

# STATE OF LOUISIANA LEGISLATIVE AUDITOR

**Grambling State University**  
Grambling, Louisiana

December 15, 2000



**Investigative Audit**

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**Daniel G. Kyle, Ph.D., CPA, CFE**  
**Legislative Auditor**

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**Daniel G. Kyle, Ph.D., CPA, CFE**

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# Grambling State University

December 15, 2000



**Investigative Audit  
Office of the Legislative Auditor  
State of Louisiana**

**Daniel G. Kyle, Ph.D., CPA, CFE  
Legislative Auditor**

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DANIEL G. KYLE, PH.D., CPA, CFE  
LEGISLATIVE AUDITOR

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December 15, 2000

**DR. STEVE A. FAVORS, PRESIDENT**  
**GRAMBLING STATE UNIVERSITY**  
Grambling, Louisiana

Transmitted herewith is our investigative report on Grambling State University. Our examination was conducted in accordance with Title 24 of the Louisiana Revised Statutes and was performed to determine the propriety of certain allegations received by this office.

This report presents our finding and recommendation, as well as your response. Copies of this report have been delivered to the University of Louisiana System, the Board of Regents for Higher Education, and others as required by state law.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Daniel G. Kyle".

Daniel G. Kyle, CPA, CFE  
Legislative Auditor

DPD:SLC:DGP:dl

[GSU]

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# Executive Summary

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## Investigative Audit Report Grambling State University

The following summarizes the finding and recommendation as well as management's response that resulted from this investigation. Detailed information relating to the finding and recommendation may be found at the page number indicated. Management's response may be found at Attachment I.

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**GRAMBLING STATE UNIVERSITY DONATED FUNDS TO THE FOUNDATION, AND THE FOUNDATION USED A SUBSTANTIAL PORTION OF THE FUNDS TO SUPPORT ITS OWN EXISTENCE RATHER THAN FOR THE BENEFIT OF THE UNIVERSITY**

**(Page 7)**

**Finding:**

From November 1996 to June 1999, the Grambling State University Foundation, Inc., (Foundation) had \$2,907,261 available to be used for the benefit of Grambling State University (University) and to fund its operations. Of this amount \$1,576,623 was clearly intended for the University and was donated by the University to the Foundation in violation of the Louisiana Constitution. In addition, the Foundation used much of the funds for purposes other than that intended, including:

1. Though the Foundation had \$229,618 in unrestricted funds which were available to finance its operations, the Foundation spent \$1,257,298 on its own administrative expenses including \$316,463 in payments to its executive director and \$187,570 to support its sports bar and student housing operations.
2. Though the Foundation collected \$1,383,147 from private donations and services provided by the University to be used for scholarships, individual University departments, and other University needs, only \$580,540 was used for these purposes and \$776,028 was transferred to the general operating account and used for administrative and operating expenses.



3. The Foundation collected \$1,294,496 related to the Bayou Classic and spent substantially this entire amount for Bayou Classic activities including \$207,362 for hotels, \$140,263 for meals, and \$17,193 for limousine rentals. However, since the Bayou Classic is a University event and no cooperative endeavor agreement existed between the entities, these funds should have been deposited with the University and subjected to the University accounting controls and state laws.

**Recommendation:**

We recommend that the University formalize, in writing, all agreements with non-profit entities receiving public funds and ensure that (1) there exists a legal obligation to transfer such funds; (2) the expenditures are for a public purpose; and (3) the services received are commensurate with the associated costs. We also recommend that the University obtain an Attorney General's opinion concerning the validity of its current cooperative endeavor agreement for the Bayou Classic football games. Furthermore, the University should gain a thorough understanding of the funds being transferred to and received by such organizations and institute procedures to ensure that the funds are used for their intended purposes and for the benefit of the University.

**Management's Response:**

Management agrees the funds held at Grambling State University Foundation on behalf of the University may not have been properly managed and may have resulted in a breach of fiduciary responsibility by the Foundation's management. However, it was not nor has it ever been the intent of the University to donate funds, but rather those funds were deposited at the Foundation for the purpose of supporting the University. It is a customarily recognized practice that all funds generated by ancillary events and private donations are deposited at University's foundations or alumni organizations.

