



STATE OF NORTH CAROLINA

PERFORMANCE AUDIT

GOLDEN LEAF

NOVEMBER 2009

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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November 2, 2009

The Honorable Beverly Perdue, Governor
Members of the North Carolina General Assembly
Mr. Dan Gerlach, President, Golden Long-term Economic Advancement Foundation (LEAF)

Ladies and Gentlemen:

We are pleased to submit this performance audit titled *Golden LEAF*. The audit objectives were to determine if Golden LEAF effectively monitors grant awards, if Golden LEAF complies with state open meeting laws, and if state laws provide adequate safeguards over Golden LEAF investments. Mr. Dan Gerlach, Golden LEAF President, reviewed a draft copy of this report. His written comments are included in the appendix.

The Office of the State Auditor initiated this audit to ensure accountability and transparency for state funds.

Respectfully submitted,

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

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PERFORMANCE AUDIT

SUMMARY

PURPOSE

The purpose of this audit was to determine if Golden LEAF effectively monitors grant awards, if Golden LEAF complies with state open meeting laws, and if state laws provide adequate safeguards over Golden LEAF investments. This audit report includes recommendations so that Golden LEAF management and state officials may take appropriate corrective action.

RESULTS

Golden LEAF procedures do not ensure effective oversight of grant activities. While Golden LEAF performs various monitoring activities, Golden LEAF grant monitoring and reporting practices are not sufficient to ensure effective and accountable economic development efforts for approximately \$326.2 million in grants awarded to date. Golden LEAF did not perform key monitoring functions such as verifying grantee-submitted data, determining if desired program results were attributable to respective grantee programs, and systematically reviewing grantee financial condition. Consequently, state funds could be wasted on grantees that are not achieving desired results or lack the capacity to sustain operations.

Golden LEAF violated North Carolina open meetings laws by approving a \$15 million grant in a closed meeting and not maintaining full and accurate meeting minutes. As a result, operational transparency and the public's right to monitor the administration of state funds were compromised.

Approximately \$726.9 million of Golden LEAF funds are not subject to state laws designed to adequately safeguard state funds from investment risks and political influence. Instead, Golden LEAF investment policy is governed by a different state law that applies to institutional funds, even though the only sources of Golden LEAF revenue are state funds - payments from cigarette manufacturers to the State and the return on those invested payments. Additionally, Golden LEAF management and directors are not subject to the State Government Ethics Act, which establishes ethical conduct and conflict of interest standards for covered persons. Instead, Golden LEAF adheres to its own conflict of interest policy.

Golden LEAF management repeatedly restricted and delayed our access to information needed to satisfy our audit objectives. Repeated audit requests for "all board minutes" were consistently met with reasons to exclude sets of minutes, and auditor access to Golden LEAF investment files was delayed. Considering the trouble we experienced in gaining access to board minutes and investment files, we determined there to be reasonable risk that auditors did not have access to all of the information that could impact our audit conclusions. Consequently, we are reporting scope limitations, as defined by Government Auditing Standards, for the audit objectives related to state open meeting laws and Golden LEAF investments.

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RECOMMENDATIONS

Golden LEAF should implement best practices for monitoring and reporting its economic development activities. Golden LEAF should establish a system of internal controls designed to verify grantee submitted data, determine that desired program results are attributable to respective grantee programs, and systematically review grantee financial condition.

Golden LEAF should comply with North Carolina open meeting laws.¹

The Governor and General Assembly should consider if allowing Golden LEAF to invest state funds outside of state rules for investing and safeguarding state funds serves the public's best interests.

AGENCY'S RESPONSE

The Agency's response is included in the appendix.

¹ Golden LEAF minutes for meetings occurring after our audit began reflected marked improvement in recording full and accurate minutes in accordance with applicable laws.

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INTRODUCTION

BACKGROUND

In 1999, a Master Settlement Agreement (MSA) was established between certain cigarette manufacturers and 46 states. The MSA required the cigarette manufacturers to make settlement payments to the states, which the states used for various purposes including general government expenses, health care, budget shortfalls, infrastructure, education, and tobacco control programs.

In North Carolina, the General Assembly created Golden LEAF (Long-term Economic Advancement Foundation) to manage half of the State's MSA settlement payments. Session Law 1999-2, Senate Bill 6, established that the rights, title, and interest of 50% of the proceeds from the MSA would be assigned to the foundation. As a result, the funds that the State provides to Golden LEAF are not subject to the budget appropriation process. The Golden LEAF Articles of Incorporation state that the activities of the foundation include, but are not limited to, education assistance, job training and employment assistance, scientific research, economic hardship assistance, public works and industrial recruitment, health and human services, and community assistance.

