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Travel and Entertainment Expenses

MIKE HATCH

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TRAVEL AND ENTERTAINMENT

Section 1.1 Introduction

Fairview Health Services ("Fairview") is a Minnesota nonprofit corporation. Fairview is registered with the Attorney General's Office as a charitable organization under Chapter 309 of the Minnesota Statutes. Fairview is the parent organization of over 50 subsidiaries and affiliates, 35 of which are nonprofits and 25 of which are tax-exempt pursuant to Section 501(c)(3) or 501(c)(4) of the Internal Revenue Code. (Exhibit 1.)

To qualify for tax-exempt status, a nonprofit organization must operate so that no part of its net earnings inures to the benefit of any private shareholder or individual. *See* I.R.C. §§ 501(c)(3) and 501(c)(4)(B). The "private inurement" doctrine prohibits the flow of income or assets from a charitable organization to or for the benefit of private individuals for noncharitable purposes. If a charitable organization's assets are used for personal enjoyment, the organization can lose its tax-exempt status. *See* IRS Gen. Couns. Mem. 38459 and 39862; *John Marshall Law School v. United States*, 1981 WL 11168 (Ct. Cl. Trial Div. 1981) (school's tax-exempt status revoked due to private inurement, which included travel expenses for school dean and his family members, club memberships and tickets to professional basketball and hockey events).

The directors and officers of a nonprofit organization owe a fiduciary duty to the entity to discharge their duties in good faith. *See, e.g.* Minn. Stat. § 317A.251, subd. 1; § 317A.361, subd. 1 (2004). They have a duty to safeguard the entity's charitable assets and ensure that assets are used to fulfill the charitable mission. Minnesota courts have described the fiduciary duty of a nonprofit corporation's officers and directors as requiring "the highest standards of integrity." *Shepherd of the Valley Lutheran Church of Hastings v. Hope Lutheran Church of Hastings*, 626 N.W.2d 436, 442 (Minn. Ct. App. 2001).

In 2001, the Minnesota Attorney General's Office ("AGO") issued a series of reports following its Compliance Review of Allina Health System ("Allina") and Medica Health Plans ("Medica"). Among other things, Allina and Medica were found to have engaged in lavish and unrestrained spending on travel and entertainment. A Compliance Review of HealthPartners in 2003 found a similar pattern of inappropriate spending on travel and entertainment.

Prior to publication of the AGO's Compliance Reviews of Allina and Medica (hereinafter "Allina report"), Fairview demonstrated a similar lack of restraint and respect for its nonprofit status in its travel and entertainment spending. Following the publication of the Allina report, however, Fairview adopted new travel and entertainment policies which were modified to be more consistent with the policies that were recommended in the Allina report. Accordingly, this report attempts to address two distinct issues as it relates to Fairview: 1) the activity of Fairview prior to the issuance of the Allina report; and 2) the adherence by Fairview to the policies that it adopted after issuance of the Allina report.

Section 1.2 Fairview's Travel and Entertainment Policies

From 1994 to January 1, 2002, Fairview's travel and entertainment policy (hereinafter the "1994 T&E Policy") required:

- Employees to use good judgment;
- Expenditures to have a valid business purpose;
- An original receipt, or other supporting documentation that includes the date and amount, for expenses of $25 or more;
- Employees who "must" travel to do so in a "cost efficient" manner, "securing comfortable, but not elaborate," accommodations;

- The use of compact or intermediate rental cars when other transportation is not practical or cost-efficient;
- Business entertainment to be "directly related to the active conduct of the company business" and "undertaken with a view of producing some value to the company," with names of the individuals in attendance provided on the expense report; and
- Expenses of spouses to be reimbursed only if approved in advance by a member of the Management Council, with a preprinted approval form attached to the expense report.

(Exhibit 2.)

The 1994 T&E Policy did not impose a daily maximum, or "per diem," on meal expenditures when its employees traveled, but instead relied on employees to exercise "good judgment." (*Id.*, p. 3.) Among other things, the 1994 T&E Policy contained no specific policies governing expenditures on sporting events, international travel, use of alcohol, golf, country and golf club memberships, meals and entertainment among Fairview executives, the purchase of gifts for and by executives and board members, and use of outside facilities for in-town meetings and overnight retreats. (*Id.*)

As set forth in Sections 1.3 - 1.12, Fairview had difficulty complying with its 1994 T&E Policy. Fairview often made expenditures without regard to its nonprofit mission and failed to require executives to adequately document a business purpose for travel and entertainment expenditures.

In January of 2002, after the Allina reports were published, Fairview revised its travel and entertainment policy (hereinafter the "2002 T&E Policy"). (Exhibit 3.) The 2002 T&E Policy imposed the following new restrictions:

- Employees must not only exercise "good judgment," but also must exercise "fiscal responsibility" in recognition of "Fairview's mission and responsibilities to the community";

- Spousal travel expenses will no longer be reimbursed;

- Dining involving only Fairview employees will no longer be reimbursed, other than at employee recognition events or with the prior approval of certain designated executives;

- Original, detailed receipts are required for all expenditures showing the details of the expense, the amount paid, the date, and the identity of the vendor. General credit card receipts, which do not itemize the particulars of the transaction, are no longer acceptable;

- Travel for seminars, conferences or conventions outside the 48-continuous United States or on cruise ships will no longer be reimbursed unless authorized by the Chief Executive Officer "well in advance" of the trip and only after review by Fairview's legal or tax department. International travel may only be authorized if it provides a "unique educational learning experience";

- A $46 daily limit applies to meals incurred while traveling;

- Sporting tickets will no longer be reimbursed;

- Employees are required to use in-house meeting rooms "whenever possible";

- Hotel room movies will no longer be reimbursed; and

- Reimbursement for out-of-town travel will only be made for those nights necessary for the business purpose. Overnight lodging will not be reimbursed for trips of less than 100 miles, unless there is a time period of less than 10 hours between meetings.