The University did not maintain accounting records of the Foundation and as such was not in a position to refute or defend how funds deposited at the Foundation were expended.

Currently the University has an executed cooperative endeavor agreement with the Grambling State University National Alumni Association. The University believes that this agreement is legally binding and complies with all state laws. However at the request of the Legislative Auditors the University will seek an Attorney General's Opinion regarding the legality of such an agreement to determine if it meets the threefold test deemed valid under the Louisiana Constitution.

The finding states that a cooperative endeavor agreement would not have met the threefold test. However, according to state regulations, the University is prohibited from using state funds to guarantee the \$1,000,000 required to broadcast the Bayou Classic Football Game. Therefore, the University now utilizes the cooperative endeavor agreement to provide the necessary guarantees.

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# Background and Methodology

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Grambling State University is a publicly supported institution of higher education. The University is a component unit of the State of Louisiana, within the executive branch of government. The University is under the management and supervision of the Board of Supervisors of the University of Louisiana System; however, the annual budget of the University and changes to the degree programs, departments of instruction, et cetera, require the approval of the Board of Regents for Higher Education. As a state University, operations of the University's instructional programs are funded through annual lapsing appropriations made by the Louisiana Legislature.

Grambling State University is located in Grambling, Louisiana, and serves as a cultural and educational center for north Louisiana. The University offers associate, baccalaureate, and selected masters and specialist degrees in the areas of liberal arts, education, business administration, and sciences and science-related technologies, nursing, and social work. Enrollment at the University was 5,070, 4,833, and 2,102, respectively, during the fall, spring, and summer semesters of fiscal year 1999; and 5,859 and 5,494, respectively, during the fall and spring semesters of fiscal year 1998. The University has 857 full-time faculty and staff members at June 30, 1999.

The Grambling State University Foundation, Inc., was founded in 1969 and incorporated under the laws of the State of Louisiana. The purposes of the Foundation were to operate as a non-profit corporation; entrusted to receive and hold by gift, bequest, devise, grant, or purchase any real or personal property, and to invest and re-invest; to use and dispose of the same for the educational and physical facilities of Grambling State University and for students attending the University pursuing their college training; and for carrying on any proper University activity.

During the Foundation's existence, the University routinely transferred public funds generated by donations to the University and fees for services provided by the University to the Foundation. On June 16, 1999, the Foundation submitted a voluntary petition with the U.S. Bankruptcy Court for liquidation under Chapter 7 of the U.S. Bankruptcy Code. At that time, all University funds on deposit with the Foundation became subject to the authority of the bankruptcy court.

We received an allegation that the University transferred public funds to the Foundation in violation of Article 7, Section 14 of the Louisiana Constitution. We performed this investigative audit to determine the propriety of the allegation.

The procedures performed during this investigative audit consisted of (1) interviewing employees and officials of the University and Foundation; (2) interviewing other persons as appropriate; (3) examining selected University and Foundation records; (4) performing observations and analytical tests; and (5) reviewing applicable state and federal laws and regulations.

The result of our investigation is the finding and recommendation herein.

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# Finding and Recommendation

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## **GRAMBLING STATE UNIVERSITY DONATED FUNDS TO THE FOUNDATION, AND THE FOUNDATION USED A SUBSTANTIAL PORTION OF THE FUNDS TO SUPPORT ITS OWN EXISTENCE RATHER THAN FOR THE BENEFIT OF THE UNIVERSITY**

From November 1996 to June 1999, the Grambling State University Foundation, Inc., (Foundation) had \$2,907,261 available to be used for the benefit of Grambling State University (University) and to fund its operations. Of this amount \$1,576,623 was clearly intended for the University and was donated by the University to the Foundation in violation of the Louisiana Constitution. In addition, the Foundation used much of the funds for purposes other than that intended, including:

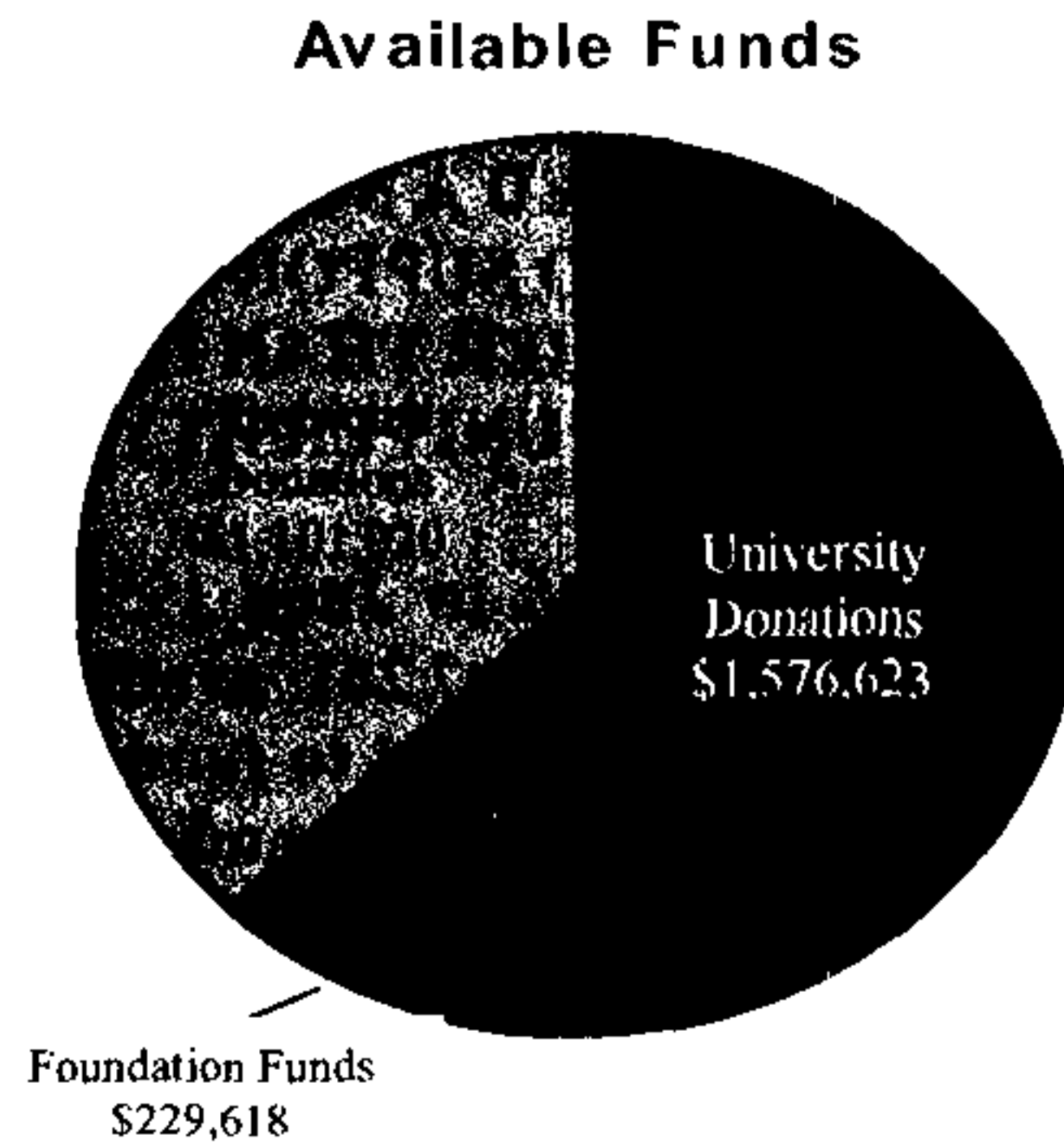
1. Though the Foundation had \$229,618 in unrestricted funds which were available to finance its operations, the Foundation spent \$1,257,298 on its own administrative expenses including \$316,463 in payments to its executive director and \$187,570 to support its sports bar and student housing operations.
2. Though the Foundation collected \$1,383,147 from private donations and services provided by the University to be used for scholarships, individual University departments, and other University needs, only \$580,540 was used for these purposes and \$776,028 was transferred to the general operating account and used for administrative and operating expenses.
3. The Foundation collected \$1,294,496 related to the Bayou Classic and spent substantially this entire amount for Bayou Classic activities including \$207,362 for hotels, \$140,263 for meals, and \$17,193 for limousine rentals. However, since the Bayou Classic is a University event these funds should have been deposited with the University and subjected to the University accounting controls and state laws.