Golden LEAF is headquartered in Rocky Mount, NC, and employs 14 people: a president, four vice-presidents, and a staff which includes program officers, administrative personnel, and a controller. Golden LEAF is legally recognized as a nonprofit organization, as defined by Section 501(c)(3) of the Internal Revenue Code, and its employees are not considered state employees. Salaries and benefits of Golden LEAF employees are set and adjusted at the discretion of its Board of Directors.

Golden LEAF is governed by a 15-member Board of Directors, with the Governor, President Pro Tempore of the Senate, and Speaker of the House of Representatives appointing five members each. State law provides that the members of the board represent the interests of tobacco production, tobacco manufacturing, tobacco employment, health, and economic development. The members hold staggered four-year terms, with no term limits.

The State expects to receive MSA payments until 2025. To date, Golden LEAF has received MSA payments totaling about \$706.5 million from the State. Golden LEAF Articles of Incorporation state that the foundation will exist in perpetuity, so Golden LEAF management has instituted policies that promote long-term growth of its assets and preserve the foundation's existence. As of June 30, 2008, Golden LEAF had awarded approximately \$326.2 million in grants, and held \$731.7 million in assets.

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objectives were to determine if Golden LEAF effectively monitors grant awards, if Golden LEAF complies with state open meeting laws, and if state laws provide adequate safeguards over Golden LEAF investments.

The Office of the State Auditor initiated this audit to ensure accountability and transparency for state funds.

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The scope of our audit included Golden LEAF grants awarded since the foundation's inception, minutes of all meetings held by board members since the foundation's inception, investment transactions of Golden LEAF, and all laws, rules, guidelines, and policies regarding administration of the foundation. Our scope also included laws pertaining to the administration of the Department of State Treasurer, Department of Commerce, Tobacco Trust Commission, and Health and Wellness Fund.

In addition to research performed in our offices, audit fieldwork was performed on site at Golden LEAF headquarters in Rocky Mount. Fieldwork began in July 2008 and substantially concluded in April 2009, with additional evidence being provided by Golden LEAF through July 2009.

To determine if Golden LEAF effectively monitors grant awards, we examined a random sample of 245 out of 683 Golden LEAF grant files for evidence of practices endorsed by the National State Auditors Association (NSAA) in its publication "Best Practices in Carrying Out State Economic Development Efforts." The NSAA publication identifies general monitoring principles and "types of practices that are more likely to result in an efficient, effective, and accountable economic development effort."

To determine if Golden LEAF complied with state open meetings law, we requested minutes of all Board of Directors meetings since inception of the foundation. As described in Finding #4, we are reporting a scope limitation, as defined by Government Auditing Standards, for this audit objective. In our professional judgment, there is reasonable risk that information may have been excluded from our access that could have significantly impacted our conclusions about Golden LEAF compliance with state open meeting laws. We reviewed all minutes provided by management for compliance with the law.

To determine if state laws provide adequate safeguards over Golden LEAF investments, we researched *North Carolina General Statutes*, reviewed the Golden LEAF investment policy, and examined a sample of investment files. As described in Finding #4, we are reporting a scope limitation, as defined by Government Auditing Standards, for this audit objective. In our professional judgment, there is reasonable risk that information may have been excluded from our access that could have significantly impacted our conclusions about the adequacy of safeguards over Golden LEAF investments. We did compare Golden LEAF policies and practices to legislation applicable to the General Fund, Highway Fund, and special funds held by the State Treasurer. We also searched *North Carolina General Statutes* for laws that govern Golden LEAF investments.

Because of the test nature and other inherent limitations of an audit, together with limitations of any system of internal and management controls, this audit would not necessarily disclose all instances of performance weaknesses or lack of compliance.

Except for the scope limitations described above, we conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for findings and conclusions based on our audit objectives. We believe the

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evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We conducted this audit under the authority vested in the State Auditor by *North Carolina General Statute 147-64*.

FINDINGS AND RECOMMENDATIONS

1. MONITORING IS NOT SUFFICIENT TO ENSURE EFFECTIVENESS AND ACCOUNTABILITY

Golden LEAF procedures do not ensure effective oversight of grant activities. While Golden LEAF performs various monitoring activities, Golden LEAF grant monitoring and reporting practices are not sufficient to ensure effective and accountable economic development efforts for approximately \$326.2 million in grants awarded to date. Golden LEAF did not perform key monitoring functions such as verifying grantee submitted data, determining that desired program results were attributable to respective grantee programs, and systematically reviewing grantee financial condition.

No Systematic Verification of Grantee Submitted Interim and Final Reports

Due to the lack of data verification and systematic use of consistent monitoring functions, Golden LEAF could waste state funds by failing to timely identify funded programs that are not achieving desired results. Through fiscal year 2008, Golden LEAF has awarded approximately \$326.2 million in grants to various government agencies and non-profit organizations.

The Grant Accountability Project² states, “Monitoring grantee performance helps ensure that grant goals are reached and required deliverables completed. In addition, monitoring performance can address potential problems early in the grant period and keep grantees on course towards goals.”

