Office of the Inspector General

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Review of Lander Foundation Oversight and Financial Management Issues

Case# 2016-1975-I

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I. Executive Summary

A review was initiated based on a credible complaint that included misspending allegations of funds belonging to The Lander Foundation, Inc. (Foundation), a nonprofit entity supporting Lander University (LU). The investigation was divided into two parts with one part focused on a misconduct investigation based on misspending allegations of Foundation resources, the results of which were provided to the Foundation and LU to address. The second part of the investigation, addressed in this report, focused on the environment leading to the allegations of misspending, which included a review of oversight by both the Foundation and the LU leadership.

The review identified an environment where the Foundation Board of Trustees (Board) did not exercise sufficient oversight of the former executive director's leadership and management of Foundation activities. There also existed confusion and misunderstanding over the lines of authority and responsibilities among the Foundation Board, the Foundation staff, and prior LU leadership. Contributing to the confusion was the fact the Foundation staff were comprised of employees of LU and were answerable to LU management. The former executive director for the Foundation also served as the VP of Advancement for LU with clear reporting requirements to the former LU president. Additionally, the LU VP of Business and Administration also served as the Foundation treasurer.

There was no memorandum of understanding or operating agreement between the Foundation and LU, which has been identified as a best practice in higher education, and would have prevented the confusion and misunderstanding over lines of authority. The Foundation lacked numerous policies and procedures, in particular, a travel policy for Foundation staff and a fiscal policy governing purchases and expense reimbursements with Foundation monies. This lack of policies, in conjunction with the confusion over responsibilities, created an environment where spending and other actions took place without proper oversight and approvals by higher authorities.

Contributing to the misunderstanding by the Foundation Board was the practice evidenced in the minutes where Foundation staff and in some cases LU staff, advised the Foundation Board of actions taken or to be taken without seeking approval from the Foundation Board. No doubt this led the Board members interviewed by the Office of the State Inspector General to characterize their role as advisory. In addition, the Foundation Board members stated "the ones in the know" were the former LU VP of Advancement, the former LU VP of Business and Administration, and the former LU president. These Board members stated they focused on scholarships and investments and left operations and spending requests to the staff.

The Foundation's endowment demonstrated no growth in the last fifteen years, which appears to have resulted primarily from an underperforming fundraising effort. The majority of fundraising activity appeared to have involved recurring scholarship donations, which are considered restricted donations. Very little unrestricted funds were raised to support the Foundation's operations, only $48,000 for fiscal year (FY) 2016. Additionally, the majority of unrestricted funds were used to meet an annual requirement of covering a shortfall in one of the Foundation's subsidiaries. As a result, LU provided most of the Foundation's operational needs, over 80% during FY 2016.

The amount of contributions reported in the Foundation's audited financial statements was misleading due to the fact it included the value of LU staff salaries ($494,000) who performed the work of the Foundation. These reported contributions also included funds associated with LU athletics ($427,000), some of which were not actually contributions, but were sponsorships, advertising fees, concession income, and program and activity fees generated by LU's athletic department. The Foundation expended those funds even though their expenditure should have taken place under the oversight of LU leadership.

This review identified two leases of property between the Foundation and LU with concerning terms. Leases between the two organizations are expected to be on a nonprofit, cost recovery basis to the Foundation. However, in these two leases, the terms appeared to result in a profit to the Foundation, and in one case, the profit seemed substantial.

The new leadership of LU recognized the majority of issues depicted in this report and took action to address them prior to the conclusion of this review. The Foundation's spending practices have been curtailed and missing policies and procedures have been implemented. Procedures were put in place to provide stricter oversight of Foundation practices and expenditures, to include a required higher level of authority review and approval by Foundation Board members and current LU leadership. The shortcomings in fundraising were identified and new experienced development staff was sought to develop a sound fundraising strategy and related fundraising efforts. Most importantly, greater communication and transparency was established between LU management and the Foundation Board.

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Administrative: Lander University's comments on this report are located at the following link: Agency Response to Oversight Report

II. Background

A. Predicate

The South Carolina Office of the State Inspector General (SIG) initiated a review of The Lander Foundation, Inc. (Foundation), based on a credible complaint which included allegations of misspending of funds belonging to the Foundation. The Foundation is a nonprofit entity supporting Lander University (LU). These allegations were associated with LU employees performing work for the Foundation, which included unauthorized expenditures; expenditures without apparent justification or benefit to LU or the Foundation; and expenditures possibly made for personal benefit.

B. Scope

The review was divided into two parts with one part focused as a misconduct investigation which resulted in a thorough review of Foundation expenditures and funds associated with the misspending allegations. The results of that investigation were provided to Foundation and LU leadership in a separate report.