(*Id.*)

The 2002 T&E Policy does not address the reimbursement of golf-related expenses or executive country and golf club memberships. (*Id.*) While spousal and family *travel* expenses are no longer reimbursable, the 2002 T&E Policy does not address the reimbursement of other spousal entertainment expenses. (*Id.*, pp. 6, 9.) With one exception, the 2002 T&E Policy does not appear to apply to board members. The policy's alcohol usage provisions appear inconsistent. The policy states that Fairview will not reimburse for alcoholic beverages purchased while an employee is traveling on Fairview business. (*Id.*, p. 4.) The policy states that, in other cases, alcohol will not be reimbursed, unless for a "Fairview function" and with pre-approval. (*Id.*, p. 6.) Elsewhere, however, the policy states that alcohol may be purchased as an entertainment expense with the pre-approval of certain designated executives. (*Id.*, p. 4.)

The 2002 T&E Policy states that Fairview's executive team will review and report to the Fairview Board of Directors annually a summary of the amount and type of travel and entertainment expenses reimbursed. (*Id.*, p. 4.) Prior to the Allina report being published, it does not appear that the Fairview board ever reviewed the organization's travel and entertainment expenditures, nor did Fairview conduct audits or formal reviews of such expenditures. The charitable assets would have undoubtedly been better protected had such reviews taken place. Since 2002, Fairview's internal audit department has sampled various travel and entertainment expenses each quarter to monitor compliance with the 2002 T&E Policy.

Section 1.3 Executive Memberships

Memberships in recreational, business and social clubs, such as country and golf clubs, athletic clubs and airline clubs, are not tax-deductible. (Exhibit 4.) This policy was promulgated by Congress because such memberships have little business value in proportion to the personal enrichment they provide. As a matter of national policy, such memberships are not considered to be legitimate business expenses.

Fairview's 1994 T&E Policy did not restrict the reimbursement of golf and country club expenses. From 1998-2002, Fairview paid at least $365,000 for its executives' memberships at various clubs. (Exhibit 5.)

For instance, Fairview paid more than $14,000 for a vice president's membership at Brackett's Crossing Country Club. (Exhibit 6.) This included additional dues for his spouse.

(*Id.*) Among other things, Fairview paid for the executive's family range plan, club storage and locker fees. (Exhibit 7.)

Fairview paid over $42,000 to the Edina Country Club for executives' membership charges. (Exhibit 5.) For one executive, Fairview not only paid for his monthly membership dues, but also reimbursed him almost $2,800 in other golf assessments, including club storage fees, handicap fees, locker fees, annual range fees, and hole-in-one fees. (Exhibit 8.) This executive also submitted other unrelated charges, such as a $100 Christmas fund charge. (*Id.*)

Fairview paid a $34,900 initiation fee for a vice president to join the Tournament Players Club. (Exhibit 9.) Fairview paid $48,000 in initiation fees for another executive to join the Minikada Club, at the spousal rate. (Exhibit 10.) Fairview paid $31,900 for an executive's initiation fee at Town & Country Golf Club. (Exhibit 11.) It paid $40,400 for the general counsel's membership at Town & Country Golf Club *and* the Minneapolis Club in 2000. (Exhibit 12.) This reflected an agreement between the general counsel and the CEO that, if the general counsel "joined a moderately priced Country Club (in the 30k-membership range), I would also agree to pay his fee to the Minneapolis Club…." (*Id.*)

Fairview paid over $26,000 to the Wayzata Country Club for executives' membership charges. (Exhibit 5.) Three executives had their monthly membership dues at that club paid by Fairview, and were also reimbursed for club storage fees, late charges, towel charges, and contributions to the club's Christmas and tree replacement funds. (Exhibit 13.) Fairview paid more than $2,800 to meet minimum food purchase requirements at that club (i.e., food and drinks that were never consumed). (*Id.*)

Fairview paid more than $25,000 for an executive's membership at the Minneapolis Golf Club. (Exhibit 5.) This included over $3,300 in other golf assessments, including the executive's annual locker fee, valet parking, handicap fee, numerous finance charges for late payments, and hole-in-one club dues. (Exhibit 14.)

Fairview also paid for memberships at the Lafayette Club, Decathlon Athletic Club, Hazeltine National Golf Club, Burl Oaks Golf Club, Minneapolis Athletic Club, and the Princeton Golf Club. (Exhibit 5.)

Fairview also paid for an executive's Northwest Airlines Club renewal, even though memberships in airline clubs are not an allowable business deduction under the Internal Revenue Code. (Exhibits 4, 15.)

After the publication of the Allina report, Fairview ceased to reimburse directly executives for country and golf club memberships. (Exhibit 16.) Unfortunately, Fairview seemed to miss the point of ensuring that charitable assets not be used for private inurement. Rather than discontinuing the payments altogether, Fairview adopted the disingenuous approach of simply increasing the executives' salaries in an amount commensurate with the loss of these perquisites. (*Id.*) Fairview has not formally modified the 2002 T&E Policy to prohibit such expenditures. (Exhibit 3.) Indeed, the 2002 T&E Policy suggests that the terms of an executive's contract could "override" the policy. (*Id.*, p. 3.)

Section 1.4 Sports Entertainment

The IRS requires entertainment expenses to be directly related to the active conduct of trade or business and be adequately substantiated. (Exhibit 17.) IRS regulations require employees to describe the nature of the business discussion or activity and the name, title and corporate affiliation of the people entertained. (*Id.*) The IRS also requires each ticket in a series of season tickets to be treated as a separate item, with records maintained to document how each ticket was used. (*Id.*)

Fairview's 1994 T&E Policy contained no specific provisions relating to the purchase of sporting event tickets (Exhibit 2), and Fairview often paid for sports entertainment expenses without documentation of a business purpose or the persons entertained. After publication of the Allina report, Fairview changed its policy and began to ask executives to supply the name of the ticket user and the business purpose. (Exhibit 18.)

For instance, in anticipation of the 2000-2001 inaugural Minnesota Wild season, Fairview purchased season club seats for over $11,000. (Exhibit 19.) The next season, Fairview renewed its purchase of the club seats at a cost of $11,440. (*Id.*) Executives did not identify attendees or a business purpose for most of the games. (Exhibit 20.)

Fairview paid over $15,000 for season tickets to the Minnesota Twins. (Exhibit 21.) Once again, executives did not identify attendees or a business purpose for most of the games. (Exhibit 22.)

Fairview paid for season tickets to Minnesota Vikings games, including playoffs, from 1998 through 2001, at a cost of more than $26,000. (Exhibit 23.) Again, executives had difficulties identifying attendees at these games or the business purpose of the expenses. (Exhibit 24.)

