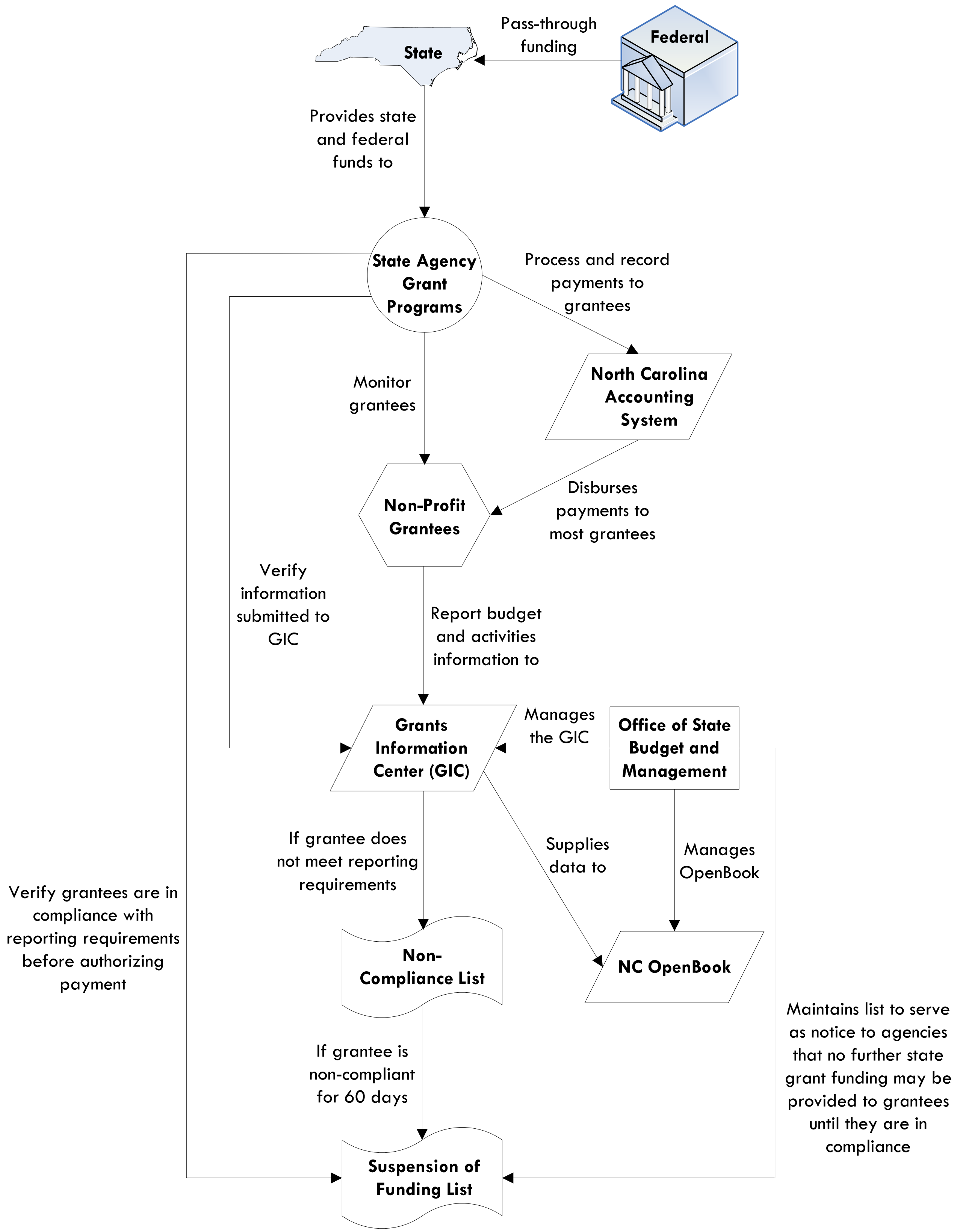
Exhibit 4 shows the process by which North Carolina administers awards to non-profit grantees. Most state agencies process disbursements to non-profit grantees through the North Carolina Accounting System. Whether funds are disbursed up-front, on a set schedule, or as reimbursement for expenses, grants are typically distributed in part or in full before state-level reporting takes place. Agencies are responsible for holding grantees accountable for grant expenditures by performing monitoring and oversight functions. The administrative rules hold grantees accountable for grant funds through reporting requirements: grantees submit activities and financial information on-line to the state's Grants Information Center. Grantees that fail to meet reporting requirements are put on the Non-Compliance list. Grantees that do not meet reporting requirements within 60 days are put on the Suspension of Funding list, which serves as notice to agencies that no further state grant funding may be disbursed to that grantee until it is compliant with reporting requirements.

The Governor's Executive Order No. 4 further promotes accountability by providing public access to information on state grants and contracts on NC OpenBook, a website created for this purpose.[7] The Grants Information Center is the data source for non-profit grants in NC OpenBook. In addition to state reporting, grants from federal sources are subject to federal reporting requirements. The federal government has been increasingly focused on accountability for programs and grantees through, for example, ExpectMore.gov.[8]

[7] Although grants to government entities are not currently reported in NC OpenBook, the Governor intends to include them in the future.

[8] The United States Office of Management and Budget and federal agencies develop the content on ExpectMore.gov. The goal is to assess the performance of every federal program and hold all accountable for improvement.

Exhibit 4: North Carolina's Process for Administering Awards to Non-Profit Grantees



Notes: State and federal agencies may require additional reporting by grantees. The Office of the State Auditor is responsible for reviewing Yellow Book audits from grantees that receive more than $500,000 in state funds and has conducted investigative audits of such funds.

Source: Program Evaluation Division.

Despite growing recognition of the importance of accountability for public resources, gaps in accountability persist. These gaps are the subject of this review. The glossary in Exhibit 5 defines terms used to describe accountability throughout this document.

Exhibit 5

Glossary of Terms Used in this Report

- **Audits** are examinations of non-profit organizations' financial reports by a Certified Public Accountant. They typically follow Yellow Book[9] or A-133 federal audit guidelines. They are triggered by reporting requirements, random checks, or reports of suspicious practices. Audits are typically conducted after all funding has been disbursed.
- **Grants reporting** to meet state requirements consists of non-profit grantees filing required forms in the Grants Information Center. Grantor agencies may require additional periodic reporting, and federal grantees must meet federal as well as state reporting requirements.
- **Grants monitoring** is ongoing oversight by the state agency that disbursed the funds. Activities may include ongoing contact with the grantee, desk reviews of financial information, performance assessments, and/or site visits.
- **Performance measurement** is the assessment of how well non-profit grantee programs are working, including indicators of program outputs (e.g., number of sessions provided, items purchased or distributed) and outcomes (i.e., whether intended results were achieved) compared against benchmarks established when the grant was funded.

Source: Program Evaluation Division.

Findings

Finding 1. State reporting requirements established by statutes and administrative rules do not ensure accountability for state funds granted to non-profits.

The financial information that grantees are required to report to the state is not adequately documented. As shown in Exhibit 6, reporting requirements group grantees by total state grant dollars received or expended during the grantee's fiscal year: less than $25,000, between $25,000 and $500,000, and more than $500,000. Grantees receiving or expending $500,000 or less in state funds within their fiscal year submit financial information to the Grants Information Center that includes line-item expenditures for personnel, contracted services, materials, and operating expenses for each grant they are awarded. The state does not require documentation to support expenditures claimed in these annual reports. According to grant monitors who responded to the Program Evaluation Division survey conducted for this review, 28% of grantee programs (57 out of 205) do not require grantees to submit documentation for expenditures. In addition, there is no audit requirement for grantees at this level of funding. Therefore, for grantees receiving $500,000 or less, the state relies entirely on the word of the grantee and the monitoring of the overseeing agency. Without good monitoring by the agency, the

[9] Comptroller General of the United States. (July 2007). *Government Auditing Standards (The Yellow Book)*. Retrieved from http://www.gao.gov/govaud/ybk01.htm.

reporting can only be considered "as good as the paper it is written on," according to the State Auditor.[10]

As shown in Exhibit 6, nearly half of the 2,758 grantees (49%, or 1,337 grantees) received state grants totaling less than $25,000 in Fiscal Year 2007-08. These grantees, however, received only 2% of total grant dollars. In contrast, a large share of grant dollars (79% of the total, or $548.8 million) was awarded to 185 (7%) of grantees.

Exhibit 6

Description of Grantee Reporting Thresholds

	State Funds Received or Expended Within a Grantee's Fiscal Year		
	Less than $25,000	**$25,000 to $500,000**	**More than $500,000**
Certify funds were used for the purposes for which they were granted	✓	✓	✓
Provide an accounting of funds received or expended	✓	✓	
Provide a description of activities and accomplishments	✓	✓	✓
Provide an audit by a Certified Public Accountant			✓
Number of grantees (percentage of all grantees) in FY 2007-08	1,337 (49%)	1,236 (45%)	185 (7%)
Grant amounts (percentage of total amount) in FY 2007-08	$11.0 million (2%)	$134.1 million (19%)	$548.8 million (79%)

Notes: For grantees receiving or expending $500,000 or less in state funds, reporting requirements must be filed within six months of the end of the grantees' fiscal year. For grantees receiving or expending more than $500,000 in state funds, reporting requirements must be filed within nine months of the end of the grantees' fiscal year.