The other part of the review, addressed in this report, focused on the environment leading to the allegations of misspending, which included a review of oversight by both the Foundation and former LU leadership and their interrelationships. The initial efforts revealed the absence of documented policies, procedures, and controls. The associated review of financial records raised concerns over the financial condition of the Foundation including the amount of resources LU has provided to the Foundation in relation to the support the Foundation provided to LU. In addition, certain lease arrangements between the Foundation and LU appeared to have been structured to benefit the Foundation, which is inconsistent with the relationship of the entities where such leases are expected to be on a nonprofit, cost recovery basis.

Reviews by the SIG are conducted in accordance with professional standards set forth by the Association of Inspectors General, often referred to as the "Green Book."

C. Overview of the Foundation

Lander University is an outgrowth originally of Williamston Female College, which moved to Greenwood in 1903 and became Lander College in honor of its founder. It was operated by the Conference of the Methodist Church until 1948. That year the Lander Foundation was formed to receive the assets of the college and take over its operation. Greenwood County initially contributed to its support, which was formalized in 1951 by action of the state legislature creating the Greenwood County Educational Commission. The county passed a referendum levying a 4 mill tax on the citizens for the college's support, making LU the only county-supported college in the nation. In 1972 by Act 1393 of the state legislature, the assets of the college were transferred to the state and LU became a state-supported institution of higher learning. The Foundation retained scholarship funds, development or alumni annual giving funds, and endowment funds. The Foundation applied for and received an exemption from federal income tax in 1975.

The Foundation is registered in South Carolina as a not-for-profit entity and, per its bylaws, is authorized to acquire property and funds and use the property and funds in furtherance of the welfare of LU. The Foundation is governed by a board of trustees (Board) that includes "not less than two members of the University Board of

Trustees" along with the LU president and several LU staff members who serve ex-officio. The Foundation is considered a component unit of LU and the results of its operations are included in LU's financial statements. The bylaws provide that, upon dissolution, the assets of the Foundation may be distributed to any organization described in Section 501(C)(3) and exempt from taxation under Section 501(a) of the Internal Revenue Code, or to a federal, state, local government or school district and used exclusively for public purposes. LU is not specifically identified as an entity that may receive a distribution of the Foundation's assets.

Beginning in 2006, the Foundation created three subsidiaries in the form of limited liability corporations (LLC) for the purpose of acquiring property and holding it for LU's use, or leasing it to LU for various purposes. Among these purposes have been the construction of a recreation, wellness, and sports complex; a fieldhouse; student housing; and offices.

III. Foundation Governance and Oversight

A. Foundation Board of Trustees

Interviews conducted of Foundation Board members found reactions of surprise and shock by the allegations of misspending. Some members stated they felt their role was advisory. One member stated "the Board does not hire or fire," and "the Board focused on scholarships and investments where operations and spending requests were left up to the staff." Another member stated "the ones in the know who knew what was going on" were the former LU Vice-President (VP) of Advancement, the former LU president, and the former LU VP of Business and Administration. All Foundation Board members stated they were usually just advised of actions that had taken place, or were to take place, as opposed to being asked to authorize those actions.

Although the Foundation bylaws make it clear the Board is not advisory, some basis for this impression may lie in the composition of the Foundation staff and confusion over lines of authority. Foundation bylaws state the Board may hire an executive director and his/her compensation may be decided by the Board. However, the executive director of the Foundation is also the VP of Advancement for LU. All Foundation Board members stated it was their understanding the executive director (VP of Advancement) reported to the president of LU. In addition, the individual functioning as treasurer of the Foundation is the VP of Business and Administration for LU. Some members noted there had been four individuals functioning as Foundation treasurer over the preceding five years, which resulted in inconsistent financial reporting making it difficult for them to know where the Foundation stood financially. The remaining Foundation employees are also employees of LU.

Only one Foundation Board member interviewed recalled receiving an orientation on board governance and being provided documentation on governance policy and procedures. The SIG identified the existence of only an investment policy and a gift acceptance policy for the Foundation. Policies which were noticeably absent from the Foundation included a fiscal policy which addressed the approval process and levels of authority for purchases, reimbursements, use of the Foundation's credit card accounts; and a travel policy for Foundation staff. The Foundation bylaws appeared to clearly establish the Board's absolute responsibility for the management of the Foundation and authority over those employees performing work for the Foundation, contrary to the opinion of those Board members interviewed.

B. Memorandum of Understanding

The SIG's research found it is a best practice for a memorandum of understanding (MOU) or operating agreement to exist between a university and its fundraising foundation. At the initiation of this review no such MOU or operating agreement existed between LU and the Foundation.

The benefits of an MOU/operating agreement include: clearly establishing the working relationship and responsibilities of each party; assuring the consistency of the mission over time; ensuring the Foundation has policies and controls in place; defining the services and support to be provided by the Foundation; identifying fundraising activities to be undertaken; and defining responsibilities and expectations for reporting and communication between the Foundation and LU.