Fairview purchased season tickets to the Minnesota Timberwolves. (Exhibit 25.) For the 1998-1999 and 1999-2000 seasons, Fairview spent over $12,000 on season tickets. (*Id.*) Before one season, Fairview paid over $1,000 to upgrade its seats. (*Id.*) Again, executives were unable to identify attendees at these games or the business purpose of the expense. (Exhibit 26.)

Fairview executives attended other sporting events without submission of the events' business purpose, and without identifying attendees or their relationship with Fairview. For example, Fairview paid for:

- Over $2,000 for season tickets to University of Minnesota hockey games for the 1999-2000 season. No identification of attendees or business purpose was submitted. (Exhibit 27.)

- Over $2,300 from 1998-2001 for season tickets to University of Minnesota football games. No identification of attendees or business purpose was submitted. (Exhibit 28.)

- Over $3,300 for season tickets to the University of Minnesota's men's basketball games for the 1999-2000 and 2000-2001 seasons. No identification of attendees or business purpose was submitted. (Exhibit 29.)

- Tickets to the 2000 NCAA men's basketball tournament. (Exhibit 30.)

In 2002, Fairview noted that it would likely no longer distribute season tickets to executives "due to the AG issue." (Exhibit 31.) Indeed, Fairview changed its policy in 2002 to prohibit reimbursement for sporting tickets. (Exhibit 3, p. 9.) As noted in the next section, Fairview continues to pay for other entertainment expenses and appears not to require prior managerial approval for such expenses. (*Id.*, p. 6.) It is unclear how Fairview will implement such a policy.

Section 1.5 Golfing

Neither the 1994 nor 2002 T&E Policies specifically address Fairview's payment of golf-related expenditures. Fairview often paid for its executives to golf with each other. For instance:

- Fairview hosted an annual golf event at the Minnetonka Country Club for its trustees and physicians. (Exhibit 32.) In 1999 and 2000, Fairview spent over $43,000 on these outings, including over 340 rounds of golf. (*Id.*)

- One Fairview executive was reimbursed nearly $1,500 to golf with other Fairview employees while purportedly discussing ongoing Fairview projects. (Exhibit 33.)

- Fairview reimbursed an executive over $350 to golf with three other Fairview employees at a Wisconsin golf club. (Exhibit 34.)

- Fairview reimbursed its CFO over $300 for a day of golfing and lunch with Fairview's financial management committee. (Exhibit 35.) No receipt was submitted. (*Id.*)
- Fairview reimbursed an executive almost $600 for two golf outings within a two-week timeframe, including over $150 in caddy charges. (Exhibit 36.)

Examples of other golf games, which occurred while executives and board members traveled, are discussed in Section 1.6.

As noted above, Fairview's 2002 T&E Policy does not restrict golf as a form of reimbursable entertainment, nor does the policy require pre-approval for such an expenditure.

Section 1.6 Travel by Board Members and Executives

Section 1.6.1 Group Travel

Section 1.6.1(a) The Naples Trip

Fairview has not adopted a formal policy relating to travel by its board of directors. The board of directors is the governing body of a nonprofit organization. The board establishes the strategic and budgeting direction of the organization. It also hires and reviews the tactical decisions of the executive team. As a result, an important responsibility of the board is to establish the culture of the organization as it relates to fiscal discipline. The board should lead by example, exercising prudence in its expenditures. While Fairview board members for the most part serve without pay, which is to be commended, some of the expenditures for the benefit of Fairview's board may have created a culture that tolerated a lack of fiscal restraint in an era of exorbitant health care costs.

For example, Fairview paid over $39,500 for the board to travel to Naples, Florida in 2000 to study corporate governance. (Exhibit 37.) At least ten Fairview board members and their spouses, and a handful of Fairview executives and their spouses, attended. (*Id.*) Fairview paid over $2,900 for golf. (Exhibit 38.) Fairview paid for dinners costing over $1,000 each on consecutive nights. (Exhibit 39.) Although the conference was in the same hotel where board members stayed, at least eight cars were rented for the three-day conference, including three Lincoln Town Cars. (Exhibit 40.) The attendees stayed at the Ritz-Carlton, at a cost of $299 per night, and used valet parking. (Exhibits 40, 41.) Fairview reimbursed executives and board members for alcohol charges and reimbursed them for expenses when no detailed receipts (or, in some cases, no receipts) were provided.

Fairview paid for similar trips in 1998, 1999 and 2001. Fairview also paid for board members to travel in smaller groups to other luxury destinations. Some of these trips are noted in Section 1.6.2 below.

Section 1.6.1(b) The Vail Ski Trips

As noted above, Fairview's 1994 T&E Policy required employees who "must" travel to do so in a "cost efficient manner," securing "comfortable but not elaborate" accommodations. (Exhibit 2.) Although Fairview only provides health care in Minnesota, it has paid for a large amount of out-of-state travel.

For example, Fairview reimbursed some executives for an annual trip to Vail, Colorado to "re-enforce [sic]...physician relationships." (Exhibit 42.) The business purpose was frequently listed as nothing more than "ski trip."

One executive was reimbursed over $2,200 for the 1998 ski trip, where he spent over $340 on lift tickets and almost $700 on one dinner. (Exhibit 43.) Another executive was reimbursed almost $1,700 for meals and refreshments while on the 1998 ski trip. (Exhibit 44.) The executive did not identify a business purpose, list attendees, or supply an itemized receipt. (*Id.*) Fairview reimbursed the executive almost $3,000 for the 1999 ski trip, including over $1,300 for alcohol and meals, although no detailed receipts were provided. (Exhibit 45.) In

2000, Fairview paid over $3,500 for this executive to participate in the ski trip, including an $1,100 dinner. (Exhibit 46.) A few nights earlier, he spent over $600 on another dinner. (*Id.*) In 2001, Fairview reimbursed the executive almost $4,000 for the ski trip. (Exhibit 47.) He was reimbursed for two dinners that cost over $1,300 and $800, respectively, including almost $500 on alcohol. (*Id.*) When Fairview accounting staff questioned the ski trip expenses, they were instructed to pay them. (Exhibit 48.)