Source: Program Evaluation Division based on 09 N.C. Admin. Code 03M.0205(a).

Paradoxically, in interviews conducted for this report, staff at the Office of the State Auditor and the Office of State Budget and Management reported grantees receiving more funds provide less detailed financial information at the grant level. Grantees receiving or expending more than $500,000 in state funds within their fiscal year are required to submit a Yellow Book audit to meet reporting requirements. Although Yellow Book audits require a Certified Public Accountant to review a grantee's documentation and internal controls, the final audit report does not provide detail on categories of expenditures at the grant-award level. Therefore, although an audit provides assurance that an independent entity has reviewed grantee financial statements, an audit does not provide enough information to determine how grantees expending more than $500,000 have spent these funds for each grant.

Furthermore, although audit reports assure that grantees conform to reporting requirements, they do not necessarily provide the level of assurance that one might expect. The Office of the State Auditor reviews

[10] B. Wood, Office of the State Auditor (personal communication, July 30, 2009).

reports for completeness, but the value of each report's content rests in the quality of the audit and the thoroughness of the auditor conducting the audit. In the course of this review, the Program Evaluation Division learned of concerns regarding the quality of audits that are meant to provide accountability assurances.

The activities information that grantees are required to report to the state does not adequately address performance goals and outcomes. According to administrative rules, non-profit grantees receiving or expending any amount of state funds must submit activities and accomplishments information. All grantees describe their original goals and submit a narrative of accomplishments. In addition, grantees receiving or expending $25,000 or more provide more detail, explaining how they have revised their goals during the course of the project and summarizing future plans and funding prospects.

Administrative rules require agencies to evaluate the outcomes of grantee activities to determine if results were achieved and whether grantee activities should continue. Nearly half of the agency grant monitors surveyed by the Program Evaluation Division reported they used the goals and accomplishments information submitted to the Grants Information Center to evaluate program results and outcomes (47%) and to determine if program results were achieved (45%).

Because the state collects the goals and accomplishments information in an open-ended format, grantees may not provide useful or enough information for agencies to properly evaluate grantee performance. For example, the state does not specify that grantees must report the number of people served or the quantity of goods or services delivered. Administrative rules require agencies to evaluate grantee results, but there is no framework to guide the assessment. The goals and accomplishments information, then, leaves the assessment of program performance inadequately addressed by state reporting requirements. Accountability cannot be fully established without performance outcomes, especially when the deliverable is a program.

Reporting deadlines complicate timely reporting on state grants and do not account for funds until after they have been expended by grantees. This issue is two-fold: first, non-profit grantee reporting cycles are determined according to each grantee's fiscal-year end, making it difficult to assess the amount and status of North Carolina grants to non-profits at any one time. Second, because annual reports are not due until six to nine months after each grantee's fiscal-year end, financial accountability may not be assured until long after funds have been spent.

Non-profit grantees report activities and financial information annually based on their organization's fiscal year, which may or may not match the state's fiscal year. Of the 2,758 grantees that received awards in Fiscal Year 2007-08, 46% had fiscal years coinciding with the state fiscal year (June), 41% had fiscal years ending in December, 8% had fiscal years coinciding with the federal fiscal year (September), and 5% had fiscal years ending in other months. Although it may be easier for grantees to report information based on their own fiscal year rather than the state fiscal year, the current reporting cycle limits the state's ability to account for grant dollars awarded and expended because there is no standardization of reporting cycles.

The second problem lies in the lag between the fiscal-year end and reporting deadlines. For example, grantees receiving or expending $500,000 or less in state funds submit their financial and activities information within six months of their fiscal-year end. Thus, a grantee with a December fiscal-year end that received grant funds in January 2009 would not need to submit financial and activities information until June 2010. Grantees receiving or expending more than $500,000 in state funds submit their financial or activities information within nine months of their fiscal-year end. Consequently, a grantee with a December fiscal-year end that received grant funds in January 2009 would not need to submit financial and activities information until September 2010. There may be as long as 18 to 21 months between disbursement and a grantee's reporting deadline. As a result, the reporting cycle limits the state's ability to account for grant dollars in real time.

Accountability suffers when agencies do not consistently enforce reporting requirements. As described in administrative rules, the state considers grantees non-compliant with reporting requirements and places them on the Non-Compliance list when grantees fail to submit information to the Grants Information Center within the timeframe allowed or fail to make corrections identified by the state agencies overseeing their grants. The Non-Compliance list serves as notice that reporting is delinquent. If grantees do not meet reporting requirements within 60 days, they are put on the Suspension of Funding list. Grantees on the Suspension of Funding list may not receive state grant funds from any agency until they meet reporting requirements. State agencies are responsible for verifying grantees are not on the Suspension of Funding list before authorizing the North Carolina Accounting System to pay them.

Weaknesses in this system allow grantees to continue to receive public funds even if they should not. One weakness results from the reporting cycle discussed above. Grantees may receive state funds 18 to 21 months before they are required to report. If grantees fail to meet reporting requirements, they do not appear on the Suspension of Funding list for another 60 days. In the time it takes for grantees to appear on the Suspension of Funding list, they could have received other state grants.

Relying on audits to ensure state-level accountability compounds delays associated with reporting cycles. Yellow Book audits typically occur after funding is disbursed, and audit results may not be available until long after the grant period ends. In cases where a grantee arouses suspicion, the Office of the State Auditor may conduct an investigative audit to determine if funds should be returned to the state. In Fiscal Year 2007-08, the Office of the State Auditor conducted 25 audits of non-profit grantees that found $797,692 in questioned costs. However, given the length of time between when grantees receive state funds and when they are audited, grantees may no longer have the funds to repay questioned costs or may no longer be in business. This problem is exacerbated when federal funds are involved because state agencies are liable for misspent federal funds. North Carolina's ability to hold grantees accountable for their use of state funds is limited because auditing only catches problems long after they have occurred. In the words of the State Auditor, "Auditing occurs too late to serve as an effective monitoring tool."

Finding 2. Inconsistent grants oversight practices among state agencies result in an overall lack of accountability.

Within the broad requirements established by the state, responsibility for setting up contracts, monitoring spending and performance, and communicating with non-profit grantees falls entirely to the state agency that oversees each grant. On the one hand, diversity in grantees and deliverables procured through grants makes flexibility essential. On the other hand, the current degree of flexibility imperils assurances that public resources are spent in the manner intended by the state.

Non-profit grantees range from large organizations (e.g., the Rural Economic Development Center) to much smaller operations such as home-based child care. The 10 non-profit grantees that received the highest dollar amount in grant funds and the 10 agencies that distributed the most grant funds in Fiscal Year 2007-08 appear in Exhibit 7 (a full list of granting agencies including grant amounts, percentage of grants to non-profits, number of grants, and number of unique grantees appears in Appendices B.1 and B.2).

The administrative rules charge agencies with oversight of non-profit grantees, but the quality of oversight is highly variable across agencies. State agencies are responsible for holding grantees accountable for the expenditure of state funds by performing monitoring and oversight functions. The administrative rules require agencies to monitor grantees through

- regular contact,
- site visits,
- reporting,
- or other means to assure grantees are administering state funds in accordance with the law and their grant contracts.

Although agencies are responsible for grants oversight, the state does not enforce or monitor the quantity or quality of agency monitoring. In a Program Evaluation Division survey of agency grant monitors, nearly all respondents (98%) reported they communicated with grantees via phone and/or email over the course of a grant. Fewer (75%) reported their grant programs conducted site visits over the course of a grant. In survey comments, respondents cited insufficient staff to conduct site visits. The quality of grantee monitoring also varies by agency; staff in the Office of the State Auditor and the Office of State Budget and Management commented that, although some monitors are well-trained and conduct thorough monitoring, others are not trained at all.

Exhibit 7

Non-Profit Grant Recipients and Grantor Agencies: Highest Dollar Amounts in Fiscal Year 2007-08

10 Highest Non-Profit Grant Recipients

Non-Profit Grantee	Total Amount (Millions)
Rural Economic Development Center, Inc.	$144.9
Child Care Services Association	25.4
Wake Forest University	19.6
North Carolina Biotechnology Center	15.6
North Carolina Coastal Land Trust	13.6
Southern Appalachian Highlands Conservancy	11.5
Cape Fear Tutoring, Inc.	10.0
Legal Aid of North Carolina, Inc.	9.1
Campbell University, Inc.	9.0
Child Nutrition Program, Inc.	6.7
Total Top 10 Non-Profit Grantees	**$265.3**
Total Awarded to All Non-Profit Grantees	**$694.0**

10 Highest Grantor Agencies

Grantor Agency/Division	Total Amount (Millions)
Department of Health and Human Services	$220.8
Department of Commerce	196.5
University of North Carolina - General Administration	108.1
Department of Environment and Natural Resources	48.0
Department of Agriculture and Consumer Services	19.5
Department of Crime Control and Public Safety	17.0
Department of Cultural Resources	12.0
Golden LEAF Foundation	11.5
Department of Public Instruction	10.0
Department of Juvenile Justice and Delinquency Prevention	9.6
Total Top 10 Grantor Agencies	**$653.1**
Total Awarded by Grantor Agencies to Non-Profit Grantees	**$694.0**

Note: Amounts include awards and positive or negative adjustments to awards during the fiscal year.

Source: Program Evaluation Division based on data from the Grants Information Center.