C. Increased Board Governance Requirements

Corporate scandals in both the for-profit sector and the nonprofit sector over the last 20 to 30 years have resulted in greater emphasis on the oversight responsibility of nonprofit boards. The Sarbanes-Oxley Act from 2002 addressed board oversight issues primarily in the for-profit sector, but also contained requirements relative to nonprofits. It focused leadership on the boardroom instead of entirely on the entity's chief executive. In addition, the Internal Revenue Service (IRS) substantially increased the need for greater board oversight by making the numerous requirements applicable to private foundations also applicable to public foundations and nonprofits. Some of the more prominent requirements include maintaining minutes of all meetings; maintaining a conflict of interest policy and reviewing it annually with all board members; approving the executive director/CEO's compensation; a review of the IRS Form 990 by the board before filing; and publically disclosing the three most recently filed Form 990s along with the organization's exemption application. Other requirements include maintaining a whistleblower protection policy; a gift acceptance policy for non-cash gifts; and a records retention/destruction policy. In fact, Sarbanes-Oxley included criminal statutes applicable to nonprofits relative to the destruction of records with the intent of impeding or obstructing an investigation.

The following for-profit requirements of Sarbanes-Oxley are recommended for adoption by nonprofit organizations:

- Boards should establish an audit committee to oversee all audit activities, which includes at least one financial expert, and members of both the finance and audit committees should be financially literate.
- Audit committees should hire the outside auditors and have the auditors provide their report to the committee or the board.
- The audit firm should be replaced every five years or the lead audit partner on the engagement should rotate off the assignment every five years.

The SIG determined the Foundation did not have an audit committee and only recently, in 2015, established a finance committee. Foundation Board members interviewed did not recall the outside auditor presenting the audit report to the Board. Foundation staff members indicated the same individual auditors have been performing the Foundation's audit for at least the last 14 years even though the firm changed when those same individuals recently purchased the Greenwood office of the former firm.

A review of the Foundation's Board minutes and the audited financial statements indicated the complexity of the Foundation's operations had increased significantly over the last ten years beginning with the creation of the RWS Properties, LLC for the development of a recreation, wellness, and sports complex known as the "Jeff May Complex" (JMC). The JMC was financed by a $14 million bond issue and was subsequently leased back to LU by the Foundation. Other property acquisitions for LU needs followed, including student housing which was financed and also leased back to LU. Most recently, the Foundation purchased a building for its offices and in turn, leased it to LU.

The Foundation's external auditors raised a concern over this increased complexity in 2012, and trained the Foundation's accounting staff in proper accounting for the various transactions. The fees charged for the annual audit were in the $20,000 range until a year ago when the audit fees increased to $51,000 for the fiscal year (FY) 2015 audit. The billing by the auditors included a discount of approximately one-half of the fee, which was shown as an in-kind services contribution to the Foundation.

This increase in fees coupled with a significant amount of time for in-kind services is puzzling as the increase in the Foundation's complexity occurred primarily between 2009 and 2012, and the accounting staff was trained in 2012 or 2013. The extent of the audit billing shown as in-kind services may also raise an independence question relative to the nature of the in-kind services the auditors performed. Specifically, if the in-kind services consisted of accounting work for the Foundation, the auditors essentially audited their own work.

D. TD Bank Building Purchase

The acquisition of a former bank building for use as the Foundation's offices is illustrative of the confusion and blurred lines of authority and oversight among the Foundation Board, Foundation staff, and LU.

The SIG identified the first mention of the bank building purchase in the Board minutes for the 10/17/2013 executive committee meeting. A review of prior Board meeting minutes dating back through 2012 revealed no mention of the purchase or related action by the Board. At this meeting, the executive committee was informed an offer of $400,000 had been made and a contract was expected. There was no request of the committee to approve the purchase. The committee was further informed that "in the plan for the purchase," half of the cost of the purchase would come from Foundation resources, and the remainder would come from a bank loan, presumably entered into by the Foundation. Ironically, at the end of the meeting under "new business," the executive committee members were asked if there was any further need for discussion regarding the purchase, and the minutes included the statement "input was encouraged at this point." No further discussion was reflected in the minutes.

The following month, as noted in the minutes of the full Foundation Board meeting on 11/21/2013, the Foundation's former executive director informed the members of the pending move of the Foundation offices and those of the LU Alumni Association to the former bank building. The former executive director also stated the Foundation will purchase the building and LU "will buy it back and make the Foundation whole." This statement was inconsistent with the "plan for the purchase" reported the previous month. Again, there was no motion to approve the purchase, and apparently the Board didn't question the action, or at least no questions or discussion were noted in the minutes.

The former bank building was next mentioned at an April, 2014 Board executive committee meeting where the Foundation's attorney, who also served as LU's attorney, reported the sale had closed, a lease was in place with the LU, and the first lease payment had been received. In addition, the Board Investment Committee chair reported that $400,000 had been removed from the Foundation's investments to pay for the building. Nowhere in these minutes or any previous minutes was there a record of a discussion or deliberation by Board members concerning a need for new office space for the Foundation, or an approval of the purchase, much less an approval to utilize investments for the purchase. Furthermore, some members of the LU Board and the Foundation Board were unaware a portion of the lease payments by LU to the Foundation were being used to fund the buyout of the former LU president's contract.

