

In 2015, the Office of Grants Management (OGM), in collaboration with the Department of Natural Resources (DNR) and Department of Human Services (DHS) held training on [Policy on the Financial Review of Nongovernmental Organizations \(08-06\)](#).

### **Policy Purpose**

Ensure that nongovernmental organizations (NGO) have the financial stability to carry out the purpose of a grant.

### **Policy Requirements**

This policy directs agencies to review a NGO's recent financial statement prior to awarding a grant over \$25,000 through a single source or competitive process. This policy is not required for legislatively named grantees, grants to individuals, or bonding and capital grants.

Your review must address items of significant concern that come from conducting a financial review with the grant applicant, by reviewing the following documents, based upon the annual income of the NGO:

- Under \$50,000 or new NGO with no IRS form 990 - the most recent, board reviewed financial statements.
- \$50,000-\$750,000 - the most recent IRS form 990.
- Over \$750,000 - a most recent certified financial audit.

### **Framework – Financial Analysis as Part of the Bigger Picture**

The financial document analysis begins to tell the story of the financial position of the NGO. It's important and helpful to approach having a conversation with the NGO as an opportunity for learning more through transparent and open dialogue. Asking questions for clarification and requesting additional documentation demonstrates that you're seeking to understand. Your detailed conversations, reflection, and analysis will assist you in completing your financial review to determine the financial stability of the NGO.

### **Documents to Review**

During the financial review process, the following documents are important in determining the NGO's financial stability:

1. **The Statement of Activities** is a snapshot of the NGO's finances for a single year. It's helpful to request and review past year's statements to look for trends and patterns. Keep in mind that reviewing statements over three years old may give an incorrect impression of an organization's current financial picture.
2. **The Statement of Financial Position** reports the cumulative effect of an NGO's financial activity over more than one year.
3. An NGO files an **IRS form 990** with the IRS in lieu of a tax return and generally contains two years of information.

## **What do I look for in Financial Statements?**

You will be reviewing financial statements and audited financial statements for the following:

- A significant operating deficit
- A deficit in unrestricted net assets
- Significant changes or size of the NGO's debt ratio

Review **the Statement of Activities** for the following:

- Change in Net Assets – Is the NGO operating under a deficit? Is there a pattern when compared to past years?
  - Examples of follow-up questions to ask an applicant when a deficit is present:
    - Why do you have a deficit?
    - Is this a planned deficit?
    - What is your plan to generate enough revenue to pay your organization's current expenses?

Review **the Statement of Financial Position** for the following:

- Unrestricted Net Assets – This represents the amount of assets an organization has with no restrictions for use. Has there been a significant change from year-to-year? Does the organization show a deficit for their current or past years?
- Debt Ratio – Calculate the debt level by taking the NGO's total liabilities and dividing it by the total of unrestricted net assets. Calculating the debt ratio for more than one year may reveal a trend. No magic number exists that represents a healthy debt load, as every organization has different dynamics. Is the debt ratio increasing or decreasing?
  - Examples of follow-up questions to ask an applicant when there is/are deficit(s) in unrestricted net assets and/or an increasing debt ratio:
    - What is contributing to your deficit in unrestricted net assets and/or increasing debt ratio?
    - What factors in your organization are present and contributing to this?
    - Is the board aware?
    - How is the board involved in approving the budget?
    - What is your organization's strategic plan?
    - Does your organization have financial policies in place to establish an operating reserve?

## **What do I look for in an IRS Form 990?**

Review an **IRS Form 990** for the following:

- Administrative Expenses: What percentage does the grant applicant spend on administrative expenses in comparison to what the grant applicant spends on programs and services?
- Additional fundraising costs: Are the totals, combined, over 25% of total expenses? If so, why? Is the NGO using a professional fundraiser?
- Surplus/Deficit: If a deficit exists, ask for follow-up, such as reasons, contributing factors, etc.
- Change in unrestricted net assets: Is this a positive or negative number?
- Executive Pay: Is it consistent with others in the area and the type of work for the NGO?
- Growth: Is the NGO growing or shrinking? Why?
- Types of Support: Types and number of funding sources –look for diversity

Please visit [OGM's training page](#) for a spreadsheet template to use when reviewing the IRS Form 990. You may also download and reference [Nonprofits Assistance Fund's IRS 990 Decoder Worksheet](#) for a more comprehensive analysis.

## **Next Steps**

Document your review of the financial documents, the results of the financial review, and your subsequent follow-up. Use these questions to help with your analysis process:

- Are there significant concerns and can the grant applicant mitigate them? If so, what actions has the grant applicant made to assuage your concerns?
- Did the organization provide clear and contextual answers to the questions you raised?
- What trends do you see?
- Would it help to request more information and ask additional questions?

Ensure that you keep all information and financial analysis results in the official grant file. Place additional requirements and controls in the grant contract agreement/notice of grant award to mitigate risk – such as a required pre-award on-site visit, additional monitoring and financial reconciliations, etc.

Healthy and transparent organizations will be forthcoming with timely responses and engage in a dialogue and conversation. An organization that is hesitant to engage in dialogue and is unresponsive in its communication could signify a concern. A document with unclear information is not a deal breaker.

Remember that you can always reach out to your agency's Internal Controls staff or Internal Audit staff as a resource for questions, consultation, and expertise.

## **Additional Resources and Templates:**

Visit [OGM's training page](#) to download sample policy and procedure templates for use at your state agency.