Despite administrative rules, then, agencies have discretion in the level of monitoring and oversight they conduct. The reasons for variability may be justified (such as a lack of staff resources), but the overall result is compromised accountability. This is not to say that all agencies fail to provide some degree of oversight. Despite issues raised in previous

Program Evaluation Division reports[11] and a 2008 performance audit conducted by the State Auditor[12] concerning contracts with providers of community support services, the North Carolina Department of Health and Human Services has adopted systematic guidelines for grants oversight. The Department requires staff to develop grantee monitoring plans and has adopted performance-based contracting agency wide that requires consistent output and outcome reporting. Other agencies, however, typically do not have such structured guidelines.

Oversight is compromised when agency grant monitors and fiscal staff do not communicate about grantee performance. State agencies are responsible for financial and program monitoring. Sometimes these functions are conducted by one person, but more often the responsibility is shared among staff. When multiple staff members are involved, coordination is needed to ensure good oversight that balances financial oversight with programmatic monitoring.

In 10 of 14 interviews conducted for this review, agency staff and administrators commented on the lack of coordination between agency fiscal staff and program monitors. One agency staff member who reviewed grantee financial reports commented, "Everyone has a piece of the puzzle, but we are not working together." Echoing and expanding on this comment, a survey respondent observed that "planning, contracts, budget, and accountability…are separate silos that are not integrated." Ideally, monitors either have expertise in both fiscal and program review, or they work in teams so that desk reviews or site visits cover both aspects of accountability. For example, an accountant at the North Carolina Department of Public Instruction explained that when he reviewed independent audits that suggested questionable grantee practices, he contacted program monitors and asked them to review and discuss the issue with him.

Balance between financial and programmatic oversight is important because matching line-item expenditures to contract terms alone does not connote accountability. Coordinated oversight is particularly important when grants fund services (e.g., child care) where deliverables are less tangible and performance is more difficult to assess. Oversight is relatively straightforward when the deliverable is tangible (e.g., goods such as equipment), has documentation to show it was purchased, and the expenditure request matches documentation.

Finding 3. Adopting best practices can improve non-profit grantee oversight.

In practice, the mere existence of grants management and reporting requirements does not ensure accountability. The state's administrative rules that define reporting and monitoring requirements for non-profit grantees give agencies a lot of leeway in how best to monitor and assure

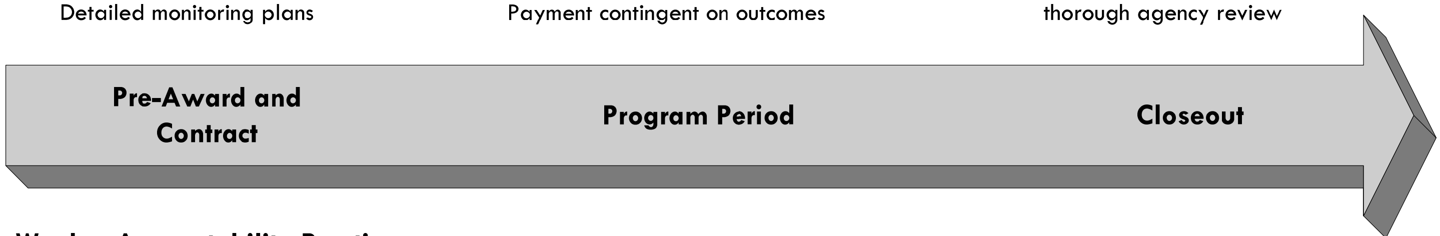
[11] Community support services are contracted and thus are outside the scope of this review. See previous Program Evaluation Division reports, *Compromised Controls and Pace of Change Hampered Implementation of Enhanced Mental Health Services (July 2008)* and *Enhanced Services Package Implementation: Costs, Administrative Decision Making, and Agency Leadership (July 2009).*
[12] Office of the State Auditor (July, 2008). *Department of Health and Human Services—Division of Medical Assistance—Oversight of the Mental Health Services Utilization Review Contract.* Raleigh, NC: State Auditor.

performance. Literature on accountability and performance monitoring describes practices that provide accountability. Exhibit 8 shows stronger practices across the grant cycle above the arrow and weaker practices below the arrow. Stronger accountability practices promote greater assurance that public resources are wisely allocated to non-profit and other private providers.

Exhibit 8: Accountability Practices Across the Grant Cycle

Stronger Accountability Practices

Pre-Award and Contract	Program Period	Closeout
Competitive awards	Integrated monitoring among agency staff responsible for fiscal and program performance	
Performance-based contracts	Structured report template with program work plan / logic model	
Detailed monitoring plans	Payment contingent on outcomes	Yellow Book or federal audit; thorough agency review



Weaker Accountability Practices

Pre-Award and Contract	Program Period	Closeout
Non-competitive awards	Siloed agency monitoring with little contact among agency staff responsible for oversight	No financial audit; minimal agency review
No performance benchmarks set in contracts	Narrative, non-specific reporting on activities	
Lack of monitoring plans	Full payment in advance	

Source: Program Evaluation Division.

Grant program monitoring plans establish guidelines for fiscal and programmatic oversight. Monitoring plans may include

- criteria for assessing a grantee's ability to meet program objectives (e.g., award size, program complexity, grantee experience);
- monitoring activities and procedures (e.g., type and frequency of review, technical assistance, corrective action plans);
- monitoring tools; and
- procedures to address compliance requirements.

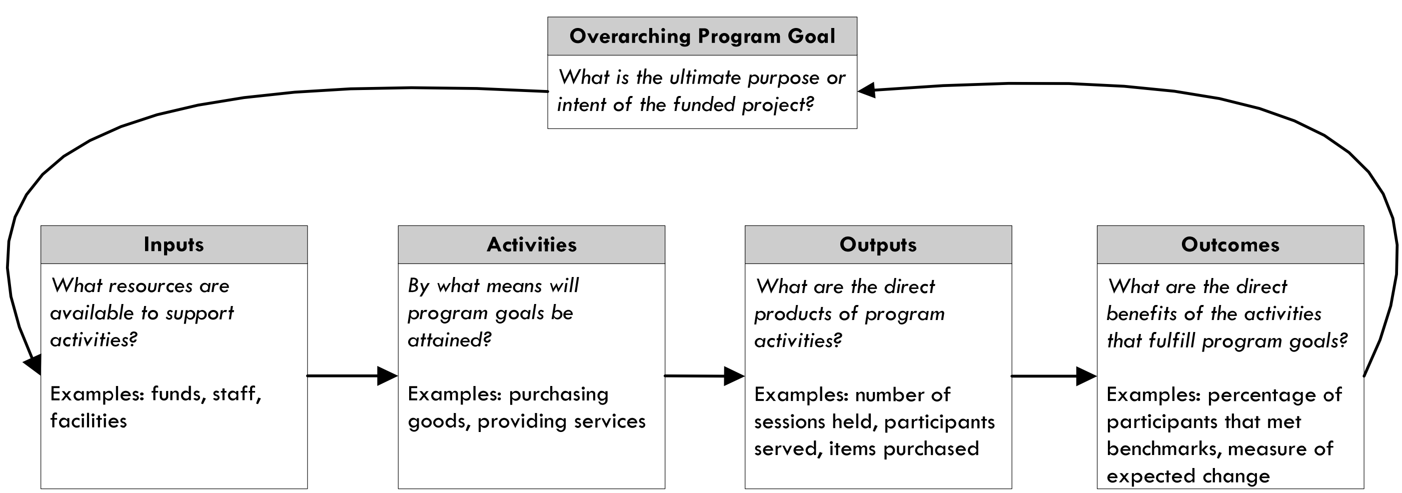
The North Carolina Department of Health and Human Services has adopted policies and procedures to clarify grant monitoring functions among staff charged with programmatic and fiscal oversight. Staff develops annual monitoring plans customized to grant programs. Program Evaluation Division interviews with monitoring staff from other agencies suggest this level of structure is not typical in other agencies.

Performance measurement is at the heart of best practices in grants oversight. Performance measurement holds grantees accountable for meeting agreed-upon goals for activities and program outcomes that establish whether public funds are achieving goals. Effective performance measurement occurs within a defined framework that links program accomplishments to benchmarks, or expectations, that are set when the program is implemented. For example, some private foundations such as United Way of America use logic models as the basis for performance measurement and reporting. In North Carolina, the Z. Smith Reynolds Foundation requires grantees to clearly link specific program goals, activities, outputs, and expected outcomes in grant application templates.

The United States Government Accountability Office defines performance measurement as ongoing monitoring of program accomplishments, particularly progress towards pre-established goals, that is typically conducted by program or agency management.[13] Performance measures may reflect program process (the type or level of program activities) and/or outcomes (results of products or services). The purpose of performance measurement is to determine whether a program has achieved its stated objectives as measured by performance standards established before program implementation.

Several key terms that describe a performance measurement framework and the relationship between them appear in Exhibit 9. Effective programs have a clear goal statement that describes the overarching intent of the funded program. Inputs are the resources available to implement and run the program that will address the goal. Activities describe what the grantee will do with the inputs. Outputs are measures—usually counts—that describe what was delivered, such as number of sessions held, participants served, or items purchased. Outcomes describe what was achieved as a result of activities, expressed in terms of expectations set at the outset (i.e., in the contract). Outcomes in turn reflect and inform the program goal by providing data on effectiveness and, with input data, can be used to derive costs and benefits of programs.