E. <u>Other Property Purchases</u>

The minutes of the August, 2013 executive committee meeting included a notation in the treasurer's report whereby the executive committee was informed of the purchase of 424 Stanley Avenue by the Foundation; however, there was no discussion of the purchase nor any Board action approving the purchase.

The minutes of the February, 2016 executive committee meeting included the notation that the Foundation purchased property near the JMC, and the building on the property was donated to Habitat for Humanity, which was going to move it to another location for renovation. Again, there was no discussion, deliberations, or Board action recorded in the minutes approving the purchase. This property, located at 401 Graydon Avenue and referred to as the Horne property, was purchased at a cost of $56,000 and was utilized as additional parking for the JMC. It was determined that payment for the property was made from an investment account for endowment funds directly to the property owner and was not recorded in the Foundation's accounting records. In addition, there was no authorization to use invested funds recorded in the Foundation's Board minutes. Further, the current LU president did not initially authorize the purchase, but did so subsequently after being told by the former LU athletic director that private gifts and funds from the Bearcat Club had been identified to fund the purchase. The current LU president authorized the purchase on the caveat that no existing funds would be used. However, a review of the Foundation's accounting records revealed that no private gifts were obtained and existing funds in various athletics accounts, held by the Foundation as custodian, were used to reimburse the investment account at the direction of the former LU athletic director.

In 2000, an individual donated 39 acres of land to the Foundation. The property located just off of Highway 11 in Pickens County and across from the entrance to Table Rock State Park contained a donation agreement which restricted the use of the property to educational purposes for LU. Per the August, 2014 executive committee meeting minutes, the former LU president advised the property was not being used by the environmental science department as was originally envisioned. He further stated the property was being listed for sale, but any proceeds were to be earmarked for environmental science, consistent with the restriction. Again, no action by the Board was requested. However, the next year during the April, 2015 meeting, a motion was made to approve the deed transfer of the property from the Foundation to a Foundation subsidiary.

The property has not been sold and is currently appraised for tax purposes at $217,000. Although other Foundation property is exempt from property taxes, Pickens County records show property taxes of $3,278 for 2016 are unpaid and shown as delinquent.

IV. Foundation Financial Condition

A. Foundation Revenues, Fundraising Activities, and Obligations

The Foundation's endowment has shown little growth through many years. The fund currently stands at the same level it was in 2003. The minutes and associated committee reports, along with financial records indicate the Foundation did not appear to have a high level of fundraising activity or success. Most activity appeared to be through recurring scholarship donations, which typically totaled around $1 million annually. Much smaller sums came from annual campaign efforts and incidental sources. During 2008 – 2010, the Foundation appeared to have conducted a successful capital campaign when it raised $2.5 million for the construction of the JMC. However, no results were reported from a capital campaign effort requested by the LU Board of Trustees in 2012 and begun shortly thereafter. Minutes of numerous meetings included various statements reporting the status of the campaign, and over a period of several years, the campaign was characterized as being in the "silent phase" of acquiring lead gifts before going public. The Foundation's financial statements do not show any capital campaign results from 2012 through 2016. The current LU president ended the campaign efforts until LU, in conjunction with the Foundation, developed a compelling case for major donors to participate, along with a well-planned effort.

There was minimal unrestricted revenue raised by the Foundation to fund its day-to-day operations. The absence of unrestricted funds to pay for capital campaign costs was noted several times in the Board meeting minutes. In relation to that need, the Board approved a proposal in 2014 for a 5% surcharge assessment on all donations to generate additional unrestricted funds. This surcharge was apparently applied to all donations, including restricted donations. The surcharge was eliminated at the end of 2015.

The most significant recurring source of unrestricted funds was a 1.5% administrative fee assessed annually on the total endowment which generated approximately $200,000. Other sources of recurring unrestricted funds were annual fund donations and proceeds from the former 5% surcharge on donations. For FY 2016, the annual fund donations totaled $48,000, and the 5% surcharge totaled $16,000. Included also was a one-time $150,500 payment from LU, which was noted as a reimbursement for certain expenses paid by the Foundation.

While the Foundation had very little unrestricted revenue for its operations, it had a significant obligation in the requirement to provide $183,000 annually to the Foundation's subsidiary, RWS Properties, LLC, which owned the JMC. After the JMC was constructed and leased to LU, a fieldhouse was added in 2012 which was financed by a $1.95 million promissory note. It too was leased to LU. By all accounts, the lease revenues did not adequately offset the annual amortization on the Jeff May Complex bonds and the fieldhouse note, which required the supplemental funding from unrestricted funds. This $183,000 annual requirement obligated the majority of the Foundation's recurring unrestricted funds.

