OLA

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

ClearWay Minnesota℠

Internal Controls and Compliance Audit

July 2013 through March 2016

October 20, 2016 **Report 16-14**

FINANCIAL AUDIT DIVISION
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Financial Audit Division

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Conclusion on Internal Controls

The Financial Audit Division bases its conclusion about an organization's internal controls on the number and nature of the control weaknesses we found in the audit. The three possible conclusions are as follows:

Conclusion	Characteristics
Adequate	**The organization designed and implemented internal controls that effectively managed the risks related to its financial operations.**
Generally Adequate	**With some exceptions, the organization designed and implemented internal controls that effectively managed the risks related to its financial operations.**
Not Adequate	**The organization had significant weaknesses in the design and/or implementation of its internal controls and, as a result, the organization was unable to effectively manage the risks related to its financial operations.**

October 20, 2016

Representative Sondra Erickson, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Joy Rikala, Board Chair, ClearWay Minnesota[SM]

Members of the ClearWay Minnesota Board of Directors

David Willoughby, Chief Executive Officer
ClearWay Minnesota

This report presents the results of our internal controls and compliance audit of ClearWay Minnesota's expenditures for the period from July 1, 2013, through March 31, 2016. The objectives of this audit were to determine if the organization had adequate internal controls over its use of Tobacco Settlement money and complied with finance-related legal requirements.

This audit was conducted by Daphne Fabiano, CPA, Auditor-in-Charge, and assisted by auditor April Lee.

We received the full cooperation of ClearWay Minnesota's staff while performing this audit.

James R. Nobles	Cecile M. Ferkul, CPA, CISA
Legislative Auditor	Deputy Legislative Auditor

Table of Contents

Report Summary

Background

ClearWay Minnesota℠ (originally known as the Minnesota Partnership for Action Against Tobacco), is a nonprofit foundation created and funded through a legal settlement.

In 1994, the State of Minnesota and Blue Cross Blue Shield of Minnesota (Blue Cross) sued the major tobacco companies. Before the case went to the jury, the companies agreed to pay more than $6 billion to compensate the state and Blue Cross for health care costs caused by tobacco products. The settlement, reached in 1998, earmarked $202 million to fund a nonprofit, public health foundation for 25 years.

The court established a 19-member board to govern the foundation. The board appoints an executive director, who supervises a 28-person staff. The board and staff must operate the foundation consistent with the settlement agreement and subsequent court orders. The court granted the Office of the Legislative Auditor authority to audit the foundation.

This is our third audit of the foundation.[1] In this audit, we examined ClearWay Minnesota's expenditures from July 2013 through March 2016. We focused on whether ClearWay Minnesota had adequate internal controls and complied with legal requirements and its own policies and procedures.

Conclusion

ClearWay Minnesota had adequate internal controls and complied with legal requirements and its own policies and procedures.

[1] Office of the Legislative Auditor, Financial Audit Division Report 01-24, *Minnesota Partnership for Action Against Tobacco*, issued May 11, 2001; Office of the Legislative Auditor Financial Audit Division Report 07-24, *ClearWay Minnesota*℠ issued September 13, 2007.

ClearWay Minnesota℠

Background

In 1994, the State of Minnesota and Blue Cross Blue Shield of Minnesota (Blue Cross) filed a lawsuit against the major tobacco companies and their affiliated organizations. The state and health insurer claimed that tobacco companies had defrauded the public about the health effects of smoking and sued to recoup smoking-related health care costs.

After a nearly four-month trial and shortly before the case was to go to the jury, the state, Blue Cross, and the tobacco companies settled the case for $6.1 billion on May 8, 1998.[2] Ramsey County District Court Judge Kenneth Fitzpatrick approved the Settlement Agreement with a Consent Judgment on that same date.[3] The judgment reserved Ramsey County District Court's continuing authority to enforce the judgment over the Minnesota Partnership for Action Against Tobacco's (MPAAT) lifespan.[4]

The settlement provided for the creation of a public health foundation to help "diminish the human and economic consequences of tobacco use," and set aside $202 million to fund its programs. The Consent Judgment specified that the tobacco companies would pay $102 million by December 1998 into an account focused on helping Minnesotans quit smoking. The judgment also required the tobacco companies to pay $10 million annually for ten years into a national research account aimed at preventing children from smoking, as well as funding other tobacco control efforts. The judgment also required the state to submit a plan to the court on how the foundation would operate.