Exhibit 9: Performance Measurement Framework



Source: Program Evaluation Division.

[13] United States Government Accountability Office. (2005, May). *Performance Measurement and Evaluation: Definitions and Relationships.* (GAO Publication No. GAO-05-739SP). Washington, DC: United States Government Accountability Office.

Awarding grants competitively and disbursing grant funds through reimbursement rather than in advance improve accountability and performance. Information collected by the Program Evaluation Division identified four processes used by North Carolina state agencies to select grantees.

- Competitive (discretionary) awards – agencies select recipients from among eligible applicants.
- Earmarks (special appropriations to legislatively named grantees) – awards are written into legislation, specifically naming the grantee, activity, and amount of award.
- Providers of unique services – awards are made to organizations that are uniquely able to provide needed services (e.g., volunteer fire departments).
- One per county or region – awards go to established providers in specific regions (e.g., economic development partnerships).

Of these options, the competitive award process has been acknowledged as a best practice that improves the odds of program effectiveness, efficiency, and quality. Assuming the awarding agency has established clear guidelines and expectations, selecting the best grantee from a field of qualified applicants provides some assurance that funds will be well spent. By contrast, the other three selection methods are non-competitive and may award funds by default. The Program Evaluation Division survey indicated 85% of grantor programs in North Carolina awarded at least some grants through a competitive process.

Funding by reimbursement is a best practice because it allows for more control over performance than payment in advance. When agencies conduct monitoring before all funds are paid out, chances of effectively addressing issues (e.g., improving performance when measures suggest it is needed) are improved. According to Program Evaluation Division survey results, 39% of grant programs disburse grant funds in advance in some of the awards they oversee. Although it may not be practical to award all grants on a reimbursement basis—especially small grants to small entities that rely on the funds to operate, best practices suggest reimbursement should be pursued whenever possible.

Finding 4. Contracts with frameworks for tracking performance are essential to improved accountability.

In its report on privatization, Florida's Office of Program and Policy Analysis and Government Accountability found that public resource accountability suffers if the state does not carefully specify services to be provided and create strong systems to monitor program performance.[14] Performance-based contracts that clearly define grantees' plans of work (including detailed statements of goals, activities, outputs, and expected outcomes) are the mechanism needed to ensure accountability.

[14] Office of Program Policy Analysis and Government Accountability (2004, January). *The Legislature Could Strengthen State's Privatization Accountability Requirements* (OPPAGA Report No. 04-02). Tallahassee, FL: Office of Program Policy Analysis and Government Accountability.

Using contracts to set the stage for performance makes logical sense because expectations are written, binding, and defined at the outset. Training materials developed by the Office of the State Auditor acknowledge contracts as an important accountability tool. A staff member in the North Carolina Department of Justice summed it up: "Expectations should be clear at the front end, and then the grantees' evaluation and communication back will be clear." However, agency staff indicated contracts do not always set performance expectations. Without delineated expectations, there is no sure way to link performance to expectations, and accountability cannot exist without this link.

This situation is most challenging when grants are awarded to legislatively named grantees. Survey responses indicated 22% of grant programs distributed some funds to legislatively named grantees. Staff at one agency reported that program descriptions in legislation are sometimes too vague to guide performance measurement.[15] Without a link to a grant application or contract, staff members must return to and attempt to interpret the often slim legislation establishing the earmark to come up with a project description that would let them know what to look for in terms of performance. Further, agency monitors may conduct less stringent oversight if they believe their authority to do so is unclear.

As interpreted by the North Carolina Budget Manual, N.C. Gen. Stat. § 143C-6-21 directs annual special appropriations of $100,000 or less be paid to non-profit grantees in a single annual payment. Based on the form for requesting payment found in the Budget Manual, these payments are likely made in advance. Because disbursement by reimbursement (as opposed to disbursement in advance) has been identified as a best practice in the literature, requiring advance payment for grants of $100,000 or less to legislatively named grantees compounds accountability weaknesses.

Grants to regional economic development partnerships exemplify the challenges of overseeing legislatively named grantees. According to staff at the North Carolina Department of Commerce, contracts with these partnerships are based on open-ended descriptions designed to provide maximum flexibility for these organizations to respond to sometimes unforeseen development opportunities. However, as described in a previous Program Evaluation Division study,[16] the lack of expectations in these contracts means there are no benchmarks to guide performance oversight.

Performance-based contracting is one method that establishes clear expectations and an accountability framework before grantees begin delivering goods or services. Performance-based contracting usually incorporates some or all of several key features:

- emphasis on results related to output, quality, and outcomes;
- outcome orientation and clearly defined objectives and timeframes;

[15] In a review of grants to non-profits, the Minnesota Office of the Legislative Auditor also cited this issue and recommended an emphasis on competitive grant funding over legislatively named grantees.

[16] Program Evaluation Division. (2008, May). *Improving Regional Economic Development through Structural Changes and Performance Measurement Incentives.* Report to the Joint Legislative Program Evaluation Oversight Committee. Raleigh, NC: General Assembly.

- measurable performance standards and quality assurance plans; and
- performance incentives and payment tied to outcomes.

Thirteen states have moved toward adopting performance-based contracting, and two of these did so through legislative changes. Legislation passed in Florida in 1994 required performance-based contracting for all state-funded programs; legislators in Maine voted to require the Department of Human Services to adopt performance contracts as of 1997. In the other 11 states, single agencies or state-funded programs have adopted performance contracts.

In North Carolina, the Department of Health and Human Services began agency-wide implementation of performance-based contracting in 2003. First, the agency trained program staff in performance contracting and contract management; once performance contracting was in place, the department implemented systematic peer reviews of programs to assess the quality of services and the consistency of grants within programs. Department staff has found performance-based contracting brings a new dimension to grants by focusing attention beyond reimbursement to outcomes achieved with the money. In addition, in lean economic times, data that result from performance-based contracting can provide an empirical basis for future funding decisions.

Grant contracts in North Carolina do not consistently establish how agencies should assess performance. Once a grant is awarded, the agency draws up a contract to ensure that all requirements in N.C. Gen. Stat. § 143C-6-23 are met. The administrative rules spell out required components of contracts, which are reflected in a contract template developed by the Attorney General's Office and provided on the internet. The template specifies required elements such as terms and conditions, the scope of work to be completed, budget documents, and various required certifications. The contract states the effective period, describes the grantee's and agency's duties, outlines payment procedures, and describes reporting requirements.

The Program Evaluation Division's review of contract templates and terms submitted by 15 state agencies suggests most agencies adopt the Attorney General's template or terms. One grant program administered by the State Treasurer, the Health and Wellness Trust Fund, has a detailed template that defines focus areas and strategies for each area and requires applicants to describe activities, outcomes, and performance measures within each area. This level of detail is possible because the grant program is narrowly defined, and the focus areas and strategies are set by the program. Most agencies, however, oversee varied programs that would not be accommodated by such a detailed, uniform template. The Department of Health and Human Services stands alone in its adoption of a flexible framework that applies across widely varied contracts and requires performance measurement.

Finding 5. Despite gaps in oversight, changes in legislation, technology, and training have improved accountability for grants to non-profits.

In North Carolina, reporting and monitoring of state grant funds have improved in recent years. Exhibit 10 shows the introduction of legislation and technology over time. In 1989, the North Carolina General Assembly first required grantees to submit financial statements to the Office of the State Auditor through N.C. Gen. Stat. § 143-6.1. Grantees were required to submit a sworn accounting of receipts and expenditures to state agencies in 1995 and activities and accomplishments information in 2003. In 2004, N.C. Gen. Stat. § 143-6.2 coordinated grants administration among state agencies, such as the Office of State Budget and Management and the Office of the State Auditor.

N.C. Gen. Stat. § 143-6.1 and § 143-6.2 were eventually replaced by N.C. Gen. Stat. § 143C-6-23 in 2006 when the General Assembly decided to increase non-profits' accountability for their use of state funds. The General Assembly established a requirement that grantees submit a conflict of interest statement and required more coordinated grants administration among state agencies.