Although not sufficient to satisfy best practices criteria, Golden LEAF performs some monitoring functions. For example, Golden LEAF requires grantees to submit interim and annual reports used to benchmark grantee results with established goals. Golden LEAF notifies grantees when they are out of compliance or not achieving agreed-upon results. Golden LEAF also withholds 20% of the grant amount until the grantee submits a final report indicating that project targets have been achieved. Additionally, Golden LEAF relies upon grantee-appointed committees to provide oversight for some grant projects and uses phone calls and site visits to monitor project results.

However, Golden LEAF monitoring procedures do not go far enough to substantiate grantee reports or to document monitoring efforts. The National State Auditor Association (NSAA) publication *Best Practices in Carrying Out State Economic Development Efforts* identifies general monitoring principles and “types of practices that are more likely to result in an efficient, effective, and accountable economic development effort.” The NSAA recommends that economic development agencies “review and verify the data submitted for accuracy and reliability, and document the verification work done and its results.”

² The Grant Accountability Project is a “collection of federal, state, and local audit organizations tasked by the Comptroller General of the United State’s Domestic Working Group to offer suggestions for improving grant accountability.” The Project published its report titled “Guide to Opportunities for Improving Grant Accountability” in October 2005.

FINDINGS AND RECOMMENDATIONS

Golden LEAF does not consistently verify or require supporting documentation for data submitted in grantee interim and final reports. Golden LEAF requires grantees to submit reports that document program results, activities, population served, project revisions, significant personnel changes, and financial data to detail how grant funds were spent. But Golden LEAF does not require grantees to submit supporting documentation for the information contained in the reports. Examples of such support would be payroll records, attendance records, satisfaction surveys, and expense receipts. While grantee committees may provide useful information for respective projects, Golden LEAF cannot be assured of the accuracy or independence of the information. Nor can Golden LEAF know if the grantee self-monitoring procedures were adequate and consistently applied. Golden LEAF does not have documented policy or procedures that ensure systematic use of phone calls and site visits as monitoring tools.

No Determination That Results Are Attributable to Grantee Programs

Golden LEAF monitoring procedures are not sufficient to ensure that the foundation's annual report to the Joint Legislative Commission on Governmental Operations accurately reflects grantee results. Golden LEAF does not conduct analyses to determine if program results are a result of grantee actions. For example, during our review of project grant files auditors noted instances where Golden LEAF attributed project inactivity or project failure to external factors such as labor disputes, economic downturn, or management problems. But auditors noted no instances in the project grant files where Golden LEAF considered external factors as contributing to the success of a program or project. Positive results were consistently reported as attributable to the respective Golden LEAF grantees. Also, Golden LEAF reports grantee results in aggregate, which prevents legislators from seeing projects that did not contribute to the outcomes achieved. Lastly, the foundation's annual report to the legislators does not include planned results or performance targets to which actual results can be compared.

Effective monitoring procedures ensure that information submitted to legislators and other interested stakeholders accurately reflects the results of grantee programs.

To ensure that grantee reports accurately reflect program results, NSAA *Best Practices in Carrying Out State Economic Development Efforts* recommends that economic development agencies monitor grantees and "critically assess whether the entity's actions actually caused the improvement, because other agencies, organizations, and miscellaneous factors also may play important roles." Economic development agencies should "count as reportable only those businesses or clients that indicate a contribution to the outcomes achieved." Additionally, reports should compare planned results with actual results.

Failure to determine that results are attributable to grantee actions and failure to report planned and actual results could result in legislators and other decision-makers relying on unrepresentative and inaccurate data. As a result, ineffective programs could continue to receive state funding.

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No Periodic Review of Grantee Financial Condition

Golden LEAF does not systematically review and evaluate the financial condition of nonprofit grant recipients. Grantee interim and final reports include a table that details how grant funds were used, and we noted several grant folders that contained audited financial statements. However, Golden LEAF does not require audited financial statements or have procedures in place to consistently monitor the financial health of grantees.

Effective monitoring procedures ensure that state funds are not granted to entities in an unstable financial condition.

NSAA “Best Practices in Carrying Out State Economic Development Efforts” recommends that “if the agency provides any type of financial assistance”, the economic development agency should periodically review and evaluate the financial condition of grantees. NSAA recommends monitoring “performance in key financial areas, such as current assets to current liabilities and long- and short-term debt ratios.”

Failure to periodically review grantee financial condition may result in funding entities that lack the capacity to sustain operations.

Recommendation: Golden LEAF should design internal controls that implement best practices for monitoring and reporting its economic development activities. Golden LEAF should verify grantee submitted data, determine that results are attributable to grantee programs, and systematically review each grantee’s financial condition.