Lander Foundation Properties, LLC currently owes approximately $500,000 on a promissory note which originally totaled $979,750 and was obtained to pay off an existing line of credit. This note is collateralized by certain properties, and its loan amortization is funded by lease revenue from LU's student housing. This subsidiary, however, appears to be adequately funded from the lease revenue.

A true picture of the Foundation's fundraising results was difficult to assess based upon a review of its audited financial statements, which, for FY 2016, reported $1.9 million in contributions. Subsequent analysis determined $494,000 of this amount was the salary cost of the LU staff performing Foundation work. The auditors chose to present this cost as a contribution from LU to the Foundation and LU was not reimbursed for this Foundation expense. Also included in the $1.9 million total was $427,000 related to LU athletics, which consisted of athletic sponsorships and advertising revenue, various sports-related fees, concession revenue, membership fees to the Bearcat Club, and donations designated for the various sports teams. Another $79,000 consisted of donations for in-kind services, which included those services performed by the Foundation's auditors. The balance of approximately $960,000 was comprised primarily of the restricted scholarship donations.

One of the more egregious recordings of a contribution occurred in FY 2016, when the prior Foundation leadership recorded $224,000, which represented a U. S. Department of Education Student Services grant to LU that was paid directly to LU, not the Foundation. The auditors removed this amount from the Foundation's financial records at year end and it was not included in the audited financial statements.

During the time period studied by this review we observed approximately ten payments to other organizations within the Greenwood Community that were characterized as sponsorships and donations. Some of the organizations were charities whose purpose was to benefit individuals and entities other than LU. The sponsorships typically involved charity golf tournaments, some of which were expected to also benefit the Foundation in excess of the Foundation's sponsorship payment, but inevitably did not. It was not appropriate for the Foundation to make contributions to benefit other entities when its chartered purpose was to benefit LU, and particularly so when it did not have sufficient unrestricted funds to cover its operating costs.

B. Investments

The Foundation does have an investment policy that appeared to be sound, and the investments were divided between two managers who provided periodic benchmarking of performance and recommendations on asset mix. However, in FY 2016 there was a reported loss in value related to oil and natural gas pipeline stocks totaling approximately $450,000 or 4.5% of the total investments. The proportion of this loss to total investments may indicate the portfolio was not as diversified as it should have been. To be clear, this was a loss in value at one point in time and the stocks may have recovered their value.

C. Foundation Operating Expenses

While the salary expense of LU employees performing the Foundation's work ($494,000), was the largest operating cost of the Foundation, the auditors' treatment of it as a contribution from LU resulted in no impact to the Foundation's cash flow. The next largest operating cost was the $183,000 annual commitment to the Foundation for the Jeff May Complex. Other Foundation expenses totaled approximately $90,000 for FY 2016 and included the audit fees; a portion of the LU president's total salary; LU faculty and staff support; and fundraising, travel, insurance, and other miscellaneous expenses.

V. Other Concerns

In reviewing the Foundation's audited financial statements and other financial records, the SIG identified several unexpected and concerning financial transactions, as follows:

A. Bearcat Village Lease

In the February, 2016 Foundation Board executive committee meeting minutes, the treasurer noted the mortgage for the Bearcat Village, a student housing complex, was paid off and the remaining funds were transferred to the Foundation. The Bearcat Village LLC acquired the property in 2010 for $2,000,065 according to Greenwood County property records. This purchase was financed with a mortgage, and the housing complex was subsequently leased to LU. The treasurer's reference to the remaining funds being transferred to the Foundation was for $219,000 transferred from the Bearcat Village LLC to the Foundation's unrestricted funds.

A review of the Bearcat Village LLC accounting records indicated this transfer of funds was the remainder of the account balances after all revenue and expenses had been recorded, and after the end of the five-year initial lease period to LU. Since the Bearcat Village LLC had recorded all the revenue and expenses of this undertaking through the years, these residual funds appear to be a profit on the lease even though the terms clearly stated the lease was to be on a nonprofit basis. There was no discussion recorded in the minutes questioning whether or not these funds belonged to the Foundation or were to be refunded to LU. The item was also presented as information to the Board. No action was requested or a motion reported.

B. TD Bank Building Lease

At the April, 2014 Foundation Board executive committee meeting, the Foundation's attorney, who also acted as the LU's attorney, noted the lease of the TD Bank building to LU was "producing a profit." He then presented a proposal from the LU Board of Trustees requesting the Foundation fund $234,000 of the buy-out package of the former LU president's contract. The attorney stated that proceeds from the lease of the building to LU could be used to fund the buyout. A motion was made to approve the proposal, but was later tabled until the next Board meeting. At that meeting, the executive committee voted unanimously to fund the buyout of the former LU president's contract.

As previously noted, the Board apparently never took any action to approve the $400,000 purchase, made with invested funds. While this is concerning, the terms of the lease are even more concerning. The lease required annual payments of $80,000 over an initial ten-year lease period. At one point, the Board meeting minutes mentioned LU will pay back the cost of the building plus 5% interest. This would be reasonable in order to replace foregone investment earnings. At an interest rate of 5%, the annual payment including principal and interest would be $49,335, which is far smaller than the $80,000 annual payment called for in the lease. The difference between these amounts may be the "profit" referred to by the Foundation attorney. The $80,000 annual payment equates to a 16% interest rate.