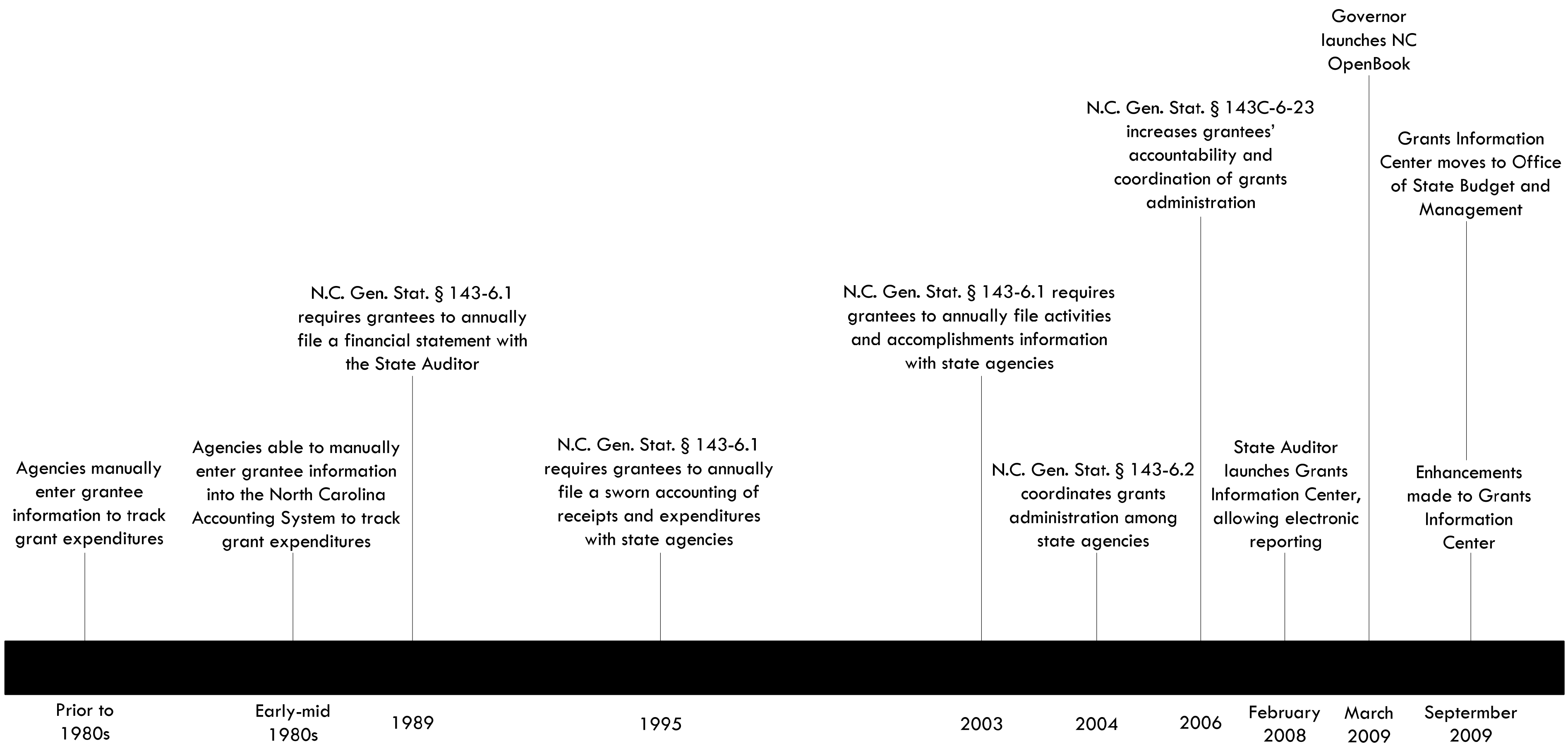
Technology has improved the state's ability to collect and report information on grant expenditures. In February 2008, the Office of the State Auditor launched the Grants Information Center, an online system that enables grantor agencies to electronically enter grants award information and enables grantees to electronically enter annual reporting requirements. Although the system has presented challenges to grantors and grantees alike, its introduction represented an important step in grants oversight.

System enhancements will ultimately enable the Grants Information Center to maintain Non-Compliance and Suspension of Funding lists in real time. Besides providing agencies with the information they need to keep from funding delinquent grantees, the Non-Compliance and Suspension of Funding lists may reduce reporting delinquencies by virtue of the public nature of appearing on the lists.[17]

The goal behind the 2009 introduction of NC OpenBook was to bring more transparency and accountability to state government and to those receiving and expending state funds. NC OpenBook currently features a searchable online database of all state grants and contracts in excess of $10,000, including information such as the expected outcomes of each grant, specific deliverables required, and the timeline for anticipated completion of the work. The Office of State Budget and Management maintains NC OpenBook and assumed operation of the Grants Information Center in September 2009. With this consolidation of the Grants Information Center, NC OpenBook, and the Suspension of Funding list functions, grantee tracking and reporting rule enforcement are housed together for the first time.

[17] Jensen, H. (2002). Optimal degrees of transparency in monetary policymaking. *Scandinavian Journal of Economics, 104,* 399-422.

Exhibit 10: Timeline for Legislation and Technological Advances Affecting Non-Profit Grantee Accountability in North Carolina



Source: Program Evaluation Division based on statutes and data from the Office of the State Auditor.

The Office of the State Auditor developed training to inform agencies and grantees about monitoring and reporting requirements, but there is no longer funding to continue the program. Since Fiscal Year 2005-06, the Office of the State Auditor has conducted 331 classes on 27 grants-related topics. Content ranged from a basic overview of grants policies and procedures—including allowable and unallowable costs and fraudulent activity—to the responsibilities of grantees and state agencies regarding monitoring and reporting.

Training was voluntary and was the only centralized, systematic way to disseminate information to agencies and grantees about reporting requirements and processes, grant monitoring, and grantee responsibilities. The Office of the State Auditor provided sessions free of charge to all interested parties, including grantees, agency grant monitors, and others involved in administering and monitoring grants. Among respondents to the Program Evaluation Division survey of agency grant monitors, 71% had participated in training. The training program was cost effective: a Program Evaluation Division cost analysis indicated that providing 110 training sessions on grants oversight and reporting to 5,274 individuals cost North Carolina approximately $36,867, or about $7 per attendee per session in Fiscal Year 2007-08.

Interviews with state agency grant monitors revealed the importance of training for grantees, especially smaller entities that may need high levels of guidance and support in order to comply with reporting requirements. According to one grant monitor, "Grantees many times do not fully understand the reporting requirements listed in the General Statutes and have had difficulty with the new on-line reporting requirements and format. It might be helpful to have . . . mandatory training for all grantees and grantors." The Office of the State Auditor, Office of State Budget and Management, and state agencies believe training is beneficial to grantees and see a need for more training in the future. However, budget constraints and the transfer of responsibility of the Grants Information Center to the Office of State Budget and Management without staff have raised questions about whether training will be continued.

An agency grant monitor commented, "Many of the grantees associated with this agency have been having a lot of problems with entering information into the Grants Information Center. It will get even worse if there is no training provided for non-profits in the future." The Office of State Budget and Management plans to develop a more user-friendly version of the Grants Information Center with built-in instructions. They also are considering offering training on-line and/or a train-the-trainer model (i.e., where selected agency staff members would receive training and then provide training to fellow staff and grantees) that focuses on making agencies aware of monitoring and reporting requirements.

Recommendations

Recommendation 1. The North Carolina General Assembly should revise N.C. Gen. Stat. § 143C-6-23(d) to require performance-based contracting, program monitoring plans, and more timely and accurate reporting on state grants to non-profits.

Programmatic accountability cannot be established unless grant program outputs and outcomes are compared with specific expectations established at the outset (i.e., when the award was made and the contract was signed). Although some state grant programs use measures to accomplish this goal, there is no systematic way to assess accountability of grants to non-profits in North Carolina. The state should require clearer contract specifications that are flexible yet specific to set benchmarks for performance.

The General Assembly should revise N.C. Gen. Stat. § 143C-6-23(d) to include a provision that the rules shall ensure each contract agreement between a state agency and a grantee includes concrete benchmarks against which to measure success. N.C. Gen. Stat. § 143C-6-23(d) directs 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. The administrative rules on contract language (09 N.C. Admin. Code 03M.0703) require statements of objectives to be achieved and expected results. However, the rules do not require grant contracts to include specific language defining benchmarks against which to measure success. Benchmarks must address expected outputs (what is done) and outcomes (what happens as a result of activities). Drawing on the framework shown in Exhibit 9, clear but flexible requirements could be adapted to grants for goods, services, and planning activities. Examples of each of these applications are shown in Exhibit 11.

Exhibit 11: Performance Measurement Framework Examples

Deliverable	Program Goal	Inputs	Activities	Outputs	Outcomes
Goods	• Ultimate purpose of goods	• Funds	• Purchasing goods	• Number of items purchased	• Successful procurement within grant cycle
Services	• Ultimate intent of services	• Funds • Staff • Facilities	• Providing services	• Number of sessions • Number of participants	• Result of activities in terms of program goals (percentage of participants achieving benchmarks)
Program Planning	• Ultimate purpose of planning process	• Funds • Staff • Facilities	• Implementation and planning • Needs assessment	• Number of planning activities	• Results of needs assessment • Conclusions from planning activities

Source: Program Evaluation Division.

The recommended model of performance-based contracting does not include making payment contingent on performance. It does, however, provide a mechanism to set concrete, measurable expectations for performance in grant contracts and to use those benchmarks to assess performance in subsequent reporting. Performance measures provide a structured means to assure that accountability is assessed systematically across grant programs. Furthermore, performance-based contracting provides information that can be used when deciding which programs to fund in the future. The existing contract template should be amended to include a performance-based contracting framework.

Without systematic evidence that grant activities achieve intended outcomes, statewide accountability cannot be established. Following the model adopted by the North Carolina Department of Health and Human Services, consistent requirements should apply across agencies and grant programs so that expected outputs and outcomes are clearly stated in the contract.

Among Program Evaluation Division survey respondents, most (71%) indicated their grant programs collected outcome measures and 80% believed performance measures should be required. These results suggest agencies may readily adapt to clearer, systematic requirements on contract specifications that would move North Carolina closer to statewide accountability for grants to non-profits.

The General Assembly should revise N.C. Gen. Stat. § 143C-6-23(d) to direct agencies to develop program monitoring plans that describe grantee oversight. Administrative rules provide flexibility in grantee oversight, but this flexibility has resulted in inconsistent practices that do not provide adequate statewide accountability. Requiring agencies to provide assurances to the Office of State Budget and Management that they have monitoring plans in place for each grant program they oversee would provide evidence of monitoring activities. To facilitate consistency, the Office of State Budget and Management should provide a template for a program monitoring plan on their website. The Department of Health and Human Services should be consulted in this effort.