The Foundation was incorporated in 1969 as a not-for-profit entity to serve Grambling State University. The purpose of the Foundation was to be the central fund-raising agency for the University and to expend its funds in any manner beneficial to education and the University. On June 16, 1999, the Foundation filed a petition for bankruptcy under Chapter 7 of the U.S. Bankruptcy Code. As of that date, all University funds on deposit with the Foundation became subject to the authority of the bankruptcy court.



## Funds Received by the Foundation

During the period November 1996 to June 1999, the Foundation had \$2,907,261 available to be used for the benefit of the University. This included \$2,677,643 that was restricted specifically for scholarships, individual University departments, and other University needs and \$229,618 received by the Foundation through donations, solicitations, administrative fees, rental fees, royalties, and a for-profit entity established by the Foundation. Of the \$2,677,643 in restricted funds, \$1,576,623 was clearly intended for the University but was transferred by the University to the Foundation in violation of the Louisiana Constitution. The remaining \$1,101,020 consisted of donations intended for the benefit of the University; however, it is unclear as to whether all of the donors intended for the donations to be deposited with the University or the Foundation.



**Funds donated by the University** - From November 1996 to June 1999, the University transferred \$1,576,623 of funds belonging to the University to the Foundation in violation of the Louisiana Constitution. These funds included private donations made payable specifically to the University, fees charged for services provided by the University, and proceeds from the Bayou Classic football games. These funds were deposited, by the Foundation, into restricted accounts intended for scholarships, individual University departments and other University needs. The funds were not intended to be used for the Foundation's administrative and operating expenses.

Article 7, Section 14 of the Louisiana Constitution provides, in part, that the funds, credit, property, or things of value of the state or any political subdivision shall not be loaned, pledged, or donated to or for any person, association, or corporation, public or private. The Louisiana Constitution further provides that for a public purpose, the state and its political subdivisions may engage in cooperative endeavors for expenditures or transfer of public funds with any public or private association, corporation, or individual, such as the Foundation.

We found no evidence of a written cooperative endeavor agreement between the University and the Foundation for the transfer of these funds. In addition, Mr. James Webb, executive director of the Foundation, stated that no cooperative endeavor agreement existed. Therefore, the transfer of public funds from the University to the Foundation appears to be a donation or a loan that is prohibited by the Louisiana Constitution.

Of the \$1,576,623 transferred by the University to the Foundation, \$189,522 consisted of private donations written specifically to the University. However, University records indicate that, during this time period, private donations collected by the University and transferred to the Foundation totaled only \$48,265. Therefore, either the University failed to record \$141,257 in

private donations or the Foundation received \$141,257 in private donations that were intended for the University without the University's knowledge.