2. GOLDEN LEAF DID NOT COMPLY WITH OPEN MEETING LAWS

Golden LEAF violated North Carolina open meeting laws by approving a \$15 million grant in a closed session and not maintaining full and accurate meeting minutes.

\$15 Million Grant Was Approved in a Closed Session

Golden LEAF, a public body as defined by *North Carolina General Statute 143-318.10(b)*, did not comply with the State’s open meetings law and approved a \$15 million economic development grant in a closed session on April 21, 2005. Minutes of the meeting document an objection by one board member who asked if the vote should take place in open session. The board chair overruled the objection and continued with the vote.

North Carolina state law recognizes that state government exists “solely to conduct the people’s business” and requires public bodies to conduct hearings, deliberations, and actions openly. Furthermore, *North Carolina General Statute 143-318.11.(a)(4)* states, “The action approving the signing of an economic development contract or commitment, or the action authorizing the payment of economic development expenditures, shall be taken in open session.”

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By approving a grant in a closed session meeting, Golden LEAF denied the public the right to be informed about the hearings, deliberations, and actions regarding state funds.

Golden LEAF management informed the auditors that “subsequent negotiations between the interested parties failed, no grant funds were ever disbursed, and the Board of Directors rescinded its prior authorization in open session less than two months later on June 2, 2005.”

Weak Internal Controls Over Board Minutes

Golden LEAF was unable to provide auditors with ready access to full and accurate minutes of all meetings of its board of directors. Deficiencies in the record keeping of board minutes included:

- Open session minutes were not maintained in an organized manner allowing ready access for review and confirmation that minutes for all meetings were maintained;
- Closed session minutes were maintained off-site with the foundation’s attorney, who was not able to provide auditors with all sets of closed minutes upon request;
- Golden LEAF’s attorney explained that some closed minutes were excluded from our request because they were still in “written note” form and some may need to be located; sound internal control ensures minutes are finalized timely and available upon request;
- Multiple versions of minutes exist for the same meeting; explanations included draft vs. final versions, as well as corrected versions; differing accounts of actions during board minutes compromises the integrity of the information;
- Minutes were not always identified correctly; some closed session minutes were labeled as “Closed Session”, while other closed sessions were labeled “Confidential”; sound internal controls provide consistency in maintaining minutes to ensure clarity;
- Golden LEAF did not provide auditors with minutes of all official meetings, which include open and closed sessions of the entire board as well as open and closed sessions of board committee meetings. Golden LEAF provided us with 400 sets of minutes dated from 1999 through 2009, but Golden LEAF did not provide minutes for 29 meetings in which evidence was identified supporting that a meeting took place. Evidence of missing minutes consists of references to meetings recorded in other minutes provided to the auditors, including 8 instances where the open meeting minutes specifically state that the closed session minutes were placed under seal. Of the total 429 identified meetings, 95 were closed sessions. Of the 29 missing sets of minutes, 20 were closed sessions.³

³ See Finding #4 regarding additional minutes provided by Golden LEAF.

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Public body meeting minutes provide a physical record of how the people's business was conducted and help ensure transparency and accountability. Public bodies can potentially circumvent open meeting laws and limit the public's ability to monitor the people's business by not maintaining full and accurate minutes of board meetings.

To ensure transparency, *North Carolina General Statute 143-318.10* states, "Every public body shall keep full and accurate minutes of all official meetings, including any closed sessions." The law further reads, "When a public body meets in closed session, it shall keep a general account of the closed session so that a person not in attendance would have a reasonable understanding of what transpired."

Weak internal controls around the board minute process create an environment that compromises the integrity of the minutes, as well as the accountability of the board and transparency of its actions.

Recommendation: Golden LEAF should strengthen internal controls to ensure compliance with North Carolina open meeting laws. Auditors noted that Golden LEAF minutes for meetings occurring after our audit began demonstrated an improved process for recording full and accurate minutes in accordance with applicable laws.

3. STATE LAWS DO NOT SAFEGUARD GOLDEN LEAF INVESTMENTS

Although the only sources of Golden LEAF revenue are state funds and the return on invested state funds, Golden LEAF investment policy is governed by *North Carolina General Statute 36B* that applies to institutional funds. As a result, \$726.9 million of state funds are not subject to the same laws designed to adequately safeguard other state funds from potential conflicts of interest, political influence, and investment risks.

No State Law to Limit Conflicts of Interest or Political Influence

Golden LEAF is not subject to the State Government Ethics Act which helps ensure investment decisions involving state funds are free from potential conflicts of interest or political influence. Instead, Golden LEAF adopted its own conflict of interest policy.

There is a risk that potential conflicts of interest or political influence play a role in Golden LEAF investment decisions. For example, in 2002 Golden LEAF invested \$30 million with an investment company owned by a well-known political campaign contributor. In 2006, Golden LEAF approved a \$10 million investment in which a board member voted on the investment after disclosing, at an earlier meeting, a conflict of interest regarding his brother's position on a related board. Also in 2006, Golden LEAF voted to invest \$6 million with an investment company formerly owned by a public official. Although the public official no longer owns the investment company, the official remains listed as a senior investment advisor to the company.