The General Assembly should revise N.C. Gen. Stat. § 143C-6-23(d) to direct more timely and accurate reporting by requiring grantees to submit cash-basis reports annually within 90 days of the state fiscal-year end. Reports submitted by non-profit grantees in North Carolina do not provide timely or comprehensive information that is easily accessed by policymakers. Currently, administrative rules direct grantees to submit annual reports within six to nine months of their own fiscal-year end. As a result, there is no point in time when the status of statewide grant funds can be easily and fully reported. Furthermore, as much as 18 to 21 months may elapse between disbursement of funds and final reporting. When there are problems with reporting or grantees are delinquent, additional funds may have already been disbursed before grantees appear on the Non-Compliance or Suspension of Funding list.

Requiring all grantees to report annually on a cash basis within 90 days of the state fiscal-year end would replace the current requirement for grantees to submit annual reports within six to nine months of each grantee's fiscal-year end.[18] This change would reduce the lag between disbursement and reporting and would provide consistent, statewide data on state grants to non-profits. The cash-basis report should include a

[18] Grantees receiving more than $500,000 in state grants would still be required to submit Yellow Book audits within nine months of their fiscal-year ends.

narrative of other program revenue and outstanding obligations anticipated by the grantee in the remaining award period.

The General Assembly should revise N.C. Gen. Stat. § 143C-6-23(d) to require reporting on program performance measures that compare actual outputs and outcomes against the benchmarks established in contracts. Because the activities information submitted to the Grants Information Center does not ensure useful information across agencies and grantees, the current format should be modified to reflect performance measures. Performance measures established in grant contracts should comprise the substance of the activities and accomplishments information so that grant program monitors can compare data on outputs and identified outcomes against benchmarks set in contracts.

Performance reporting should be reviewed by the agency overseeing the grant on an ongoing basis. An annual performance report should be submitted to the Grants Information Center together with the cash-basis reporting discussed above. To facilitate consistency, the Office of State Budget and Management should provide a template for a performance measurement reporting structure on their website.

Recommendation 2. The North Carolina General Assembly should emphasize a competitive awards process and limit the number of grants awarded to legislatively named grantees.

When legislation names grantees, there may be scant statutory language to guide contracts, agency oversight, or performance measurement. The lack of competition for awards means that, in cases where there is more than one suitable non-profit provider, the funds may not go to the best grantee. Furthermore, oversight is compromised if the agency charged with oversight believes they lack authority to request and assess performance information. For these reasons, contracts should be awarded through a competitive awards process whenever possible.

According to the North Carolina Budget Manual, N.C. Gen. Stat. § 143C-6-21 directs grants of $100,000 or less made through special appropriations be paid in a single annual payment. Based on the forms found in the Budget Manual, these payments are likely made in advance. Because disbursement in advance is not a best practice, this requirement further recommends against naming grantees in legislation.

In cases where the General Assembly chooses to name grantees in legislation, the language should specify expectations for outputs and outcomes. In addition, the General Assembly should authorize the responsible agency to name benchmarks in grant contracts and use them to oversee and assess grantee performance.

Recommendation 3. The North Carolina General Assembly should direct the Office of the State Controller to electronically stop payments to grantees on the Suspension of Funding list.

Current administrative rules require agencies to stop payment and/or not award new grants to grantees that appear on the Suspension of Funding list that is maintained by the Office of State Budget and Management. Most grant monitors (81%) said they do not disburse funds to grantees on the Suspension of Funding list. Nineteen percent of grant programs, then, may disburse funds to suspended grantees even though the rules expressly prohibit it. Staff from the Office of the State Auditor, Office of State Budget and Management, and grantor agencies acknowledged the current law is not effectively implemented or enforced.

The North Carolina Accountability System, which controls most payments to grantees, could be strengthened to prohibit electronic payment to grantees that should not receive funds. N.C. Gen. Stat. § 143B-426.39 should be revised to direct the State Controller to stop payment to suspended grantees immediately by whatever means necessary. According to staff at the Office of the State Controller, the North Carolina Accounting System could be updated to include an electronic mechanism to block payment to suspended grantees. Agencies that do not process payments through the system would not be affected by this change; however, all but a few state entities that oversee grants to non-profits use the system.[19]

If the grant funds in question are a pass-through of federal funds, then the Office of State Budget and Management must consult with the granting federal agency and the state agency that is the recipient of the pass-through funds prior to blocking payment.

Recommendation 4. The North Carolina General Assembly should amend the State Budget Act to give agencies the authority to withhold up to 2% of grant awards to fund oversight.

Grants oversight—including agency monitoring, timely and accurate reporting, and the infrastructure necessary to support these activities—is essential to ensure that grantees understand and abide by reporting rules, provide accountability, and control fraud. The introduction of federal stimulus funds has only increased demand for accountability. The current system relies heavily on auditing, and oversight is uneven across agencies, which may not have sufficient resources to conduct effective monitoring.

Oversight requires resources, and a small portion of grant awards could be used to cover the costs. Specifically, the General Assembly should revise N.C. Gen. Stat. Chapter 143C to give agencies the authority to withhold up to 2% of annual grant awards to cover agency monitoring and statewide oversight activities. If the grant represents a pass-through of federal funds, the grantor agency should be authorized to withhold funds unless withholding is not allowable under the terms of the federal funding.

[19] Six entities with grants to non-profits listed in Appendices B.1 and B.2 do not use the North Carolina Accounting System to disburse funds: Department of Transportation, Golden LEAF Foundation, Housing Finance, State Bar, University of North Carolina – General Administration, and Western North Carolina Regional Economic Development Commission. Together, these entities oversaw 20% of grant funds.

Of this amount,

- 1.5% shall cover grantor agencies' costs of monitoring grantee compliance with performance-based contracts and reporting requirements;
- 0.5% shall be transferred to the Office of State Budget and Management at the time the grants are disbursed to cover costs related to statewide oversight, such as maintaining the Grants Information Center and providing training to agencies and grantees.

The recommended level of withholding and proposed allotment was derived by members of the Grants Oversight Committee based on the amount needed to generate approximately $500,000 to maintain and expand the Grants Information Center and provide support for agency monitoring activities. Given the discretionary nature of the withholding and the likely restrictions on applying it to grant funds from federal sources, members of the Grants Oversight Committee believed this level of withholding could generate the needed funds.

In Fiscal Year 2007-08, grant funds from state sources totaled $452.3 million (65% of $694 million from all sources). Assuming that agencies might apply the discretionary withholding to 25% of grant funds from state sources, this withholding would have produced $1.7 million (1.5%) for agency oversight and $565,000 for statewide oversight.

Adopting performance-based contracting will require agency resources to implement and monitor the contracts. As it is, agencies surveyed for this review indicated they did not have adequate resources to conduct site visits, and overseeing performance-based contracts will require an investment beyond what is needed to meet current oversight demands. Giving agencies discretionary authority to withhold and commit 1.5% of grant awards has the potential to generate funds to build needed oversight capacity.

Technology and training have already improved non-profit grants oversight in recent years. The 0.5% discretionary withholding should be targeted toward future improvements including

- enhancements to the Grants Information Center, including a more user-friendly interface and stronger on-line help;
- changes to the North Carolina Accounting System to stop payment to suspended grantees, as described in Recommendation 3; and
- training for agency grant monitors and grantees that provides information about reporting responsibilities and procedures.

Appendices

Appendix A: General Statutes on Grants to Non-Profits

Appendix B.1: Grant Summary for Each Funding Agency by Name

Appendix B.2: Grant Summary for Each Funding Agency by Total Amount

Agency Response

A draft of this report was submitted to the Office of the State Auditor and the Office of State Budget and Management to review and respond. Their responses are provided following the appendices.

Program Evaluation Division Contact and Acknowledgments

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Staff members who made key contributions to this report include E. Kiernan McGorty and Pamela L. Taylor. Interns Carmen J. Brooks and David Orsbon also contributed. John W. Turcotte is the director of the Program Evaluation Division.

The following individuals provided reviews of this report: Beth A. Wood, State Auditor, and David Nance, Audit Manager, Office of the State Auditor; Anne Bander, Assistant State Budget Officer, and Erin Matteson, Associate State Budget Officer, Office of State Budget and Management; Dan Stewart, Assistant Secretary for Finance and Business Operations, Department of Health and Human Services; and Janet Hayes, Office of the State Auditor (retired).

Appendix A: General Statutes on Grants to Non-Profits

Chapter 143C.

State Budget Act.

Article 6.

Administration of the Budget.

Part 3. Non-State Entities Receiving State Funds.

§ 143C-6-21. Payments to nonprofits.
Except as otherwise provided by law, an annual appropriation of one hundred thousand dollars ($100,000) or less to or for the use of a nonprofit corporation shall be made in a single annual payment. An annual appropriation of more than one hundred thousand dollars ($100,000) to or for the use of a nonprofit corporation shall be made in quarterly or monthly payments, in the discretion of the Director of the Budget. (2006-203, s. 3.)