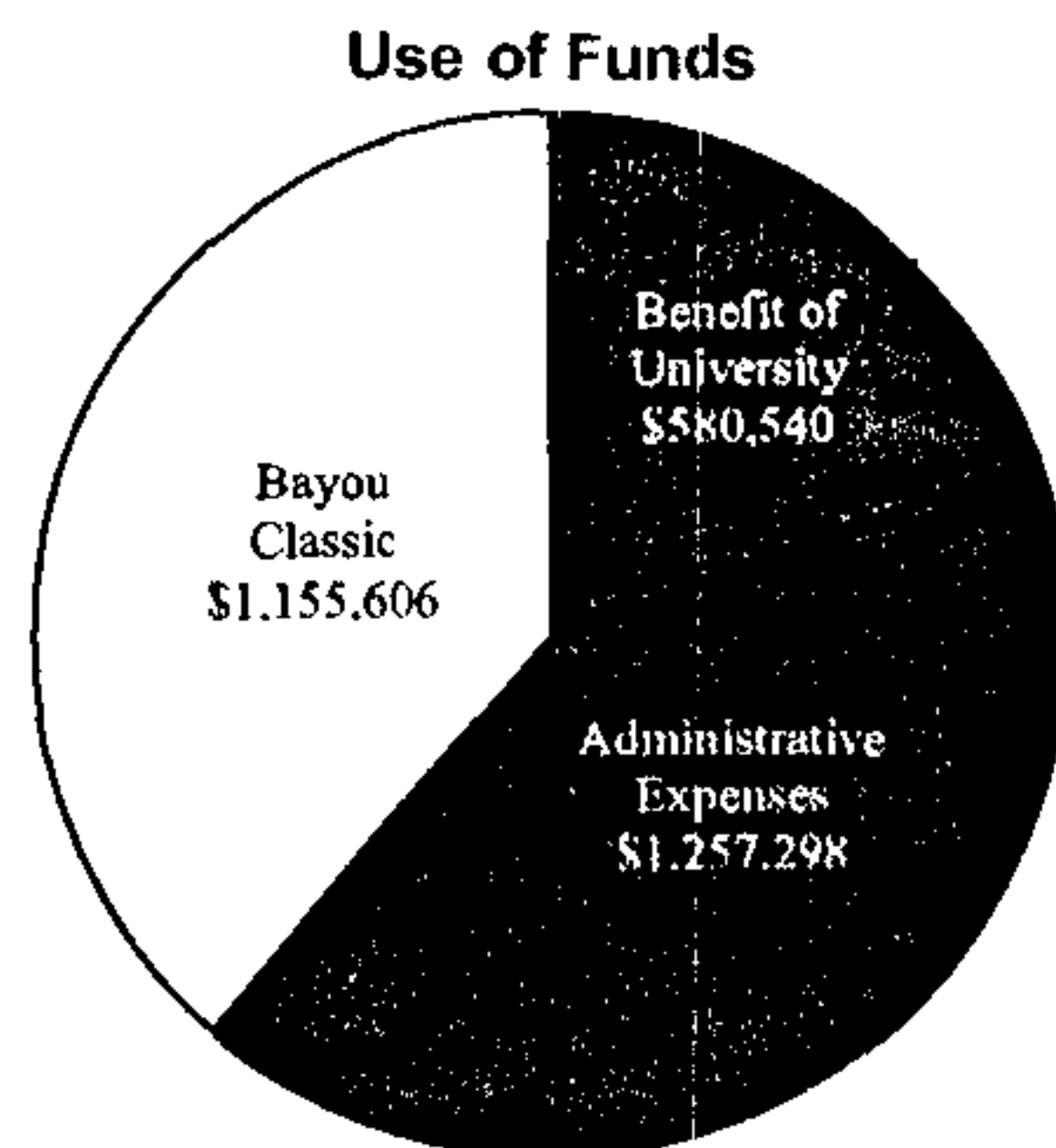
**Funds restricted for the benefit of the University** - The Foundation received \$1,101,020 in funds made payable to the Foundation or individual University departments that were restricted for scholarships, individual University departments, and other University needs. Although it is unclear as to which entity should have received the donations (Foundation or University), these funds were deposited into restricted bank accounts controlled by the Foundation. The Foundation's articles of incorporation provide that the Foundation shall perform the duties of trustee and, as such, act in a fiduciary capacity on behalf of the University. According to the Foundation's policies, expenditures from these accounts must be for purposes that meet the guidelines established for that account and for restricted funds in general.

During the period November 1996 through June 1999, these restricted bank accounts included deposits for approximately 120 University departments and support organizations, as well as trust funds established for scholarship purposes. The funds on deposit were restricted for the benefit of those departments and support organizations. As of January 1, 1997, Foundation records showed that the trust funds contained \$800,000 in restricted donations. These donations were made substantially with the intent that the principal would remain intact and unused while the interest would be used to fund scholarships.