After Fairview adopted the 2002 T&E Policy, an executive requested pre-approval to dine while in Vail. (Exhibit 49.) The request was approved by Fairview's COO. Fairview then paid for a dinner which totaled over $800, including over $150 for alcohol. (*Id.*) Fairview's 2002 T&E Policy prohibits the reimbursement of alcohol while traveling.

Section 1.6.2 Other Executive and Board Travel

Other trips by Fairview executives and board members also raise questions about the organization's implementation of its travel policies prior to 2002. For example:

- Fairview paid over $9,000 for an executive and two employee-board members to attend a three-day conference at the Phoenician Inn in Scottsdale, Arizona, where they studied board accountability. (Exhibit 50.) One board member/employee and the executive played a $460 round of golf. (*Id.*) Another day, all three attendees played in a golf tournament that cost over $600 for green fees and club rental. (*Id.*) The executives submitted credit card receipts with no detail for multiple dinners that cost over $200 each. (*Id.*)

- Fairview reimbursed its COO over $1,500 to attend a conference in Orlando, Florida, including tickets to Walt Disney World to "entertain and get to know" a board member. (Exhibit 51.) The COO was reimbursed $275 for a rental vehicle driven 88 miles. (*Id.*)

- Fairview paid almost $2,000 for its CEO's food and lodging at a three-day "governance conference" at the Arizona Biltmore. (Exhibit 52.) Fairview's chairman of the board approved the attendance of the CEO's spouse to help him "network." (*Id.*) Fairview reimbursed him over $300 for dinner that included himself, his spouse and Fairview's board president. (*Id.*) No detailed receipt or business purpose was provided. (*Id.*)

- Fairview paid over $6,500 (not including airfare) for an executive and two board members to attend a health care symposium at the Phoenician Inn in Arizona. (Exhibit 53.) This included nearly $500 to rent a Chevy Suburban and multiple meal and "private bar" charges for which no receipt or business purpose was provided. (*Id.*)

- Fairview reimbursed an executive almost $5,000 (not including airfare) for a "governance" conference at the Ritz Carlton in Naples, Florida that he attended with two board members. (Exhibit 54.) Fairview paid for valet parking, golf greens fees and club rental, and for their beach pavilion charges. (*Id.)*

- Fairview paid over $300 for in-room hotel movies for one executive. (Exhibit 55.)

- Fairview paid over $1,000 for a dinner at Pleasure Island in Florida during a conference attended by the CEO, COO, and other Fairview executives. (Exhibit 56.) No detailed receipt was attached, nor was there an explanation of the business purpose. (*Id.*)

- Fairview paid over $2,000 for an executive to attend a conference in Orlando, Florida. (Exhibit 57.) Fairview paid over $700 for a dinner that included another Fairview executive, three board members and two of their spouses. No detailed receipt was submitted. (*Id.*)

- In 2001, Fairview paid more than $4,300 for an executive to attend a conference in Phoenix, Arizona. (Exhibit 58.) Fairview reimbursed the executive for a $775 dinner with senior management, board members, and their spouses. (*Id.*) Only a credit card receipt was provided. (*Id.*) Fairview also reimbursed him over $1,150 for golf for himself, two board members, and an executive's spouse. (*Id.*) The business purpose was described as "entertainment." (*Id.*)

After publication of the Allina report, Fairview modified its travel policy to reference a table used by the federal government to determine maximum allowable hotel rates by city. (Exhibit 3, p. 7.) The 2002 T&E Policy states that Fairview will not reimburse an employee for the expenses of spouses who accompany the employee on business travel. (*Id.*, p. 6.) While this policy modification is appropriate, there is concern as to whether it was fully implemented. For instance:

- Fairview appears to have continued to pay for governance retreats for board members and executives. At one such retreat in Naples, Florida in 2003, Fairview paid over $500 for a dinner for board members and senior executives and five of their spouses. (Exhibit 59.) Fairview paid over $400 per night for their rooms at the Ritz-Carlton. (*Id.*) Included on the bill were several meals without detailed receipts, a fitness charge, and an in-room cabinet charge. (*Id.*) The accounting department at Fairview requested clarification several times, with no apparent response.

- In 2002, Fairview paid almost $2,500 for an executive to attend a conference in Florida. (Exhibit 60.) Fairview paid over $450 in airfare for his spouse to accompany him. (*Id.*) Fairview reimbursed the executive almost $800 for a seafood dinner for his spouse and three board members and their spouses. (*Id.*) The remarks on the travel voucher state that the CEO pre-approved the dinner, which included over $200 in alcohol charges. (*Id.*) No pre-approval letter was provided by Fairview. (*Id.*) The 2002 T&E Policy disallows the reimbursement of alcohol-related expenses while traveling. (Exhibit 3.)

- Fairview paid over $5,000 for two employees to travel to New York City in 2002, where they spent two nights at the Waldorf Astoria Hotel, at a cost of over $500 per night. (Exhibit 61.) According to its 2002 T&E Policy, the maximum reimbursable hotel rate in Manhattan that year was $208 per night. (Exhibits 3, 62.)

Section 1.7 Travel By Physicians

Fairview physicians may generally be reimbursed up to $4,000 each year for educational expenses, including travel to seminars. (Exhibit 63.) Physicians are able to roll over half of that expense to the following 12 months if it is not used, thereby imposing a "use it or lose it" policy. (*Id.*) Allina and HealthPartners offered similar "use it or lose it" educational policies. During the AGO's review of Allina and HealthPartners, concerns were raised as to whether any version of the "use it or lose it" rule encouraged physicians to select seminars for their vacation destination quality, not their substantive, educational quality. Such travel also appears to be an issue with Fairview.

From 1998-2003, Fairview paid for over 60 flights to over 20 different international destinations on four continents—Europe, Australia, Asia, and North America. (Exhibit 64.) A sample of expense reimbursements indicates that employees often did not submit documentation to justify the business purpose for such trips.