Subjecting Golden LEAF to the State Government Ethics Act would contribute to the integrity of the investment transactions, as well as provide an actionable basis for state

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authorities to evaluate Golden LEAF use of state funds. For example, Golden LEAF holds investments with some of the same companies as the State Treasurer. Both Golden LEAF and the State Treasurer are investing state funds. However, the State Treasurer is subject to state laws governing conflict of interest and political influence; Golden LEAF is not. Golden LEAF has instituted its own policies to address these risks, which includes following the Chartered Financial Analyst (CFA) code of ethics. But failure to follow the CFA code of ethics would not be a violation of state law whereas failure to abide by the State Government Ethics Act would be a violation of state law and actionable by the State.

In 2006, the General Assembly enacted the State Government Ethics Act to “ensure that elected and appointed State agency officials exercise their authority honestly and fairly, free from impropriety, threats, favoritism, and undue influence.” The Act requires that “potential and actual conflicts of interests are identified and resolved, and that violations of standards or ethical conduct and conflicts of interest are investigated and properly addressed.” The Act prohibits covered persons from using their public positions or information gained by way of their public responsibilities for private gain. The Act also requires covered persons to submit annual statements of economic interest.

However, Golden LEAF management and the Board of Directors are not recognized as covered persons pursuant to the State Government Ethics Act. Therefore, the persons who provide oversight and make investment and grant decisions for \$726.9 million of state funds are not subject to oversight by the State Ethics Commission and do not operate under the same restrictions as other state executives.

State Law to Limit Investment Risks

Golden LEAF is not subject to state laws that ensure investment risks are properly managed for state funds. Instead, Golden LEAF is subject to the state law that applies to institutional funds.

The difference in state restrictions increases the risk that Golden LEAF will make investments that are riskier and less liquid than the State allows for other state funds. For example, Golden LEAF had 37% of the fund’s market value, or \$268.9 million, invested in limited partnerships on June 30, 2008. In comparison, the state generally restricts state fund investments in limited partnerships, partnerships, and limited liability companies to 20% of a fund’s market value. These alternative investments lack liquidity and do not have a fair market value that is readily determinable by reference to published market prices. The 20% limit also applies to alternative investments made by the Tobacco Trust Fund and the Health and Wellness Fund.

The General Assembly has established laws to protect the investment of other state funds. To ensure that state funds are invested in the public’s best interest, *North Carolina General Statute 147-69.1* identifies the authorized investments for General Fund and Highway Fund assets, and *North Carolina General Statute 147-69.2* identifies the authorized investments for special funds held by the State Treasurer.

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The State Treasurer is also required to invest Tobacco Trust Fund and the Health and Wellness Fund assets in accordance with *North Carolina General Statute 147-69.2*. The Tobacco Trust Fund and the Health and Wellness Fund each receive 25% of North Carolina's share of the Master Settlement Agreement (MSA) with certain tobacco companies. Golden LEAF receives the other 50% of the MSA.

Golden LEAF invests millions of state dollars in alternative investments without being subject to the state laws designed to protect state funds. Instead, Golden LEAF investments are subject to *North Carolina General Statute Chapter 36B – Uniform Management of Institutional Funds Act*, which provides for the lawful administration of institutional funds. Although legally defined as institutional funds in this context, Golden LEAF funds are substantively state funds.

No State Oversight of Golden LEAF Investments

Creation of Golden LEAF as a nonprofit corporation exempted state funds from state rules and regulations that apply to other state funds.

The February 24, 1999, Select Committee on the Tobacco Settlement meeting minutes document that the then State Attorney General spoke to the committee regarding the background of the tobacco settlement and explained how the consent decree created a nonprofit corporation that would exempt the funds from state law.

Golden LEAF management operates under the legal premise that the funds Golden LEAF invests are subject to state rules and regulations applicable to institutional funds rather than state funds. However, the court decree that established the payments to Golden LEAF recognizes that the funds are state funds. The consent decree states, "It is further agreed by the parties and recognized by the Court that any funds distributed to the non-profit corporation as set forth hereinafter are made at the direction and on behalf of the State of North Carolina."

Furthermore, Golden LEAF funding and operations indicate that, although legally defined as a nonprofit corporation, the foundation is substantially the same as other state agencies. Consider the following:

- State funds (payments from cigarette manufacturers to the State and the return on invested payments) are the only Golden LEAF revenue source.
- Golden LEAF financial statements state that the foundation is a component unit of North Carolina.
- Golden LEAF performs grant and loan activities on behalf of the State that are similar to grant and loan activities of existing state agencies, specifically the NC

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Department of Commerce, Tobacco Trust Fund Commission⁴, and Health and Wellness Trust Fund.⁵

- Members of the Golden LEAF Board of Directors are appointed by the Governor, the President Pro Tempore of the Senate, and the Speaker of the House of Representatives.
- Golden LEAF cannot dispose of its assets pursuant to *North Carolina General Statute 55A.12.02* without General Assembly approval.
- Golden LEAF cannot amend its Articles of Incorporation without General Assembly approval.
- The General Assembly can repeal Golden LEAF's charter at will and has the authority to dissolve the foundation and take possession of its assets.