**Funds earned by the Foundation** - The Foundation had \$229,618 that it received through donations, fund raisers, rent receipts, administrative fees, royalties, and revenues from the Comfort Zone, Inc., a for-profit entity established by the Foundation. These funds were deposited into the Foundation's general operating account for use by the Foundation at its discretion and should have been the only funds used for the Foundation's operations.

## Use of Funds by the Foundation

As stated before, the Foundation received \$2,677,643 restricted specifically for scholarships, individual University departments, and other University needs. Of this amount, \$1,294,496 was generated from sponsorships, ticket sales, and donations associated with the Bayou Classic football games and the remaining \$1,383,147 was received from private donations and services provided by the University. In addition to the \$2,677,643, the Foundation received \$229,618 of donations and other self-generated revenues that could be used for the benefit and administration of the Foundation at its discretion. However, during this time period, the Foundation spent \$1,257,298 for its own operating and administrative expenses. Therefore, the Foundation used University and restricted funds totaling \$1,027,680 for purposes other than intended, thus violating the Louisiana Constitution and its fiduciary duties of trustee as provided for in its articles of incorporation.





***Payments related to the University*** – In addition to funds generated by the Bayou Classic as explained below, the Foundation received \$1,383,147 from private donations and services provided by the University. These funds were restricted for scholarships, individual University departments, and other University needs. Of this amount, only \$580,540 was actually used for these purposes. The Foundation's restricted bank account balance as of June 1999 was \$26,579; therefore, at least \$776,028 of these restricted funds was transferred to the Foundation's general operating account.

In addition, Foundation records indicate that the University departments and support organizations should have had deposits on hand totaling \$694,426 as of June 16, 1999; however, as mentioned above, the Foundation had an ending balance of only \$26,579 in its restricted bank accounts. The Foundation's other bank accounts only contained \$29,354.

***Payments related to the Bayou Classic football games*** - The Bayou Classic is an annual University function consisting of a football game between Southern University and Grambling State University, a beauty pageant, a battle of the bands, and other ancillary events. The University transferred its sponsorship rights to the Bayou Classic and the rights to proceeds generated by the ancillary events to the Foundation.

During the period November 1996 through June 1999, the Foundation received revenue from sponsorships, ticket sales, and donations associated with the Bayou Classic football games totaling \$1,294,496. Of these proceeds, \$111,375 was transferred to the Foundation's general operating account. The Foundation recorded total expenses of the Bayou Classic football games at \$1,155,606. By transferring the rights to these proceeds from the University, the Foundation could spend the funds without the restrictions imposed by the University's internal controls, state travel regulations, and state purchasing regulations. As a result, these funds were susceptible to being spent in a manner not in the best interest of the University and/or otherwise prohibited by the Louisiana Constitution. Some of these expenses included hotel and meal rates in excess of those allowed by State Travel Regulations and the rental of limousines for transportation.

During the three-year period, the Foundation spent \$207,362 for hotels, \$140,263 for meals, and \$17,193 for limousine rentals. In addition, for the 1997 Bayou Classic football game, the Foundation paid \$5,696 to cater the University's presidential suites at the game. This purchase included food, drinks, and alcoholic beverages. The \$207,362 in hotel charges included rooms and receptions catered by the hotels. The following are examples of the hotel charges paid through the Foundation using Bayou Classic proceeds (These charges are for 1997 and 1998 only.):

- *\$7,580 for presidential rooms* - Each year the University president was provided a suite and ten additional rooms for his guests.
- *\$6,471 for presidential receptions* - The University president hosted numerous receptions each year for his guests.
- *\$25,621 for other receptions* - The University employees assigned as coordinator and co-coordinators of the Bayou Classic hosted receptions each year for their guests.

As stated before, a written cooperative endeavor agreement did not exist between the University and the Foundation; therefore, the revenues received and related expenditures were in violation of the Louisiana Constitution and may not have been in the best interest of the University.