Fairview paid over $2,500 for a physician to attend a "winter conference" in Ixtapa, Mexico. (Exhibit 65.) Fairview appears to have reimbursed the physician for six nights of lodging for a three-day conference. (*Id.*) Fairview also reimbursed the physician to upgrade his room to an ocean view, and paid an additional fee for an all-inclusive plan. (*Id.*)

Fairview paid almost $5,000 for a physician to travel to Australia for 13 days for a course in "diving and hyperbaric medicine" held on the Great Barrier Reef. (Exhibit 66.) The physician was reimbursed for a scuba diver special package. (*Id.*) No business purpose was identified, nor was a schedule for the conference provided with the expense report. (*Id.*)

Fairview paid nearly $3,000 for a physician to attend conferences in Aruba in 2000 and 2001. (Exhibit 67.) In 2000, the conference ran three days (15 hours), but Fairview paid for a week of lodging expenses, including a "six day sailing package." (*Id.*) In 2001, Fairview paid for the same physician to return to Aruba for a week to attend a seminar entitled, "Medical-Dental-Legal Update." (*Id.*)

A few other examples of such travel include:

- Fairview paid $1,700 for a physician to travel to Cozumel, Mexico for a four-day "winter conference." (Exhibit 68.)
- Fairview paid over $5,600 for a physician to attend three separate conferences in Aruba over a 13-month span from November of 2000 to December of 2001. (Exhibit 69.) In 2000, Fairview paid for his sailing package. (*Id.*)
- Fairview reimbursed a physician over $2,300 for a conference at the Hotel Del Coronado in San Diego, California. (Exhibit 70.) The physician flew

to Los Angeles to visit friends and then took a shuttle to San Diego, where he rented a minivan. (*Id.*) The physician stayed two nights after the scheduled closing of the conference, for which Fairview reimbursed his costs. (*Id.*)

- Fairview paid over $2,700 for a physician to attend a five-day conference in San Diego, California, which included numerous meals from room service without detailed receipts. (Exhibit 71.)

- Fairview paid almost $2,000 for a physician to attend an Oregon conference on alternative medicine. (Exhibit 72.) It reimbursed the physician for the extra expense of his family to stay in a penthouse room and to add the physician's spouse as an additional driver to a rental car. (*Id.*)

- Fairview paid almost $4,000 for a physician to attend an Arizona seminar designed to teach executives how to "lead beyond the bottom line." (Exhibit 73.) He submitted no detailed receipts for over ten meals. (*Id.*)

- Fairview paid almost $3,000 for a physician to attend a conference in Cambridge, Massachusetts and reimbursed him to rent a Chevy Blazer. (Exhibit 74.) He did not submit any conference materials to support the expenses. (*Id.*)

- Fairview paid over $2,200 for a physician to attend a conference in Maui, Hawaii. (Exhibit 75.) No receipt was submitted showing the detailed expenses of the physician's lodging. (*Id.*)

After publication of the Allina report, Fairview modified its T&E Policy to permit travel outside the 48 continental United States or on cruise ships only if authorized by the CEO "well in advance of the trip." (Exhibit 3, p. 7.) It also must be reviewed by Fairview's legal or tax department and must "be of such a nature to provide a unique educational learning experience." (*Id.*) There is concern that the policy does not appear to have been fully implemented. The following are a few examples of trips taken since the new policy was enacted:

- In 2003, Fairview paid over $2,600 for an anesthetist to attend a seminar in Kaanapali Beach, Hawaii. (Exhibit 76.) Although there was pre-approval from a director at a Fairview subsidiary, that authorization does not comply with the 2002 T&E Policy, which requires travel outside the 48 states to be authorized by the CEO after review by Fairview's legal or tax department. (Exhibit 3.) The seminar ran from January 12-17, but

Fairview paid for the employee's airfare from January 9-19. (Exhibit 76.) No information was submitted with the expense report to justify the longer stay. (*Id.*)

- Fairview paid almost $1,800 for an anesthetist to attend a conference at a Canadian resort. (Exhibit 77.) Because the trip was outside the 48 states, the CEO's approval was required. (Exhibit 3.) Five months *after* the conference, a pre-approval form was signed by a Fairview executive, but not the CEO. The conference schedule called for four hours of instruction each day, with a daily eight-hour ski break. (Exhibit 77.)

- Fairview paid nearly $2,000 for a physician to travel to Cancun, Mexico for a 2002 conference entitled, "Cardiology at Cancun." (Exhibit 78.)

- Fairview paid over $2,000 for a physician to attend a conference in Monterey Bay, California, including two additional days for a rental car while the physician stayed in California after the conference. (Exhibit 79.)

Section 1.8 Entertainment for Executives and Board Members

Fairview's 1994 T&E Policy does not specifically address the reimbursement for parties or other gatherings of Fairview's board of directors or executives. With regard to executives, the general provisions of the 1994 T&E Policy allowed for entertainment expenses to be reimbursed if "directly related to the active conduct of the company business...." (Exhibit 2.)

Fairview hosted numerous parties and gatherings for executives and board members. The following are a few examples:

- Fairview paid over $11,600 for two board meetings at the Edina Country Club in 2000 and 2001. (Exhibit 80.) Over $1,100 was spent on alcohol. (*Id.*)

- Fairview reimbursed an executive over $2,800 for "gathering/refreshments" at the Edina Country Club, including over $400 for alcohol. (Exhibit 81.)

- Fairview paid almost $2,200 for two "summer parties" in 2000 and 2001, which included board members, including nearly $400 in alcohol and half the cost of two jet skis. (Exhibit 82.)

- Fairview spent $5,700 at a board meeting at the Town & Country Club, including over $1,200 on alcohol. (Exhibit 83.)

- Fairview paid over $780, including over $200 in alcohol, for a 1999 board dinner at the Minneapolis Café. (Exhibit 84.) No list of attendees was submitted. The executive who incurred the expense had a subordinate request the reimbursement (payable to him), which he then approved. (*Id.*)

- Fairview paid almost $1,000 for its CEO to entertain a former United States Senator at his residence to "build" and "grow" their relationship. (Exhibit 85.) Eleven people attended. More than $280 was spent on flowers. Fairview's accounting department noted that "[w]e usually don't pay for spouses but this will be okay." (*Id.*)

- Fairview reimbursed its CEO over $4,500 for a 1999 farewell party for one of its executives. (Exhibit 86.) The party was attended by other executives and their spouses. (*Id.*) Over $400 was spent on alcohol and flowers. (*Id.*)

- Fairview paid over $7,000 for a banquet at the Wayzata Country Club for its incoming CEO. (Exhibit 87.)