§ 143C-6-22. Use of State funds by non-State entities.
(a) Disbursement and Use of State Funds. – Every non-State entity that receives, uses, or expends any State funds shall use or expend the funds only for the purposes for which they were appropriated by the General Assembly. State funds include federal funds that flow through the State Treasury.
(b) Compliance by Non-State Entities. – If the Director of the Budget finds that a non-State entity has spent or encumbered State funds for an unauthorized purpose, or fails to submit or falsifies the information required by G.S. 143C-6-23 or any other provision of law, the Director shall take appropriate administrative action to ensure that no further irregularities or violations of law occur and shall report to the Attorney General any facts that pertain to an apparent violation of a criminal law or an apparent instance of malfeasance, misfeasance, or nonfeasance in connection with the use of State funds. Appropriate administrative action may include suspending or withholding the disbursement of State funds and recovering State funds previously disbursed.
(c) Civil Actions. – Civil actions to recover State funds or to obtain other mandatory orders in the name of the State on relation of the Attorney General, or in the name of the Office of State Budget and Management, shall be filed in the General Court of Justice in Wake County. (2006-203, s. 3.)

§ 143C-6-23. State grant funds: administration; oversight and reporting requirements.
(a) Definitions. – The following definitions apply in this section:
 (1) "Grant" and "grant funds" means State funds disbursed as a grant by a State agency; however, the terms do not include any payment made by the Medicaid program, the State Health Plan for Teachers and State Employees, or other similar medical programs.
 (2) "Grantee" means a non-State entity that receives State funds as a grant from a State agency but does not include any non-State entity subject to the audit and other reporting requirements of the Local Government Commission.
 (3) "Subgrantee" means a non-State entity that receives State funds as a grant from a grantee or from another subgrantee but does not include any non-State entity subject to the audit and other reporting requirements of the Local Government Commission.
(b) Conflict of Interest Policy. – Every grantee shall file with the State agency disbursing funds to the grantee a copy of that grantee's policy addressing conflicts of interest that may arise involving the grantee's management employees and the members of its board of directors or other governing body. The policy shall address situations in which any of these individuals may directly or indirectly benefit, except as the grantee's employees or members of its board or other governing body, from the grantee's disbursing of State funds, and shall include actions to be taken by the grantee or the individual, or both, to avoid conflicts of interest and the appearance of impropriety. The policy shall be filed before the disbursing State agency may disburse the grant funds.

(c) No Overdue Tax Debts. – Every grantee shall file with the State agency or department disbursing funds to the grantee a written statement completed by that grantee's board of directors or other governing body stating that the grantee does not have any overdue tax debts, as defined by G.S. 105-243.1, at the federal, State, or local level. The written statement shall be made under oath and shall be filed before the disbursing State agency or department may disburse the grant funds. A person who makes a false statement in violation of this subsection is guilty of a criminal offense punishable as provided by G.S. 143C-10-1.

(d) Office of State Budget Rules Must Require Uniform Administration of State Grants. – The Office of State Budget and Management shall adopt rules to ensure the uniform administration of State grants by all grantor State agencies and grantees or subgrantees. The Office of State Budget and Management shall consult with the Office of the State Auditor and the Attorney General in establishing the rules required by this subsection. The rules shall establish policies and procedures for disbursements of State grants and for State agency oversight, monitoring, and evaluation of grantees and subgrantees. The policies and procedures shall:

(1) Ensure that the purpose and reporting requirements of each grant are specified to the grantee.
(2) Ensure that grantees specify the purpose and reporting requirements for grants made to subgrantees.
(3) Ensure that State funds are spent in accordance with the purposes for which they were granted.
(4) Hold the grantees and subgrantees accountable for the legal and appropriate expenditure of grant funds.
(5) Provide for adequate oversight and monitoring to prevent the misuse of grant funds.
(6) Establish mandatory periodic reporting requirements for grantees and subgrantees, including methods of reporting, to provide financial and program performance information. The mandatory periodic reporting requirements shall require grantees and subgrantees to file with the State Auditor copies of reports and statements that are filed with State agencies pursuant to this subsection. Compliance with the mandatory periodic reporting requirements of this subdivision shall not require grantees and subgrantees to file with the State Auditor the information described in subsections (b) and (c) of this section.
(7) Require grantees and subgrantees to maintain reports, records, and other information to properly account for the expenditure of all grant funds and to make such reports, records, and other information available to the grantor State agency for oversight, monitoring, and evaluation purposes.
(8) Require grantees and subgrantees to ensure that work papers in the possession of their auditors are available to the State Auditor for the purposes set out in subsection (i) of this section.
(9) Require grantees to be responsible for managing and monitoring each project, program, or activity supported by grant funds and each subgrantee project, program, or activity supported by grant funds.
(10) Provide procedures for the suspension of further disbursements or use of grant funds for noncompliance with these rules or other inappropriate use of the funds.
(11) Provide procedures for use in appropriate circumstances for reinstatement of disbursements that have been suspended for noncompliance with these rules or other inappropriate use of grant funds.
(12) Provide procedures for the recovery and return to the grantor State agency of unexpended grant funds from a grantee or subgrantee if the grantee or subgrantee is unable to fulfill the purposes of the grant.

(e) Rules Are Subject to the Administrative Procedure Act. – Notwithstanding the provisions of G.S. 150B-2(8a)b. rules adopted pursuant to subsection (d) of this section are subject to the provisions of Chapter 150B of the General Statutes.

(f) Suspension and Recovery of Funds to Grant Recipients for Noncompliance. – The Office of State Budget and Management, after consultation with the administering State agency, shall have the power to suspend disbursement of grant funds to grantees or subgrantees, to prevent further use of grant funds already disbursed, and to recover grant funds already disbursed for noncompliance with rules adopted pursuant to subsection (d) of this section. If the grant funds are a pass-through of funds granted by an agency of the United States, then the Office of State Budget and Management must consult with the granting agency of the United States and the State agency that is the recipient of the pass-through funds prior to taking the actions authorized by this subsection.

(g) Audit Oversight. – The State Auditor has audit oversight, with respect to grant funds received by the grantee or subgrantee, pursuant to Article 5A of Chapter 147 of the General Statutes, of every grantee or subgrantee that receives, uses, or expends grant funds. A grantee or subgrantee must, upon request, furnish to the State Auditor for audit all books, records, and other information necessary for the State Auditor to account fully for the use and expenditure of grant funds received by the grantee or subgrantee. The grantee or subgrantee must furnish any additional financial or budgetary information requested by the State Auditor, including audit work papers in the possession of any auditor of a grantee or subgrantee directly related to the use and expenditure of grant funds.

(h) Report on Grant Recipients That Failed to Comply. – Not later than May 1, 2007, and by May 1 of every succeeding year, the Office of State Budget and Management shall report to the Joint Legislative Commission on Governmental Operations and the Fiscal Research Division on all grantees or subgrantees that failed to comply with this section with respect to grant funds received in the prior fiscal year.

(i) State Agencies to Submit Grant List to Auditor. – No later than October 1 of each year, each State agency shall submit a list to the State Auditor, in the format prescribed by the State Auditor, of every grantee to which the agency disbursed grant funds in the prior fiscal year. The list shall include the amount disbursed to each grantee and other information as required by the State Auditor to comply with the requirements of this section. (2006-203, s. 3; 2007-323, s. 28.22A(o); 2007-345, s. 12.)

Appendix B.1: Grant Summary For Each Funding Agency by Name

Funding Agency/Division	Total Amount	Percent of Total Dollars	Number of Grants	Number of Unique Grantees
Administrative Office of the Courts and Court System's Office of Indigent Defense Services	$ 3,247,875	0.47%	42	36
Community College System	851,002	0.12%	33	24
Department of Administration	3,535,396	0.51%	181	110
Department of Agriculture and Consumer Services	19,512,351	2.81%	197	173
Department of Commerce	196,514,558	28.32%	29	28
Department of Correction	2,176,293	0.31%	4	4
Department of Crime Control and Public Safety	17,011,822	2.45%	384	143
Department of Cultural Resources	12,031,550	1.73%	346	249
Department of Environment and Natural Resources	48,024,395	6.92%	194	84
Department of Health and Human Services				
Division of Aging and Adult Services	905,947	0.13%	5	5
Central Administration	80,290,459	11.57%	509	278
Division of Child Development	11,900	0.00%	1	1
Division of Health Service Regulation	4,232,461	0.61%	19	19
Division of Mental Health, Developmental Disabilities and Substance Abuse Services	9,319,515	1.34%	12	12
Office of Education Services	957,176	0.14%	2	1
Division of Public Health	107,118,617	15.44%	1,753	1,013
Division of Social Services	17,975,710	2.59%	239	155
Total Department of Health and Human Services	220,811,785	31.82%	2,540	1,351
Department of Insurance	5,862,895	0.84%	584	543
Department of Justice	715,564	0.10%	5	4
Department of Juvenile Justice and Delinquency Prevention	9,622,106	1.39%	120	107
Department of Labor	122,992	0.02%	17	16
Department of Public Instruction	10,037,619	1.45%	92	87
Department of Transportation	7,141,792	1.03%	86	43
Golden LEAF Foundation	11,494,562	1.66%	88	61
Housing Finance Agency	103,589	0.01%	54	32
Office of State Budget and Management	1,460,342	0.21%	8	8
State Bar	8,977,492	1.29%	8	5
State Treasurer	6,330,868	0.91%	120	94
University of North Carolina - General Administration	108,071,352	15.57%	152	40
Western North Carolina Regional Economic Development Commission	110,746	0.02%	8	7
Wildlife Resources Commission	218,500	0.03%	5	4
Total	**$ 693,987,445**	**100.00%**	**5,297**	**2,758**