Therefore, Golden LEAF funds are state funds that are not invested in accordance with the state laws that govern other state fund investments such as the General Fund, the Highway Fund, and special funds held by the State Treasurer discussed above. Approximately \$726.9 million of state funds have been exempted from state oversight resulting in decreased transparency and accountability to the public.

Recommendation: The Governor and General Assembly should consider if allowing Golden LEAF to invest state funds outside of state rules for investing and safeguarding state funds serves the public's best interests.

4. SCOPE LIMITATIONS - MANAGEMENT RESTRICTED AUDITOR ACCESS TO RECORDS

Auditors are required to evaluate management cooperation with the audit process, within the context of the audit objectives. Auditors evaluate management's responses to auditor requests, as well as availability of staff and access to records. Generally, cooperation with the audit process demonstrates a commitment to sound management and financial practices and establishes the "tone at the top" that auditors use to evaluate risks related to internal control, fraud, and abuse.

Golden LEAF management was less than cooperative throughout the audit, and several events contributed to the scope limitations. While any single instance noted below may not have resulted in a scope limitation, when considered in total, these factors delayed the completion of our work and created an environment where auditors identified risks regarding the integrity of information obtained from the foundation. The following factors contributed to the scope limitations:

⁴ The Tobacco Trust Fund Commission was established under the oversight of the NC Department of Agriculture.

⁵ The Health and Wellness Trust Fund was established under the oversight of the NC Department of State Treasurer.

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- Previous Golden LEAF management⁶ challenged our authority to perform an audit, and we were able to engage only after negotiations involving our legal counsel and our then Chief Deputy;
- Under the previous Golden LEAF President, some Golden LEAF staff did not respond to auditor inquiries or provide requested documents until clearance had been received from Golden LEAF management;
- The current Golden LEAF President requested that all audit requests be routed through him or the Senior VP;
- Auditor requests for “all Golden LEAF board minutes, regardless of the nature of the meeting” had to be repeated over and over again because Golden LEAF management persistently omitted sets of minutes;
- Golden LEAF provided us with 400 sets of board minutes dated from 1999 through 2009. But Golden LEAF did not provide minutes for 29 meetings that occurred between 2000 and 2006 in which auditors identified evidence that meetings had taken place. Of the 29 missing sets of minutes, 20 were closed sessions. On July 27, 2009, Golden LEAF provided new drafts of 21 sets of minutes. Seventeen of these 21 were closed session minutes. Golden LEAF explained that these were either corrected versions of earlier minutes identified as audit exceptions or minutes drafted for the first time from “written notes” taken during the meetings. While we recognize Golden LEAF’s effort to address the issue by providing newly drafted minutes, and we found no instances of noncompliance within the minutes provided, audit standards require that we remain skeptical of the reliability of the content.
- On October 8, 2008, after auditors were granted access to the investment file room by the VP of Investments, with notice to the President, the Senior VP confronted a staff auditor and removed him from the room. The Senior VP’s insistence that the auditor leave the room immediately, along with the confrontational manner, contributed to our judgment that information may have existed within the room that management was withholding from our review;
- Golden LEAF explained that the Senior VP acted in this manner because he believed the audit supervisor had acted outside of the agreement to submit audit requests through himself and the new President. The VP for Investments granted access to the investment room via email on October 6 and copied the new President. Notwithstanding that the Senior VP was acting based on a perceived breach of the agreement, we are required to consider whether the actions of the Senior VP were motivated by an urgency to separate the auditor from the information in the room.

⁶ The Golden LEAF presidency changed in early October 2008.

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- Our original request for access to investment files was made on September 24, 2008. Golden LEAF cited trade secret protection and confidentiality requirements that resulted in delaying our access to the files. After our initial review of the sample of investment files resulted in evidence of potential conflicts of interest and political influence, professional skepticism required that we design additional audit procedures to address our concerns. The audit manager requested unrestricted access to the investment file room on Friday, October 10, 2008, and access was granted on Tuesday, October 14, 2008;
- Information within board minutes and investment files eventually obtained contributed to our findings regarding conflicts of interest and political influence. Consequently, missing and redrafted board minutes, as well as restricted and delayed access to investment files, established risk that not all instances may have been discovered by our audit process.