- Fairview paid almost $3,000 for a retirement party for a physician in 2000. (Exhibit 88.) Over $350 was spent on wine. (*Id.*) Fairview was unable to identify who attended the function when asked by its accounting department. (*Id.*)

- Fairview paid over $700 (almost $300 of which was alcohol) for a board appreciation dinner at the Edina Country Club in 1998. Attendees included executives, their spouses, and board members. (Exhibit 89.)

- Fairview paid over $600 for a dinner boat cruise for the "management team." (Exhibit 90.) The expense report states that this cruise was the second that summer. (*Id.*) No detailed receipt was submitted. (*Id.*)

After publication of the Allina report, Fairview modified its T&E Policy to require executive entertainment expenses to be "reasonable." (Exhibit 3, p. 6.) An employee recognition policy was modified to require recognition events to have a "legitimate business purpose and appropriate documentation" and that any single instance of recognition not exceed $50 (or $150 per employee per year, "normally"). (Exhibit 91.) The policy also requires in-house meeting rooms to be used for events, including board meetings, "whenever possible."

(Exhibit 3.) Other than the use of meeting rooms, the modified policy does not appear to apply to board members, and it is unclear whether the modified policy applies to employees who are also board members.

Section 1.9 Holiday Parties

Fairview's 1994 T&E Policy did not specifically address holiday parties. Fairview routinely paid for elaborate holiday parties. For example:

- During one evening in 1999, Fairview held two separate holiday parties at the Edina Country Club, with a total cost of over $16,600. (Exhibit 92.) Fairview spent over $2,800 on alcohol during the evening. (*Id.*)

- Fairview hosted holiday parties at the Minneapolis Golf Club totaling over $32,000, including valet parking and open bars with alcohol. (Exhibit 93.)

- Fairview paid over $8,000 for a holiday party at the Edina Country Club in 2000. (Exhibit 94.) Over $700 was spent on alcohol. (*Id.*)

- Fairview reimbursed an executive over $1,700 for a holiday party in 2000, at the Oceanaire Seafood Room. Fifteen people attended. (Exhibit 95.) The dinner included spouses of employees and over $450 in alcohol charges. (*Id.*)

- The following year, Fairview reimbursed the same executive for a holiday party that included spouses at Jax Café. (Exhibit 96.) The bill for the event totaled nearly $5,400, including more than $1,100 for alcohol. (*Id.*)

- Fairview paid over $5,000 for a holiday party in 2001 at the Town & Country Club. (Exhibit 97.) Almost $1,000 was spent on liquor. (*Id.*)

- Fairview hosted a 2000 board holiday event at the Minneapolis Golf Club, costing over $5,500, including over $750 for alcohol. (Exhibit 98.)

After publication of the Allina report, Fairview adopted a policy which allocates $20 per full time equivalent ("FTE") to a corporate function fund, and $15 per FTE to a departmental function fund, to be utilized for holiday parties, departmental parties, employee recognition, and the like. (Exhibit 91.) The policy states that recognition monies will not be spent on alcohol.

(*Id.*) Expenditures from the funds must be approved by the care system president or senior vice president (for the corporate function fund) or by the department director (for the departmental function fund). (*Id.*) In other words, Fairview states that it will use the budget process to attempt to limit such expenditures. It does not appear, however, that Fairview has fully implemented the policy, as it continues to underwrite lavish holiday parties. For example:

- Fairview paid over $7,800 in 2002 for a holiday party for senior executives at the Town & Country Club. (Exhibit 99.) The event, authorized by the CEO, included over $1,300 in alcohol. (*Id.*)

- Fairview paid over $4,000 for a 2002 holiday party at the Minneapolis Golf Club, including alcohol. (Exhibit 100.)

- Fairview paid over $6,000 for a 2002 holiday party at the Town & Country Club, including over $800 in alcohol. (Exhibit 101.)

- In 2002, Fairview reimbursed an executive almost $1,000, including alcohol, for a holiday party for 12 employees and their guests. (Exhibit 102.)

It would be prudent for Fairview executives to keep in mind that a nonprofit organization which provides health care during a time of rapidly rising health costs should be sensitive to expenditures on parties. There is an inconsistency between Fairview's alcohol reimbursement policy and its reimbursement of alcohol at these functions. The executives and the board know that the adoption of a policy does nothing if it is routinely ignored. Indeed, it can create a culture where employees will routinely ignore all policies and procedures.

Section 1.10 Other Parties, Meals and Alcohol Reimbursement

Section 1.10.1 Banquets

Just as it had no formal policy for holiday parties prior to publication of the Allina report, Fairview lacked a formal policy for organizational parties. The following are a few examples of banquets and parties paid for by Fairview:

- Two of Fairview's entities hosted separate dinner parties at the Edina Country Club on the same evening in 2001, totaling over $7,200. (Exhibit 103.) Over $500 was spent on dessert. (*Id.*)

- Fairview paid $13,800 for a Saturday night banquet at the Lafayette Club, which included a live band, valet parking, and over $2,600 in alcohol. (Exhibit 104.)

- Fairview hosted a "corporate meeting" that featured dinner and an evening boat cruise, costing a combined $6,200. (Exhibit 105.)

- Fairview hosted an annual dinner at the Bracketts Crossing Country Club from 2000 through 2003. (Exhibit 106.) The combined cost of the dinners was over $20,000, of which $2,800 was spent on alcohol. (*Id.*)

As noted above, it appears that Fairview now relies on policies which allocate money per FTE to departmental and corporate functions. (Exhibit 3.) It is unknown whether this policy is followed.

Section 1.10.2 Meals

The 1994 T&E Policy required employees to use "good judgment" when dining and allowed "reasonable and necessary" meals in the conduct of company business to be reimbursed. (Exhibit 2, p. 1.) The policy also required documentary substantiation for all meals, including original receipts for meals over $25 and a valid business purpose for the meal. (*Id.*) Fairview permitted credit card receipts, which do not contain details on the items purchased, to constitute such documentation. (*Id.*) The policy also required the names of individuals in attendance to be provided on the expense report. (*Id.*)

Fairview frequently reimbursed executives for meals with other executives and their spouses, often based upon inadequate substantiation. For example, Fairview reimbursed almost $2,100 to an executive of one of its hospitals for three meals in November, 2000. (Exhibit 107.) One dinner was with the CEO and his spouse and two vice presidents and their spouses. (*Id.*) No business purpose was identified. A few other examples of such dinners include:

- Over $1,500 for 33 meals between Fairview's former CFO and his administrative assistant between January of 1998 and March of 2001. Lunch locations included Morton's, Kincaids, W.A. Frost, and the Grazzi Italian Café. (Exhibit 108.)