The Attorney General has recognized a threefold test for cooperative endeavors to be deemed valid under the Louisiana Constitution:

- (1) the expenditure or transfer of public funds or property must be based on a legal obligation or duty;
- (2) the expenditure must be for a public purpose; and
- (3) the expenditure must create a public benefit proportionate to its cost.

It does not appear that all points of the Attorney General's threefold test would have been met by the University had a valid cooperative endeavor agreement existed between the University and the Foundation. A cooperative endeavor agreement would not have met the test because no service was provided by the Foundation that could not have been provided by the University since the University's faculty, staff, and students performed key functions such as Bayou Classic officials and support staff. In addition, the public benefit of contracting with the Foundation was not proportionate to its cost since the Foundation incurred expenses that were not in the best interest of the public.

***Payments to the Foundation's Executive Director*** - Although the Foundation had only \$229,618 available for its own administrative and discretionary use, during the period January 1997 through June 1999, the Foundation paid Mr. James Webb, executive director, \$316,463 in salary, consulting fees, long-distance fees, and expense reimbursements. The consulting and long-distance fees were paid to TLW, Inc., a corporation owned by Mr. Webb. Therefore, funds intended to benefit the University were used by the Foundation to compensate its executive director.

***Payments related to the Comfort Zone, Inc., and student housing*** - In December 1996, the Foundation established a for-profit entity called the Comfort Zone, Inc. The Comfort Zone, Inc., was a sports bar and game room created to provide entertainment to University students. The Comfort Zone, Inc., appears to have been open for business approximately one year. In addition, the Foundation used its facility to provide students with rental housing. Total revenues for the sports bar and student housing was \$50,610; however, the Foundation spent at least \$238,180 to start-up, operate, and finance the for-profit business. Because these operations were not self-supporting, \$187,570 of funds intended for the benefit of the University was used by the Foundation for a sports bar.

***Payment of the Foundation's administrative and operating expenses*** - In addition to the payments to its executive director and for the Comfort Zone, Inc., the Foundation incurred other administrative and operating expenses totaling \$702,655 (see table on the following page). In total, \$1,257,298, or 43%, of the funds received by the Foundation was used to support the existence of the Foundation rather than for support of the University.

<u>Item</u>	<b>Amount</b>
Telephones/pagers/utilities	\$34,918
Taxes and insurance	103,731
Employee pay and reimbursement/contract labor	242,835
Loan payments	133,906
Miscellaneous	187,265
<b>Other Administrative Expenses</b>	<b>\$702,655</b>
Payments to the executive director	\$316,463
Payments for the Comfort Zone, Inc.	238,180
<b>Total Administrative and Operating Expenses</b>	<b>\$1,257,298</b>

## **Recommendation**

We recommend that the University formalize, in writing, all agreements with non-profit entities receiving public funds and ensure that (1) there exists a legal obligation to transfer such funds; (2) the expenditures are for a public purpose; and (3) the services received are commensurate with the associated costs. We also recommend that the University obtain an Attorney General's opinion concerning the validity of its current cooperative endeavor agreement for the Bayou Classic football games. Furthermore, the University should gain a thorough understanding of the funds being transferred to and received by such organizations and institute procedures to ensure that the funds are used for their intended purposes and for the benefit of the university.

# Attachment I

## Management's Response





# Grambling State University

OFFICE OF THE PRESIDENT

Grambling, Louisiana 71245

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(318) 274-6117

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December 13, 2000

Dr. Dan Kyle  
Office of the Legislative Auditor  
1600 North Third Street  
Baton Rouge, LA 70804-9397

Dear Dr. Kyle:

In reference to the finding--Grambling State University donated funds to the foundation and the foundation used a substantial portion of the funds to support its own existence rather, than for the benefit of the university, we submit the following response.