The Office of the State Auditor takes reporting scope limitations seriously. Each audit engagement presents challenges for the agency under audit to accommodate auditor requests while performing their normal duties. Our auditors use professional judgment to recognize these challenges and determine whether management's approach to the audit process is cooperative or not, as well as to determine whether management is intentionally trying to compromise the audit process. Office of the State Auditor decisions to report scope limitations are rare, and the decision must be confirmed by the respective audit supervisor, audit manager, deputy state auditor, and the State Auditor.

In our professional judgment, there is reasonable risk that the auditors did not have access to all of the information that could have impacted our conclusions related to state open meeting laws and investments, and we are reporting scope limitations for these objectives as required by Government Auditing Standards.

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APPENDIX

GOLDEN LEAF FOUNDATION (GLF) RESPONSE

EXECUTIVE SUMMARY

The Golden LEAF Foundation's Board of Directors and staff are dedicated to transparency and accountability in all of the Foundation's practices. Over time, we have taken steps to improve our performance in this regard. We want to continue to work to be as perfect as possible in the areas noted by the State Auditor.

GRANT OVERSIGHT

The Foundation is dedicated to accountability from its grantees. The Foundation will take steps to develop additional uniform policies for monitoring and reporting on grants as recommended by the Auditor. The Foundation is also participating in the Joint Legislative Performance Audit Committee's efforts to examine best practices in grant management.

Additional Detail on Current Oversight Practices. As the Auditor noted, the Foundation provides an annual report to the Joint Legislative Commission on Governmental Operations. That Commission has a long history of oversight responsibility. The Foundation has in the past testified and responded to questions from the Commission.

The Foundation's Audit Committee specifically requested that our independent auditors, Ernst & Young, annually perform internal control testing over our grant monitoring procedures. The auditors test not only the grant authorization process, but also test the Foundation's ongoing follow-up and review of information received from grantees. Since Ernst & Young commenced performing these procedures years ago, the Foundation has received no findings.

In addition to the Auditor's description of the Foundation's steps to verify grantee performance and compliance above, Foundation staff made over 169 site visits and numerous telephone calls in the past year alone to monitor grantees. The Board often makes special requirements for some grants that must be met before any grant funds are released. Moreover, all grantees are required to participate in a grants management workshop or consult with staff to gain training in Golden LEAF grants and reporting requirements before any funds are released. As aforementioned, the Auditor recommends additional steps over and beyond all these to ensure accountability and effectiveness, and the Foundation concurs that taking additional steps along these lines would be beneficial.

Grantee financial statements are required by the Foundation as a condition of completing a grant application. Incomplete grant applications are not funded. To reduce risk, the Foundation generally does not support grants to startup organizations or that would provide some benefit to startup organizations. Most of the larger grants are to audited organizations.

Economic Catalyst Grants. The Auditor points to the NSAA report as the benchmark for grantee oversight. That publication is geared toward economic development incentive programs, such as the Foundation's Economic Catalyst Grant Program. The Foundation

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requires financial statements, job creation and economic development impact through the maintenance of payroll data from the Employment Security Commission, and clawback provisions for failure to perform for all grants made under the Foundation's Economic Catalyst Cycle. The Foundation will review NSAA best practices for better monitoring.

Other Grants. Most of the Foundation grants are for scholarships, agricultural programs, health care and K-12 education initiatives that are different in type than those contemplated by the NSAA report. While the Foundation has standard requirements for all grantees, the practice has been to implement additional requirements depending on the characteristics of the grant. The Foundation will examine ways to standardize these additional requirements to meet the Auditor's concerns.

OPEN MEETINGS LAW COMPLIANCE

The Foundation will comply with the Open Meetings Law. Most of the issues identified by the Auditor in this regard were from several years ago.

The Foundation had held 429 Board and committee meetings at the time of the audit. The Auditor found 1 instance (0.2 percent of meetings) with a grant award that was improperly made in private session four years ago and noted above 8 instances (1.8 percent of meetings) that do not have proper minutes.

GLF will make all grants in open session. The Foundation agrees that even one instance of noncompliance is problematic. To provide context and transparency about the single instance of noncompliance, the following facts should be noted: the grant was withdrawn in 60 days in an open meeting of the Board and no dollars were ever released. The company and the Department of Commerce warned the Foundation that disclosure of the grant award would lead to the company going to another state, depriving a Tier One county of the chance to compete for needed jobs and investment.

The Foundation staff now informs every prospective grantee and other interested parties that all final awards will be made in public session, with no exceptions. The Foundation regrets this single instance of noncompliance, and it will not be repeated.

GLF agrees that minutes must be finalized in a timely and consistent manner and be readily accessible. The Foundation agrees that minutes for all meetings were not provided upon initial request, and the Foundation has taken subsequent steps to ensure that minutes are kept and are well-organized. The Foundation has taken action to address this concern.