In response, the state proposed the creation of a nonprofit organization called the Minnesota Partnership for Action Against Tobacco (MPAAT). The plan provided that a 19-member board of directors would govern the organization.[5] The court approved the plan on August 27, 1998, and MPAAT began operating as an

[2] The settlement required the tobacco companies to make payments estimated to be worth approximately $6.1 billion to the State of Minnesota and $469 million to Blue Cross Blue Shield of Minnesota.

[3] Also known as an "Agreed Judgment," a Consent Judgment is "a settlement that becomes a court judgment when the judge sanctions it." Bryan A. Garner, Editor in Chief, Black's Law Dictionary (St. Paul: Thomson Reuters, 2014), 970.

[4] Since MPAAT/ClearWay Minnesota's inception, several judges have overseen the organization.

[5] The board would include eleven at-large members and eight appointed members. Of the eight appointed members, the Speaker of the House appoints two directors (of different political parties); the Senate Majority Leader appoints two directors (of different political parties); the Governor appoints two directors; and the Attorney General appoints two directors. At-large members are elected based on their expertise in a variety of areas, including nonprofit management, finance, tobacco and health, community organizing, and public affairs.

independent, nonprofit organization in September 1998.[6] The approved plan also required MPAAT to report annually to the court, the Minnesota Legislature, and granted the Office of the Legislative Auditor with authority to audit MPAAT.[7]

In 2002, Attorney General Mike Hatch filed a motion with the court to dissolve MPAAT and appoint the Department of Health and the University of Minnesota Medical School to administer the funds the court had set aside.[8] Attorney General Hatch called MPAAT "rife with conflicts of interest" and accused it of failing to fund smoking cessation programs.[9] MPAAT disagreed.[10] While the judge overseeing MPAAT at the time, Michael Fetsch, did not dissolve MPAAT, he did order important changes. Judge Fetsch required MPAAT to restructure its Board to guard against conflicts of interests. He also required MPAAT to spend more money on helping individual smokers quit. MPAAT made those changes. In 2006, MPAAT changed its name to ClearWay Minnesota.

In 2013, ClearWay Minnesota asked Ramsey County District Court to allow it to further clarify its conflict of interest policy to help board members and staff identify actual situations where there may be conflicts of interests or the appearance of a conflict, even if no actual conflict exists. The judge approved the revisions.[11]

ClearWay Minnesota's board will undergo further changes in the years ahead. Earlier this year, ClearWay Minnesota proposed revising the board's make up from 19 to 11 members in preparation for ClearWay Minnesota's dissolution in 2023. On June 21, 2016, ClearWay Minnesota submitted its proposed changes to Ramsey County Chief Judge John Guthmann who approved the revisions on the same day.

ClearWay Minnesota's Chief Executive Officer David Willoughby is in charge of day-to-day operations. He and his staff operate under policies established by the board, as well as procedures required by the Consent Judgment, the court-approved plan that established the foundation, and subsequent court orders.

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[6] Judge Kenneth Fitzpatrick, who issued the Consent Judgment retired shortly after the trial. Ramsey County Chief Judge Lawrence Cohen approved the State's plan.

[7] A public accounting firm annually audits ClearWay Minnesota's financial statements. ClearWay Minnesota has received unqualified (clean) audit reports every fiscal year.

[8] Mike Hatch became Minnesota Attorney General in 1999. He succeeded Hubert H. Humphrey, III who launched the state's lawsuit against the tobacco companies in 1994. Attorney General Hatch's motion called for the University of Minnesota Medical School to administer the medical research funds and for the Minnesota Department of Health to oversee the tobacco cessation funds.

[9] Hatch Aff. 7, May 14, 2002.

[10] MPAAT argued it provided direct services to smokers through telephone quit lines. Hurt Aff. 11, April 25, 2002.