**RESPONSE:**

Grambling State University agrees that funds held at Grambling State University Foundation (Foundation) on behalf of Grambling State University (GSU) may not have been properly managed and may have resulted in a breach of fiduciary responsibility by the Foundation's management. However, it was not nor has it ever been the intent of the university to donate funds, but rather, those funds were deposited at the Grambling State University Foundation for the purpose of supporting GSU. *It is a customarily recognized practice that all funds generated by ancillary events and private donations are deposited at university's foundations or alumni organizations.*

Grambling State University Foundation was a separately chartered entity operating apart from Grambling State University. The university did not exercise significant influence over management decisions regarding the day-to-day operations of the Foundation. The university's president served as an ex-officio member of the Foundation board of directors. The university **did not** maintain accounting records of the foundation and as such was not in a position to refute or defend how funds deposited at the foundation were expended.

Letter to Dr. Kyle  
Investigative Audit of GSU  
Page Two

Management does acknowledge that Grambling State University Foundation was founded in 1969, and incorporated as a non-profit, entrusted to receive and hold by gift, bequest, devise, grant, or purchase any real or personal property, and to invest and re-invest; to use and dispose of the same for the educational and physical facilities of Grambling State University and for students attending the university pursuing their college training; and for carrying on any proper university activity. Therefore, during 1996, in keeping with the purposes for which the Foundation was established, the university's president, authorized the ancillary activities associated with the annual GSU versus Southern University football game (a.k.a. State Farm Bayou Classic) be managed by the Grambling State University Foundation. Unfortunately, university management failed to execute a new cooperative agreement and operated under the auspices that the 1988 agreement (with the exception of the change of the depository for funds from the Grambling University Athletic Foundation to the Grambling State University Foundation) governed all ancillary events.

Shortly after becoming president of GSU, I requested the Executive Director of the GSUF to provide me with the foundation's most recent audit report. Mr. Webb informed me that the 1997 and 1998 audit reports were being conducted at that time. All attempts made by the university's president and internal auditor to obtain these reports were to no avail. As a result of the lack of response from the GSUF, the university was left with no other alternative than to establish the GSU Tiger Fund at the university in October 1998 to accept and manage donations in accordance with state guidelines.

On June 16, 1999 the foundation sought relief under Chapter 7 of the U.S. Bankruptcy Code. The university joined other creditors by filing an initial claim in the amount of \$1,800,000 which was monies held in trust for Grambling State University as well as the scholarship debt recorded on the university's books. After consultation with the university's management board and the legislative auditors the university was directed to amend its claim to only reflect the scholarship indebtedness of \$338,573.00.

Currently the university has an executed cooperative endeavor agreement with the Grambling University National Alumni Association. The university believes that this agreement is legally binding and complies with all state laws and provides substantial support for the university's public purpose and mission. However, at the request of the Legislative Auditors the university will seek an Attorney General's Opinion regarding the legality of such an agreement to determine if it meets the threefold test deemed valid under the Louisiana Constitution.



Letter to Dr. Kyle  
Investigative Audit of GSU  
Page Three

The finding states that a cooperative endeavor agreement would not have met the test because no service was provided by the Foundation that could not have been provided by the University since the University's faculty, staff, and students performed key functions at the Bayou Classic. However, according to state regulations, the university is prohibited from using state funds to guarantee the \$1,000,000 required to broadcast the Bayou Classic Football Game. Therefore, the university now utilizes the cooperative endeavor agreement to provide the necessary guarantees.

Additionally, the university has secured the services of a highly recognized law firm specializing in bankruptcy matters to protect the interest of GSU, the University of Louisiana System, and the State of Louisiana. The university has also, forwarded to the University of Louisiana System legal counsel for review, funds management agreements with all GSU affiliate organizations.

Sincerely,

A handwritten signature in black ink, appearing to read "Steve A. Favors", with a long, sweeping flourish extending to the right.

Steve A. Favors  
President



**Attachment II**  
**Legal Provision**

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# Legal Provision

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**Article 7, Section 14 of the Louisiana Constitution** provides, in part, that except as otherwise provided by this constitution, the funds, credit, property, or things of value of the state or of any political subdivision shall not be loaned, pledged, or donated to or for any person, association, or corporation, public or private.