The Foundation auditors treated this lease as a "direct financing lease," which is a type of lease where ownership typically transfers to the lessee (LU) at the end of the lease period. This is consistent with the statement that the LU "will buy it back." However, this lease did not contain the standard lease language which provided for the building's transfer of ownership as is found in other capital-type leases between LU and the Foundation. Instead, the terms of the lease included a "right of first refusal" clause, whereby, should the Foundation receive an offer to purchase from a third party at any time during the lease period, LU could match the third party's offer and purchase the building. However, the lease terms did not provide any credit to LU for prior lease payments.

An extreme example illustrating how this clause might work would be if a third party offered the Foundation $500,000 for the building in the ninth year of the lease, LU could acquire the building by meeting the $500,000 third party offer after having made $720,000 in lease payments for a building initially costing $400,000.

LU, along with other state agencies, must meet certain statutory and regulatory requirements in the leasing of real property. The Property Services Office in the Division of Facilities Management is designated by statute as the single broker for the leasing of real property for all agencies, including colleges and universities (South Carolina Code Section 1-11-55(2)). Property Services maintains a number of requirements regarding the leasing of real property, which include: requiring a justification for the lease; requiring the use of a standard lease form approved by the Attorney General; assuring the lease payments represent no more than fair market rental value; and requiring the agency to submit an adequate financial plan for meeting the obligations under the lease.

In addition, the Commission on Higher Education (CHE) also has review and approval authority over leases involving public colleges and universities. The statute does exempt colleges and universities from most of the Property Services requirements if the annual lease payments are under $100,000. Leases are also exempt from the CHE requirements if the payments over a five year period do not exceed $1 million. The bank building lease is exempt in both instances. However, Property Services and the CHE both require exempt leases to be reported and copies be provided to both agencies. The SIG determined neither Property Services nor the CHE had a record of the bank building lease. While this lease was exempt from most requirements, it clearly was not structured in the spirit of the state statutes and regulations.

VI. Conclusion

A. Governance and Oversight

In recent years, the Foundation Board has operated under a cloud of misunderstanding and confusion over its governance and oversight responsibilities. The byproduct of this lack of oversight may have been serious misspending or at a minimum, a waste of funds that could have benefitted LU. The misunderstanding and confusion at least partially stemmed from the dual responsibility of the Foundation staff who were LU employees answering to LU management, but who were also responsible to the Foundation Board for the operation of the Foundation. Foundation Board members felt their staff reported to and followed the direction of LU management, while LU management, at least in some cases, felt the opposite.

The Foundation bylaws clearly established the Board's responsibility for Foundation operations, but regardless, most members felt they were advisory. Only one member recalled having a board orientation or being given a "board book," which might indicate at least some members never saw the bylaws. Most importantly, there was no MOU or operating agreement, a best practice in higher education, which would have prevented any misunderstanding from developing.

As reflected in the Board minutes, this faulty concept was reinforced by actions of not only LU staff and leadership, but also by the Foundation's attorney, who also represented LU. A number of entries in the Board minutes show Board members being informed of actions that had taken place, which were of such significance they should have been discussed and acted on by the Board. One member noted there was a vague line between what LU paid for and what the Foundation paid for. Another said the Foundation was used when LU needed something quickly. Yet another member said the Board focused on scholarships and investments where operations and related spending were left up to the staff. There were no documented procedures and policies for spending authorizations or approvals. The absence of oversight and confusion on supervision and reporting responsibility created an environment where funds could be spent with dubious, if any benefit to either the Foundation or LU.

It would be a misstatement to say that the Board never raised questions. Some did and they reported being stonewalled or just told everything was fine. Certainly one contributing factor was the almost yearly turnover during the preceding five years in the treasurer's position, which resulted in inconsistent and incomplete financial reporting. The recently formed finance committee was the result of Board members not getting answers at a time when the Foundation was running short of money, as a Board member explained.

The Foundation's operations grew increasingly complicated over the last ten years with the creation of its subsidiaries along with property acquisition and leasing. Prior to that, the Foundation's activities did likely center on obtaining scholarships and managing investments, which was probably accomplished with fewer staff. With the growth in activity and complexity, requisite policies and procedures were never implemented. As is common in many smaller nonprofit organizations, the Foundation failed to adopt requirements and best practices in board governance and oversight resulting from both the for-profit and nonprofit sector scandals of the 1990s. Among the missing governance policies and documents were: board orientations for new members with related documentation; a conflict of interest policy; a whistleblower policy; a review of the IRS 990; and an audit committee comprised of knowledgeable members overseeing all aspects of the audit including the selection of the auditor and assuring the auditor's independence by rotating auditors regularly; and other requirements and best practices. The size of the fee for the most recent audit is concerning as is the amount of in-kind services performed by the auditor. The reasons for both should be determined.