Appendix B.2: Grant Summary For Each Funding Agency by Total Amount

Funding Agency/Division	Total Amount	Percent of Total Dollars	Number of Grants	Number of Unique Grantees
Department of Health and Human Services	$220,811,785	31.82%	2,540	1,351
Department of Commerce	196,514,558	28.32%	29	28
University of North Carolina - General Administration	108,071,352	15.57%	152	40
Department of Environment and Natural Resources	48,024,395	6.92%	194	84
Department of Agriculture and Consumer Services	19,512,351	2.81%	197	173
Department of Crime Control and Public Safety	17,011,822	2.45%	384	143
Department of Cultural Resources	12,031,550	1.73%	346	249
Golden LEAF Foundation	11,494,562	1.66%	88	61
Department of Public Instruction	10,037,619	1.45%	92	87
Department of Juvenile Justice and Delinquency Prevention	9,622,106	1.39%	120	107
State Bar	8,977,492	1.29%	8	5
Department of Transportation	7,141,792	1.03%	86	43
State Treasurer	6,330,868	0.91%	120	94
Department of Insurance	5,862,895	0.84%	584	543
Department of Administration	3,535,396	0.51%	181	110
Administrative Office of the Courts and Court System's Office of Indigent Defense Services	3,247,875	0.47%	42	36
Department of Correction	2,176,293	0.31%	4	4
Office of State Budget and Management	1,460,342	0.21%	8	8
Community College System	851,002	0.12%	33	24
Department of Justice	715,564	0.10%	5	4
Wildlife Resources Commission	218,500	0.03%	5	4
Department of Labor	122,992	0.02%	17	16
Western North Carolina Regional Economic Development Commission	110,746	0.02%	8	7
Housing Finance Agency	103,589	0.01%	54	32
Total	**$ 693,987,446**	**100.00%**	**5,297**	**2,758**

STATE OF NORTH CAROLINA
Office of the State Auditor

BETH A. WOOD, CPA
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October 19, 2009

Mr. John Turcotte, Director
Program Evaluation Division
212 Legislative Office Building
300 N. Salisbury Street
Raleigh, NC 27603

Dear Mr. Turcotte:

I appreciate the opportunity to provide a response to the findings and recommendations in your report entitled *Accountability Gaps Limit State Oversight of $694 Million in Grants to Non-Profits*. In general, I agree with your conclusions; however, I have provided some additional responses to the findings and recommendations.

Finding 1. State reporting requirements established by statutes and administrative rules do not ensure accountability for state funds granted to non-profits.

Finding 1 overly minimizes the importance of post-audits in ensuring accountability. Accountability begins with maintaining an accurate accounting of funds received, disbursed, and available for future uses. Financial statement audits provide assurance that recipients have the capacity to track funds. Also, audits conducted in accordance with the Yellow Book include a report citing internal control deficiencies that could lead to future lost accountability, as well as instances of noncompliance with grant requirements that have a material impact on the determination of financial statement amounts. Reading these reports and following up on reported audit findings are integral parts of any effective grants monitoring plan. The report seems to acknowledge this in Exhibit 8. The better point to be made here is the timing of the audit reports, which are not due until 9 months after the non-profit's fiscal year-end.

Finding 2. Inconsistent grants oversight practices among state agencies result in an overall lack of accountability.

The report points out that the State does not enforce or monitor the quantity or quality of agency monitoring. It is important to note that federal regulations require the Office of the State Auditor to identify and assess monitoring plans for all <u>federal</u> grants selected for audit that are administered by state agencies in any given fiscal year. However, for <u>state</u> grants awarded by state agencies, due to the size of the grants, limited oversight of state monitoring is done.

Recommendation 1: The North Carolina General Assembly should revise N.C. Gen. Stat. §143-6-23(d) to require performance-based contracting, program monitoring plans, and more timely and accurate reporting on state grants to non-profits.

The report suggests that having agencies provide assurances to the Office of State Budget and Management that they have monitoring plans on file would provide evidence of monitoring activities. To some degree this is true, but I believe such evidence is slight. In my opinion, much better assurance can be provided by our audits of state agency monitoring efforts. As referred to previously, we annually audit state agency monitoring of federal subgrants. However, due to limited resources, we only sporadically are able to audit the monitoring of state grants. Perhaps a portion of the 2% administrative allowance recommended in the report could be used to pay for our audits of state grant monitoring.

Further, the report does not appear to give due consideration to the cost of the various accountability measures. As noted in Exhibit 6, grants to only 185 recipients account for 79% of the awarded dollars. Concentrating accountability measures on these moneys is a cost-effective approach to ensuring proper use of public funds, which is why these are the entities required to have audits. While I agree that the remaining 21% of the funding should not be ignored, an appropriate cost/benefit analysis is needed to ensure that the accountability measures themselves are not wasteful.

In **Finding 3**, and elsewhere in the report, the Department of Health and Human Services is cited as being ahead of other agencies in ensuring accountability for its grants to non-profits. I agree with this assertion; however, I am compelled to point out that each year this Office reports several deficiencies in the Department's subrecipient monitoring practices.

Finally, I suggest that great care should be taken before stop-payments of federal grants are executed in accordance with **Recommendation 3**. There is a reasonable possibility that such action could violate the terms of the federal funding, including cash management requirements. Likewise, directing 2% of federal grants to pay costs of oversight in accordance with **Recommendation 4** would likely violate grant provisions for many programs. A safer alternative would be to withhold 2% of state grant funds only.

Again, thank you for the opportunity to offer my perspective on your report. Your advocacy for improved accountability over grants to non-profits is certainly welcome. Please let me know should you wish to discuss any of these matters further.

Sincerely,

Beth A. Wood, CPA

Beth A. Wood, CPA
State Auditor

301.01

STATE OF NORTH CAROLINA

OFFICE OF STATE BUDGET AND MANAGEMENT

BEVERLY EAVES PERDUE
GOVERNOR

CHARLES E. PERUSSE
STATE BUDGET DIRECTOR

September 25, 2009

John Turcotte
Director, Program Evaluation Division
North Carolina General Assembly
212 Legislative Office Building
300 N. Salisbury St.
Raleigh, NC 27603

Dear Mr. Turcotte:

Thank you for the opportunity to review and comment on the Program Evaluation Division's report, "Accountability Gaps Limit State Oversight of $694 Million in Grants to Non-Profits." The report documents the policies and practices that account for state grants to non-profit organizations, and comes during a transition of grant reporting responsibilities from the Office of State Auditor to the Office of State Budget and Management (OSBM).

We find the report to be an accurate description of how state agencies fund the activities of non-profit organizations. As the report clearly shows, state agencies are inconsistent in how they manage their grants. We largely concur with your recommendations and will consider a number of the proposed changes as we review and update the rules governing administration of state grants.

We agree that a performance-based contracting framework and more consistent requirements for agency program monitoring plans would promote greater accountability across state agencies. Greater oversight and monitoring at the agency level is the most effective way to ensure that grant funds are spent in the manner intended and that performance outcomes are being achieved. However, resource limitations have been a significant barrier for many agencies in developing an effective monitoring program. As proposed in Recommendation 4 of your report, the authority to withhold a percentage of grant awards to fund oversight would ensure agencies had the resources necessary to implement these recommendations.

On pages 25-26, the report cites a lack of timely, comprehensive information and the lack of a point in time status of statewide grant funds as two detriments to accountability. We agree that tightening the reporting deadline from six or nine months to 90 days would help prevent additional funds from being disbursed before grantees appear on the Suspension of Funding List. However, we feel additional consideration is necessary on the question of changing the reporting period to the state fiscal-year. We offer a few points:

1. *Moving the reporting period from the grantee's fiscal-year to the state's fiscal-year may contribute to grantee confusion and less accurate reporting*. If the expectation is for grantees to report on their full grant award, this change would require grantees to forecast upcoming expenditures and outcomes for the remaining award period. Alternatively, if they are only reporting on actual expenditures and activities to-date, the report would not provide a complete accounting of the grantee's activities. As a result, annual reports would either lose accuracy or provide an incomplete picture.
2. *Moving the reporting period from the grantee's fiscal-year to the state's fiscal-year may make it more difficult to measure the outcomes of programs still in progress.* For example, summer lunch programs for school-age children and many economic development initiatives span two state fiscal years, so final outcomes of these programs would be unknown at the time their report is submitted.
3. *OSBM is currently making enhancements to the automated system, and will allow easier "point-in-time" disbursements.* Better integration with the State's accounting system will allow OSBM to report on actual disbursement to every grant for any time period requested (e.g., by calendar year, by state fiscal year, or federal fiscal year). This functionality, while not associated with grantee year-end outcomes, will nevertheless be able to provide information on what grantees have received, regardless of where they are in their grant cycle.

If reporting continues to be an annual requirement, we believe that reporting by the grantee's fiscal-year is the best way to obtain a complete report of how grant funds were used. In-progress reporting should be accomplished through agency monitoring programs.

We believe these points help demonstrate some of the nuances of grant reporting as well as the challenges OSBM and agencies face in improving accountability.

Thank you again for the opportunity to review and comment and for the thoroughness of this report.

Sincerely,

Charles F. Perusse

Charles Perusse