To provide some context, the Foundation provided all minutes, both from open and closed sessions, that it thought it had by mid-August 2008. The Auditor constructed a catalog of meetings and identified some meetings for which no minutes were provided. The Foundation then undertook another search and provided additional minutes that it had. In addition, Foundation counsel, after notification to the Auditor, constructed minutes from notes taken during some of the meetings for which minutes had not been completed. In many of those cases involving closed sessions, it was and remains the opinion of Foundation's counsel,

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based in part on published guidance from an Institute of Government expert, that the minutes of those meetings already in the possession of the State Auditor complied with the statutory requirement of “full and accurate minutes,” either by noting that a closed session was held and that no action was taken in closed session or by describing the action that had been taken in closed session.

Nearly all of the problems the Auditor identified with regard to minutes were from meetings that took place over 6 years ago. The Foundation has worked to improve its policies and procedures regarding minutes and open meetings, and the Foundation appreciates the Auditor’s acknowledgement of improvement. In short, this has been rectified. The Foundation appreciates the Auditor’s assistance in identifying these issues so that appropriate actions can be taken.

The Foundation website (www.goldenleaf.org) provides access to information on all grants made by the Foundation, our annual audited financial reports, and our annual reports.

INVESTMENTS

All GLF Investments Require Due Diligence

Of the investments cited by the Auditor as potential examples of political influence, two of these investments were of institutional quality and received investments from other institutional investors and, after due diligence, the Foundation did invest. It is worth clarifying that the Auditor indicates that these were issues about potential, not actual, political influence. The other example was a contingent commitment to invest that was withdrawn after further analysis of the investment opportunity by the Foundation, and all money that was put forward was returned to the Foundation with interest. A board member had disclosed a potential conflict of interest and did not participate in the discussion at the time the Board voted to make the contingent commitment, but not at the Board meeting where the full Board unanimously authorized the President to sign the formal document.

GLF, as a Foundation, has different objectives than state government for investments. The Foundation is not subject to state laws that govern investment allocation for other state funds. The Foundation’s investment goals are different than those for state funds. The Articles of Incorporation for the Foundation, approved by the General Assembly, provide that the Foundation make grants out of the income generated from its assets to the extent practical. As a result, the Foundation’s investment objectives include engaging in prudent investment strategies to increase returns to make grants. The Foundation’s asset allocation and investment practices are similar to those used by other foundations with similar investment objectives.

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SCOPE LIMITATION

Timing of Audit Was During Foundation's Busiest Time of Year. The Foundation respectfully disagrees that a scope limitation concerning access to files is warranted. The Foundation's overall effort was to balance the time required for Foundation staff to respond to auditor requests with the time needed by them to meet their responsibilities. The former Auditor began this audit in the middle of the busiest grants-making time of the year. Over 250 grant applications had to be evaluated within 60 days before external reviews. The audit of the investment files began in late September 2008, in the midst of the greatest financial upheaval since the Great Depression when Foundation staff was acting to protect and preserve its assets as prudently as possible and only one investment position was filled, a reduction of one-half. The Foundation regrets that efforts to balance needs were seen as "delaying" or "restricting." The Foundation President was out of town at previous commitments after the 6th, having just assumed office on the 1st, but worked with senior OSA staff to identify ways for the auditors to complete their work as comprehensively and quickly as possible in a manner at the time that seemed satisfactory to the Foundation, and at the time, the Auditor. The President did not receive the request for access to the investment file room until after business hours on Friday October 10th, and responded that night to the Auditor to arrange for access to the files on Tuesday October 14th as the Vice President of Investments was on vacation on Monday October 13th.

Foundation board, counsel and staff asked about the Auditor's statutory authority to conduct the audit over a nonprofit that is not a state government agency. Unlike the two funds that share in the balance of the tobacco settlement money, there is no explicit authority of the Auditor to conduct this audit. The Foundation did not ultimately contest the audit, and staff was directed to cooperate.

The Foundation Management Did Not Know Its Agreements Caused Concern. Staff did keep management informed of auditor requests, but did not require "clearance" beyond what any other request for information would normally entail. Staff did not know that this process caused the Auditor concern. Golden LEAF management, in retrospect, could have done more to emphasize to staff that the State Auditor has constitutional and statutory authority for access that are unlike other public information requests, and that the statute provides for "ready access" to records and personnel. Foundation management was not aware that an agreement about how to access files and staff time was less than satisfactory to the Auditor. The Foundation acknowledges that when a senior staff member saw an auditor in the investment file room, he asked the auditor to leave so that the agreement for access to investment files would be followed. We do not believe that there was any bad intention on either party's part. The Auditor had been onsite since July, but did not start the investment file review until late September.

The Foundation appreciates the time and energy of the Office of the State Auditor on this audit.

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ORDERING INFORMATION

Audit reports issued by the Office of the State Auditor can be obtained from the web site at www.ncauditor.net. Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports may be obtained by contacting the:

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