- Over $1,000 for a "dinner for VPs" at Goodfellows. (Exhibit 109.) No detailed receipt was submitted. (*Id.*) At least four spouses attended. (*Id.*)

- A $600 dinner (including over $100 in alcohol) between Fairview's CEO and other executives at the Hyatt Whitney Grille. (Exhibit 110.)

- A $650 "dinner and refreshments," including about $200 in alcohol, at Zelo, for members of a hospital's board and their spouses. (Exhibit 111.)

- A $1,000 dinner attended by the CEO of Fairview, the CEO of Blue Cross Blue Shield, and five others at Goodfellows. (Exhibit 112.) No detailed receipt was submitted. (*Id.*)

- A $1,400 dinner at Chang O'Haras. (Exhibit 113.) No list of attendees was submitted. (*Id.*)

- A $1,600 "staff bonding" party at the Chanhassen Dinner Theatre. (Exhibit 114.) No list of attendees was submitted. (*Id.*)

- A $185 dinner (including 16-year old scotch) for two at the Whitney Grill between Fairview's CEO and the CEO of HealthPartners to "discuss healthcare business in the Twin Cities area." (Exhibit 115.)

- An $1,100 dinner for employees at the Edina Country Club. (Exhibit 116.)

After publication of the Allina report, Fairview modified it policies to require Fairview employees to submit the actual restaurant receipt itemizing the items purchased, rather than a credit card receipt. (Exhibit 3, p. 10.) The policy also prohibits reimbursement for meals with other employees (other than at official employee recognition events or with pre-approval of certain executives). (*Id.*, p. 6.) Once again, it is important that Fairview not only adopt such policies, but also implement them.

Section 1.10.3 Alcohol

Fairview's 1994 T&E Policy did not impose any limitations on the reimbursement for alcohol expenses. (Exhibit 2.) After publication of the Allina report, Fairview modified its policy to prohibit reimbursement of alcohol-related expenses incurred while traveling. (Exhibit 3, p. 4.) The modified policy states that alcohol may only be purchased at "Fairview functions" if pre-approved by certain executives. (*Id.*, p. 6.) Elsewhere, however, the policy states that alcohol *may* be purchased for entertainment purposes if the cost is reasonable. (*Id.*, p. 4.)

It appears that Fairview could benefit from a consistent alcohol policy that is enforced. For example:

- Fairview paid over $1,000 for a Friday afternoon "reception" for employees at Tejas, including $275 worth of alcohol. (Exhibit 117.)

- Fairview regularly reimbursed an executive for afternoon happy hours and other "get togethers." (Exhibit 118.) The executive failed to submit detailed receipts for these events. (*Id.*)

- Fairview paid for a "get together" of the CFO and four other executives at McCormicks. (Exhibit 119.) The business purpose was listed as, "Get together after all-day retreat." (*Id.*) Nothing but alcohol was consumed. (*Id.*)

- Fairview paid over $175 for alcohol at the Edina Country Club. (Exhibit 120.) The "refreshments" were for attendees at an "educational" conference. (*Id.*) No list of attendees was provided. (*Id.*)

Section 1.11 Retreats and Other Off-Site Activities

Section 1.11.1 Retreats

Fairview's 1994 T&E Policy did not contain a policy on retreats. As a result, there appears to have been little guidance on expenditures for retreats involving executives and board members. For example:

- Fairview paid over $1,200 for a "board retreat" at the Nicollet Island Inn. (Exhibit 121.)

- Fairview hosted two board retreats at the St. James Hotel in Red Wing, Minnesota at a cost of over $46,000. (Exhibit 122.)

- In 2001, Fairview hosted a retreat for 11 board members and executives who stayed overnight at the Radisson Hotel at a cost of almost $3,900. (Exhibit 123.) Although the attendees were mostly metro-area residents, Fairview paid for overnight accommodations, "to include opportunities for social time and team-building...." (*Id.*)

- In the spring of 2001 and 2002, members of Fairview's board of directors and its executives attended a retreat at the Oak Ridge Conference Center. (Exhibit 124.) Each year, Fairview paid over $9,000 for the two-day event, including lodging. (*Id.*) Some executives and board members brought spouses.

After publication of the Allina report, Fairview modified its policy to disallow reimbursement for travel that is at less than 100 miles from the employee's place of business, unless there is a time period of less than ten hours between the end of one meeting and the start of another meeting. (Exhibit 3, p. 7.) The Oak Ridge retreat (Exhibit 124) suggests that Fairview does not apply the modified policy to retreats for board members.

Section 1.11.2 Other Off-Site Meetings

The 1994 T&E Policy imposed no limitations on the use of outside facilities for meetings among Fairview employees. Fairview regularly paid to host such gatherings at hotels and country clubs. The following are a few examples:

- a $7,500 "meeting" at the Calhoun Beach Club, including a full bar of alcoholic beverages (Exhibit 125);

- a $380 morning meeting of thirteen people at the Calhoun Beach Club (Exhibit 126);

- a $260 meeting of five people (including the CEO, COO, CFO, and the General Counsel) at the Edina Country Club (Exhibit 127);

- a $540 meeting at the Edina Country Club for thirteen people (Exhibit 128);

- an $1,140 meeting of twenty people at the Radisson Hotel South (Exhibit 129);

- a $460 afternoon meeting at the Radisson Hotel South (Exhibit 130); and

- a $250 meeting for six people at the Northland Inn (Exhibit 131).

After publication of the Allina report, Fairview modified its T&E Policy to state that Fairview will only reimburse reasonable facility costs if Fairview facilities are unavailable. (Exhibit 3.) This makes sense, particularly where Fairview has many conference rooms in its hospitals and clinics which are capable of accommodating small meetings.