[11] Judge John Guthmann approved the changes on May 15, 2013.

ClearWay Minnesota provides grants to health, community, and academic organizations throughout the state to support research, intervention, and related program activities. In addition, ClearWay Minnesota provides help to individual tobacco users through its QUITPLAN® Services. Those services include a telephone helpline, nicotine patches, and text messaging and email support programs. In addition, ClearWay Minnesota also contracts for advertising services, community development services, communications, public affairs, and research.

Since 2007, ClearWay Minnesota's main source of revenue has been investment income from its tobacco settlement funds. Grant and contract expenses accounted for approximately 73 percent of ClearWay Minnesota's expenses in our audit period.

Table 2 shows information extracted from ClearWay Minnesota's audited financial statements about its assets, liabilities, and net assets, as of June 30, 2015.

Table 2
ClearWay Minnesota[SM]
Statement of Financial Position
As of June 30, 2015

Assets:	
Cash and cash equivalents	$ 18,485
Accounts receivable	99,414
Prepaid expenses	50,090
Investments	71,968,643
Equipment and leasehold improvements	30,213
Total Assets	$72,166,845
Liabilities and Net Assets:	
Liabilities:	
Accounts payable	$ 1,101,133
Accrued expenses	179,773
Grants payable	3,023,520
Total Liabilities	4,304,426
Net Assets:	
Unrestricted – designated for tobacco research and other tobacco control purposes	$67,862,419
Total Net Assets	$67,862,419
Total Liabilities and Net Assets	$72,166,845

Source: ClearWay Minnesota's audited financial statements as of June 30, 2015. Contact ClearWay Minnesota to obtain a full financial report.

Table 3 shows information extracted from ClearWay Minnesota's audited financial statements about its revenue and gains, expenses, and change in net assets for the year ended June 30, 2015.

Table 3
ClearWay Minnesota[SM]
Statement of Activities
For the Year Ended June 30, 2015

Revenue and Gains:	
Net investment income	$ 1,896,782
Contributions and grants	123,955
Total Revenue and Gains	$ 2,020,737
Expenses:	
Program services:	
Tobacco cessation	$12,060,970
Research and other tobacco issues	1,906,344
Total Program Services	$13,967,314
Supporting services:	
General and administrative	1,181,438
Total Expenses	15,148,752
Change in Net Assets:	(13,128,015)
Net Assets at beginning of year	$80,990,434
Net Assets at end of year	$67,862,419

Source: ClearWay Minnesota's audited financial statements as of June 30, 2015. Contact ClearWay Minnesota to obtain a full financial report.

Audit Objective, Scope, and Methodology

The objective of our audit of ClearWay Minnesota for the period July 1, 2013, through March 31, 2016, was to answer the following questions:

- Did ClearWay Minnesota have adequate internal controls to ensure it safeguarded its financial resources; accurately paid employees, grantees, and vendors in accordance with management's authorization; complied with finance-related legal requirements; and created reliable financial data?
- For items tested, did ClearWay Minnesota comply with legal requirements related to its financial operations, including elements of Ramsey County District Court documents and ClearWay Minnesota Board of Directors' policies and procedures?
- Did ClearWay Minnesota resolve prior audit findings?

To answer these questions, we reviewed the tobacco settlement agreement, Ramsey County District Court orders, and ClearWay Minnesota's policies and procedures. We designed our audit approach based on our consideration of the risk that errors and noncompliance could occur. We obtained and analyzed the accounting data to identify unusual trends or significant changes in financial operations. In addition, we selected samples of financial transactions and reviewed supporting documentation. We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective.

Audit Criteria

We assessed ClearWay Minnesota's internal controls using the internal control standards published by the U.S. Government Accountability Office.[12] To establish legal compliance criteria for grants, contracts, and other expenditures we tested, we examined the requirements in the following documents:

Ramsey County District Court Documents:

- Settlement Agreement (sets terms of settlement between the tobacco companies and the State of Minnesota);
- Consent Judgment (court approval of the settlement);
- Order Approving Plan of Administration (court order approving the state's plan of administration for ClearWay Minnesota);
- Order approving revised Cessation Plan, dated February 25, 2003 (court order approving ClearWay Minnesota's revised comprehensive governance plan involving individual smoking cessation activities);
- Order removing certain salary limits, filed June 13, 2005 (court order revising ClearWay Minnesota staff's salary limits from not exceeding 120 percent of the Governor's salary to salaries based on an independent compensation study); and
- Order approving ClearWay Minnesota's Restated Conflict of Interest Policy filed May 15, 2013.