The Foundation's investment policy appeared to be sound and complete. However, a recent loss in value related to oil and gas pipeline stocks of approximately 4.5% of the total portfolio is concerning, although it may recover over time. If practical, a periodic review of investments by an independent investment consultant may be beneficial to assure the investment strategy, asset mix, and benchmarking of results are appropriate and consistent with the needs of the Foundation. The university's newly appointed VP of Advancement (Foundation executive director) and the LU VP of Finance and Business Administration who serves as both the LU chief financial officer and the Foundation's treasurer are currently evaluating this issue.

B. <u>Fundraising and the Endowment</u>

The Foundation's endowment is next to the smallest among the public college and university foundations in South Carolina. The endowment has not grown in the last 15 years, and this lack of growth appears primarily to be due to very little fundraising efforts or results, and less due to endowment spending or losses during economic downturns. The annual 1.5% assessment on the endowment used to fund the operating expenses and commitments of the Foundation is not an appropriate use of endowment funds. All endowed funds and related investment earnings should be used for the exclusive benefit of LU. A strong annual fund campaign and other similar activities should be utilized to raise unrestricted funds to meet the day-to-day operating needs of the Foundation. Such activities should include the goal of raising enough funds to eventually reimburse LU for the Foundation work performed by LU staff.

Additionally, as part of its efforts to raise additional funds, the Foundation should assess all unutilized properties with LU management and jointly decide if any property should be sold to raise funds for LU or Foundation needs, as appropriate within any related restrictions.

C. LU Athletic Funds in the Foundation

The $427,000 amount related to LU athletics reported as Foundation contributions gives the impression it came about through Foundation fundraising efforts, when it did not. These contributions were entirely related to LU athletic department activities and efforts. The Foundation, as custodian of these funds, expended them at the request of the LU athletic department staff. Allegations were made that monies were routinely transferred among the various team's funds and possibly spent contrary to their intended purpose. Those allegations were beyond the scope of this review. However, if a donor to the Bearcat Club designated additional funds for a specific team, that constituted a restricted donation and there was a legal obligation to spend those monies as the donor intended.

The larger question is whether or not it's proper for the Foundation to serve as the custodian for these funds and expend them. Athletics is a function of the university, not the Foundation, and is managed within the chain of command and control processes of LU. All spending of funds related to and obtained for the benefit of the athletic department should be budgeted and expended under the control and policies of the LU leadership. Some of these funds, not considered contributions, should never have gone to the Foundation. They include advertising and sponsorship monies, concession revenue, and various activity fees. However, it is appropriate for contributions, Bearcat memberships, and possibly other fundraising proceeds to flow through the Foundation. Doing so has the benefit of capturing donor information for future fundraising efforts; promptly and consistently acknowledging donations; and assuring the legally-required acknowledgements are provided. It is much preferred to have one organization with those responsibilities and one master list of donors. Periodic transfers of donated funds, intact, could be made from the Foundation to LU along with any required designations, with all spending taking place within LU.

D. Questionable Lease Terms

Bearcat Village Lease

The initial five year period for the Bearcat Village student housing lease ended in 2015 and the Bearcat Village, LLC's accounting records showed a surplus of funds totaling $219,000. During 2016, the Foundation transferred these surplus funds from the Bearcat Village LLC to the Foundation as unrestricted funds without the knowledge of the current LU president. Records show the borrowing by the LLC to purchase the property was paid in full during 2015, and it appears the Bearcat Village LLC recorded all expenses associated with the undertaking during the five year period. The lease included a clause stating it was entered into as part of the Foundation's mission to support LU and was done so on a nonprofit basis. However, the records would indicate the $219,000 was a profit to the Bearcat Village LLC, but also could be unspent funds initially provided by LU for agreed-upon improvements. Regardless, there should have been a determination made at the time as to whether or not LU was entitled to some or all of this surplus.

This lease was reviewed and approved by the State Property Services Office. As such, a legal review and analysis of this outcome may be beneficial to determine if there are any lingering issues that should be addressed. Bearcat Village ownership remains in the name of the Bearcat Village LLC and has not been transferred to LU, which is continuing the lease under the extended lease terms by making annual lease payments of $1.

<u>TD Bank Building Lease</u>

The Foundation acquired this former bank building in 2014 for its offices by using funds from its investments. Through interviews the SIG determined the former President was interested in purchasing this building for use as a Montessori school, but it was determined the building was inadequate for that purpose. At a later date, after the building had been on the market for some time, the former LU president again became interested in the building due to a general need for additional office space. It was determined that housing the Foundation office and alumni staff was the best use for the building. It was obtained for $400,000, down from the initial asking price of $925,000. The justifications for this purchase included the freeing up of office space on the campus and providing greater visibility for the Foundation and alumni offices, along with providing convenient parking.