Section 1.12 Gifts

Prior to 2002, Fairview had no policy relating to providing gifts. As a result, it regularly reimbursed executives for gifts. For example, Fairview paid for:

- an executive to give over $2,500 in holiday gifts to board members and senior staff management from 1998-2000 (Exhibit 132);

- over $500 of fishing gear for an executive (Exhibit 133);

- a $1,600 shotgun (*Id.*);

- $170 in jewelry (Exhibit 134);

- a $350 graphite driver (Exhibit 135);

- a $300 watch and leather case (*Id.*);

- over $500 in Waterford Crystal and glassware for board members (Exhibit 136);

- Waterford Crystal for board members at a cost of $900 (Exhibit 137);

- a $425 painting of an "Autumn Evening" (Exhibit 138);

- a $350 "Great Big Bertha" driver (Exhibit 139);

- a $250 gift certificate to a sporting goods store (Exhibit 140); and

- a $300 gift certificate to Golf Galaxy for which Fairview's CFO appeared to have been reimbursed twice (Exhibit 141).

It is noted that the IRS does not allow more than $25 to be deducted annually for a gift, which reflects national policy that gifts in excess of that amount do not serve a business purpose. (Exhibit 142.) After publication of the Allina report, Fairview adopted a gift policy. (Exhibit 91.) The policy generally prohibits gifts in excess of $50 for a single instance of recognition and $150 per employee per year, unless a higher amount is approved in advance by a senior vice president or care system president. (*Id.*) The new policy also requires documentation for gifts, including the name of the recipient. (*Id.*) The policy does not appear to apply, however, to gifts purchased by or for board members. (*Id.*) Application of the policy to board members is appropriate.

Section 1.13 Recommendations

Prior to the publication of the Allina report, Fairview incurred travel and entertainment expenses in a manner similar to Allina, Medica, and HealthPartners prior to 2002; namely, it did not attempt to restrain such expenses, nor did it attempt to adequately document the business purpose, reasonableness, and necessity of the expenditures. After publication of the Allina report, Fairview modified its travel and entertainment policies so that, if properly implemented, wasteful spending of limited health care resources should be sharply curtailed. (Exhibit 3.) Fairview must understand, however, that it is not enough simply to adopt new policies. Rather, it must also rigorously enforce and fully implement them.

In light of the above comments, it is recommended that Fairview take the following actions:

1. Fairview must fully implement and enforce its existing policies. Because it does not appear that all policies have been fully-implemented, Fairview's internal audit department should continue to review expense

reports on a quarterly basis. For a period of one year, it should, on a quarterly basis, file such reports with the Attorney General's Office.

2. In its 2002 T&E Policy, Fairview states that it will no longer pay for sporting tickets. The policy does not extend to charges for participation in sporting *events*, such as golf games. Fairview should prohibit reimbursement for expenses relating to participation in sports, such as golf games, unless approved in advance by the board chair or his designee. Before the board chair or his designee approves such an expenditure, Fairview should require a demonstration that the expense has a legitimate business purpose and is not excessive.

3. Fairview claims that it stopped paying for country and golf club memberships in 2002. Fairview's 2002 T&E Policy, however, does not articulate the organization's policy with regard to such memberships. Indeed, the 2002 T&E Policy states that its terms can be preempted by an executive's employment contract. Fairview should modify its policies to reflect what it claims to be its current practice, which is to prohibit the purchase of executive club memberships.

4. Fairview's 2002 T&E Policy provides that spousal *travel* is not reimbursable. Fairview does not appear, however, to have adopted a policy for reimbursement of other non-employee expenditures (i.e. expenses incurred by spouses, friends, or family members). Fairview should adopt a policy that such expenditures are not reimbursable.

5. The 2002 T&E Policy does not appear (with one exception relating to the use of in-house meeting rooms) to apply to members of Fairview's board of directors. It is noteworthy that board members are not compensated. Its 2002 T&E Policy might be modified as applied to board members so as to give appropriate recognition for their service. Fairview should adopt a policy to apply to board members. Among other things:

   5(a) Fairview does not appear to have adopted a specific policy relating to out-of-state travel by board members. It should extend the 2002 T&E Policy's travel provisions to apply to board members.

   5(b) Fairview should clarify that its policy on in-state overnight lodging also applies to overnight retreats by board members.

   5(c) Fairview's "employee recognition" policy, which limits the amount of money which may normally be spent on going away parties and the like, should apply to board members. In addition, Fairview should clarify that a board member who is also an employee of Fairview is governed by the 2002 T&E Policy applicable to employees.

5(d) Fairview's gift policy does not appear to apply to gifts purchased by or for board members. Because the members serve without compensation, it would be prudent for Fairview to adopt a different policy specifically for gifts to board members.

6. Fairview's 2002 T&E Policy contains inconsistent language on the reimbursement of alcohol-related expenses. The policy states that Fairview will not reimburse for alcoholic beverages purchased while an employee is traveling on Fairview business. On page six, the policy states that alcohol will not be reimbursed unless it is to be used at a Fairview function and pre-approved in writing by certain designated executives. On page four, however, the policy states that alcohol *may* be purchased for entertainment purposes. It would be prudent for Fairview to clarify its alcohol reimbursement policy to limit reimbursement for alcoholic beverages.

7. Fairview states that it will pay for entertainment expenses if they are "reasonable." In light of the above findings, it is unclear how Fairview employees will make a determination of reasonableness. Fairview should require advance managerial approval for all entertainment expenditures, so that a demonstration of the business purpose and reasonableness of the expense is made *prior to* the expense being incurred. The executive should attach the pre-approval form to the expense report. In addition, a subcommittee of the board should be authorized to meet with the accounts payable staff to review such expenditures on a periodic basis, perhaps quarterly, to provide guidance to management.

8. A number of Fairview's policies grant discretion to executives to approve expenditures. On a number of occasions, the accounts payable staff questioned expenditures, only to be overruled by executives. Fairview should develop a system to vest accounts payable staff, who may be lower in the organizational chain of command, with authority to enforce the disapproval of expenses of executives which do not comply with Fairview's policies. In addition, a subcommittee of the board should be authorized to meet with the accounts payable staff on a periodic basis, perhaps quarterly, to review such expenditures and give guidance to the executives.

Section 1.14 Conclusion

All parties to the health care transaction--including consumers, employers, and governmental agencies--are struggling with the extraordinary cost of health care. Nonprofit health care organizations have a responsibility to exercise prudence and discipline in their expenditures. Fairview is commended for cutting back on its travel and entertainment spending in 2002 following publication of the Allina report. It should take the above-described additional steps to ensure that scarce health care dollars are not squandered and the public's confidence in the organization not eroded.

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