ClearWay Minnesota Policies and Procedures:

- Grant-Making Process Guidelines;
- Service Agreement Contracting Guidelines;
- Fiscal Policies, Procedures, and Guidelines Manual;
- ClearWay Minnesota Conflict of Interest Policy;
- ClearWay Minnesota Bylaws; and
- ClearWay Minnesota Policies on Tobacco Use and Interactions with the Tobacco Industry.

[12] Comptroller General of the United States, Government Accountability Office, *Standards for Internal Control in the Federal Government*, (Washington D.C., September 2014). In September 2014, the State of Minnesota adopted these standards as the internal control framework for the state's executive branch.

Status of Prior Audit Findings

Our 2007 audit report included three findings (areas that caused us concern).[13] In this section, we restate each finding and discuss our approach to determine whether ClearWay Minnesota resolved the finding:

(1) ClearWay Minnesota had expenses that may have been unnecessary and unreasonable, not authorized by a board approved policy, and not adequately documented.

We reviewed current board policies and procedures to see if the board had set limits and established standards for authorization, approval, and documentation for the types of expenses questioned in the prior report.

We found that board policies now allowed ClearWay Minnesota to establish a Chief Executive Officer Special Events Fund as a separate budget item in the annual budget presented to the board for approval.[14] The policy stated, "The total amount of the budget line item shall be limited to 0.5 percent of the total budgeted salaries or $10,000 (whichever is greater) for any budget year."

The policy states that the purpose of the fund is for "special events relating to staff, Board Members, Committee Members and other stakeholders of ClearWay Minnesota." The policy further provides examples of the types of allowable events, including, but not limited to, special recognition, appreciation or rewards, retirements and staff resignations, staff meetings and events, and other events approved by the chief executive officer.

In addition to the special events fund, the board's policies and procedures allowed for payment of costs related to board and committee meetings, conferences and events, and special projects.

ClearWay Minnesota continued to have expenses similar to those noted in our 2007 report, including meals, lodging, and other costs. For example, ClearWay Minnesota paid costs associated with the following events:

- board/staff strategic planning meetings,
- employee recognition,
- luncheon to celebrate ClearWay Minnesota's 15th anniversary, and

[13] Office of the Legislative Auditor, Financial Audit Division Report 07-24, *ClearWay Minnesota*[SM] issued September 13, 2007.

[14] Fiscal Policies, Procedures, and Guidelines Manual, ClearWay Minnesota[SM] revised August 2011.

- events to prepare for and facilitate a "Day at the Capitol" for grantees to interact with legislators and their staff.

We reviewed documentation supporting these and other expenses and discussed the events with ClearWay Minnesota's management. We concluded these expenses complied with board policies, limits, and budgets related to the Chief Executive Officer Special Events Fund and board expenses. In addition, the documentation for these expenses showed appropriate board and management approval and supported the costs incurred.

(2) ClearWay Minnesota did not execute some contract amendments in a timely way.

Our testing related to contract payments made during the period from July 2013 through March 2016 showed that ClearWay Minnesota executed all contract amendments in a timely way.

(3) ClearWay Minnesota did not always complete purchase orders in advance of purchases.

Our testing of purchases during the period from July 2013 through March 2016 showed that ClearWay Minnesota routinely completed purchase orders in advance of the purchase; however, we noted a few instances when ClearWay Minnesota completed purchase orders shortly after the purchase occurred. For each of these instances, we found other evidence of approval prior to the purchase. We concluded that ClearWay Minnesota resolved this prior audit finding.

Conclusion

ClearWay Minnesota had adequate internal controls and complied with legal requirements applicable to its use of tobacco settlement money. ClearWay Minnesota also resolved the prior audit findings.