Determining if this purchase and use of the building was appropriate and justified is beyond the scope of this review, although its lease to LU resulted in LU subsidizing another cost of the Foundation's operations. The Foundation's unrestricted revenues should be increased to the point it can fund its own space. At some point the Board and LU management may consider reevaluating the use of this building.

The lease terms of this former bank building are astonishing. The annual lease payment of $80,000, almost twice the amount needed for the Foundation to recover its investment plus foregone investment earnings, is inappropriate for a nonprofit lease between related parties. Contrary to statements in the minutes, the lease terms did not provide LU with the option to acquire the building at the end of the lease. Only through a "first refusal" clause could LU obtain ownership, and then only under harsh financial terms. The treatment of this lease as a direct-financing lease in the Foundation's audited financial statements is questionable due to the absence of the appropriate language for a transfer of ownership.

Within several months of the lease being executed, the Foundation Board was presented with the request to fund the buyout of the former LU president's contract in the amount of $234,000. At that time, the Board was told the "profit" from this lease could be used for this purpose. The SIG is not able to determine if the greatly-inflated lease payment was intended to provide funding for the buyout and, if so, what purpose was served by accomplishing that in such a round-about way.

Based on the terms of the bank building lease and the end results of the Bearcat Village lease, all current leases should be re-evaluated to ensure they are on a true nonprofit basis. If any are found not to be, they should be renegotiated, including the bank building lease.

E. Foundation's Benefit to the University

There should be recognition of the amount of support received by LU in relation to how much support LU provides to the Foundation. The cost of the Foundation staff provided by LU as well as the Foundation's office facility provided at a considerable cost to LU, are significant in relation to the benefits LU receives. Such a dollar-based analysis is not entirely appropriate because there are other unmeasurable benefits, but it does underline the need for the Foundation to significantly increase its fundraising results with a goal of increasing the endowment and support to LU, along with funding more of its day-to-day operating costs.

F. Current Status – Actions Already Taken

It must be said that most issues and problems were identified by the new LU management well before this review was concluded, and many actions have been taken to address those issues. Spending was curtailed and procedures were put in place requiring review and approval of financial transactions. An effort was begun to identify and implement other policies and procedures. The need to ramp up fundraising was recognized, and a capital campaign, long underway but achieving nothing, was halted until a better-conceived campaign could be undertaken. Staffing changes were made and a search was begun for an experienced development officer. Most importantly, increased communication and transparency was established between LU management and the Foundation Board.

Findings and Recommendations

Finding #1: The Foundation Board did not exercise adequate governance and oversight and lacked essential policies and procedures for the management and control of its organization.

Recommendation #1a: The Board should implement required and recommended policies and procedures.

Recommendation #1b: The Board should seek guidance in board governance from nonprofit associations and other resources in addition to implementing board orientations for all members, along with providing Foundation governance documentation to the members.

Finding #2: Confusion and misunderstanding existed over responsibilities, lines of authority, and supervision among Foundation staff, the Foundation Board, and LU staff, which created an environment that resulted in questionable expenditures that lacked benefit to either the Foundation or LU.

Recommendation #2a: LU and Lander Foundation leadership should develop and implement a memorandum of understanding or operating agreement modeled after recommended agreements between universities and supporting foundations and ensure those involved in each organization are familiarized with the agreement.

Finding #3: The Foundation's fundraising efforts underperformed which resulted in no growth in its endowment or support to LU and minimal unrestricted revenue to offset its operating costs.

Recommendation #3: The Foundation and LU should hire experienced development staff and charge that staff with developing, in conjunction with the Foundation Board and LU leadership, a sound fundraising strategy and plan consistent with the LU's strategic plan needs.

Finding #4: The Foundation was made the custodian of funds associated with the LU's athletic department and expended those funds outside the control of LU management.

Recommendation #4a: The Foundation should only receive proceeds of fundraising efforts related to LU athletics that represent donations or contributions, and should periodically transfer those funds intact to LU to expend.

Recommendation #4b: LU athletic funds in the categories of advertising and sponsorship revenue, concession revenue, fees for camps and activities, and any other funds not considered donations, should be deposited and expended by LU.

Finding #5: Several leases of Foundation property carry questionable lease terms and may have been structured to produce a return greater than their costs to the Foundation.

Recommendation #5: All leases between LU and the Foundation should be reviewed and analyzed to assure their terms are on a nonprofit, cost recovery basis to the Foundation; any that are not, should be renegotiated.

Finding #6: LU provides significant, unreimbursed support to the Foundation in the value of the staff performing the work of the Foundation and a facility provided for the Foundation's offices, while the Foundation raises little unrestricted funds to support its operating costs.

> **Recommendation #6:** The Foundation should assess all unutilized properties with LU management and jointly decide if any property should be sold to raise funds for LU or Foundation needs, as appropriate within any related restrictions.

Administrative: Lander University's comments on this report are located at the following link: Agency Response to Oversight Report