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Robert S. Bower, Esq.
Rutan & Tucker, LLP
611 Anton Boulevard, 14th Floor
Costa Mesa, CA 92626-1931

Re: Audit of California State University Stanislaus Foundation (the "Foundation")

Dear Mr. Bower:

The Charitable Trusts Section of the Attorney General's Office has completed its limited review of the Foundation's records for the narrow purpose of determining whether the Foundation's board of directors ("Board") has fulfilled its fiduciary duty in managing and protecting the Foundation's assets.

This letter sets forth our conclusions and identifies the corrective action we have determined the Foundation must take, and to which the Foundation board has agreed. You have informed us that the Board had, prior to the initiation of our audit, begun to address some of the issues discussed herein. The Foundation's agreement to take the corrective action stated below will not be taken as a concession of liability.

Our Review and Conclusions

We did not conduct a full review of the Foundation's books and records; rather, we requested and received production of a limited number of documents relating primarily to fiscal and governance policies and procedures.

It appears from our review of financial documents produced that no charitable assets have been diverted to improper uses. We do note, however, that during the course of the 2009-10 independent audit, accounting adjustments in excess of $1.5 million were made to correct misclassification of net assets (i.e., restricted assets were classified as unrestricted).[1] Our overall conclusion, after reviewing all of the documents produced, is that the Board has not exercised adequate fiscal oversight for most of the period reviewed (January 1, 2005 to present).

[1] The Board has responded specifically to this finding in 2(b) below.

We also note that even where fiscal controls and procedures were in place, they have not been followed in some areas. The failure of the Board to exercise proper responsibility for and authority over the Foundation's charitable assets raises the possibility that those assets could be lost as a result of mismanagement or diversion. If this occurred, the Board would be in breach of its fiduciary duty and liable for any loss. In response to these concerns, we have been advised that, during fiscal year 2009-10, the Board has made a determined effort to improve internal controls through policy development, increased administrative oversight, and enhanced accounting practices.

Our conclusions can be summarized as follows:

1. Independent auditor recommendations were not implemented. We note that some recommendations made by the auditor relating to internal controls were not implemented, in some cases for three years following receipt of the recommendation. The audited financial statements also reveal that, in some cases, procedures developed in response to auditor recommendations were not followed in subsequent years.

Board response: During the 2009/10 fiscal year, the Board has been working with the independent auditor to address all recommendations not previously implemented or followed and to institute internal controls to assure consistent application of those recommendations.

2. The Board has not consistently acted to adequately protect charitable assets under its control. This failure to protect the Foundation's assets from possible waste and diversion breaks into four primary categories:

a. The Board does not compare and analyze revenues and expenses on a periodic basis in order to determine if the Foundation is meeting budgetary goals (i.e. comparing budgeted expenditures to those actually incurred). It is impossible for the Foundation to know how much money it has to spend if this analysis is not performed monthly.

Board response: The Board conducts this analysis on an annual basis and, during the current fiscal year, has been working with the independent auditor to institute internal controls to assure review is conducted on a monthly basis.

b. Reconciliation of endowment accounts and the accurate identification of restricted versus unrestricted assets have been inconsistent. In fiscal year 2008-09, a prior period adjustment of $1.5 million was required to correctly identify permanently and temporarily restricted assets. Correctly identifying restricted and unrestricted funds should be of significant interest to the board because it is the Board's duty to safeguard restricted funds. If funds converted to unrestricted status cannot be replaced by accounting adjustment or another source of unrestricted assets, Board members are required to replace those funds personally.

Board response: During the 2009/10 fiscal year, the Board, working in consultation with the independent auditor, has directed management to develop policy and implement internal controls that respond to all issues raised and recommendations made in order to assure restricted assets are and will continue to be correctly classified and accounted for. It should be noted that the need for the reclassification of net assets was due to an "accounting rule" interpretation error by staff. Under audit review, it was found to be misclassified, hence the $1.5 million adjustment. It was not because the Board failed to respect donor restrictions.

c. Board review of budgets for special events. Although first noted in the audited financial statement for fiscal year 2008-09, it appears that the Board had not, prior to that fiscal year, prepared a budget for its fundraising events. Assessing the effectiveness of fundraising events is essential in order to avoid waste of charitable assets.

Board response: Recently implemented operational policy requires all organizers of major events to submit a budget in advance of the event to the Foundation Executive Director's Office for review and evaluation. After the event has been held, procedures require staff to produce a final event accounting, which is compared to the budget and evaluated for effectiveness. Presently, this accounting process is a manual effort; however, imminent enhancements to accounting software is designed to timely produce event financial reports and will assist the Board to exercise its responsibility of evaluating major fund raising events.

d. The Board did not manage fundraising activities administered by outside groups on the Foundation's behalf. The Board must exercise control over the representations made by fundraisers in order to assure those representations are accurate and to determine whether they include language that may restrict donations for a specific purpose. The Board is also responsible for supervising fundraising activity to assure that it receives all donations solicited on its behalf.

Board response: During the 2009/10 fiscal year, the Foundation in conjunction with the University, solidified policy requiring organizers of major fundraising events to contact University Advancement prior to engaging and contracting with professional fundraisers for services to ensure compliance with applicable law and clearly understand the terms and conditions of the solicitations.

3. The Board does not appear to fully understand its duties and responsibilities under applicable law, including the Supervision of Trustees and Fundraisers for Charitable Purposes Act (hereafter the "Supervision Act") (Gov. Code, § 12580 et seq.), the California Nonprofit Public Benefit Corporation Law (Corp. Code § 5000 et seq.), and those provisions of the Probate Code that govern the management of endowments (i.e., the Uniform Prudent Management of Institutional Funds Act (hereafter "UPMIFA") (Prob. Code, § 18501 et seq.).[2] This conclusion is based in part on the following findings:

a. The fact that, as noted in the independent audit, $1.5 million of net assets needed to be reclassified indicates a general lack of understanding of how endowments are

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2 Formerly entitled "the Uniform Management of Institutional Funds Act," which was in effect until 2008.

accounted for and classified. Failure to reconcile endowment accounts correctly can lead to misclassification of funds, as described above.

Board response: During the 2009/10 fiscal year, in an effort to increase its knowledge of applicable law, the Board conducted a comprehensive internal review of all endowment accounts, including examination of original agreements, analysis of historical transactions, and review of donor restrictions and application of UPMIFA. See also Board response to 2(b) above.

b. The Foundation was not in compliance with the Supervision Act. Government Code section 12599 regulates fundraising activities conducted by for-profit entities for charitable purposes. The Board was apparently unaware of its obligations pursuant to section 12599 when it employed for-profit fundraisers that were not registered with the Registry of Charitable Trusts and failed to enter into written contracts as statutorily required.

Board response: See response to 2(d) above.

c. Failure to understand the parameters of Board oversight, as described in sections 1 and 2 above.

Board response: The Board agrees to participate in "board training" as described below.

d. Failure to understand charitable trust concepts. Based on comments made by board members regarding the most recent fundraiser held by the Foundation, at least some board members do not clearly understand that all revenue received by the Foundation is impressed with a charitable trust. Whether "new money" or existing assets, all these funds must be used for trust purposes. The only question is whether their use is restricted to a specific purpose – such as when a donation is obtained on the representation that it will be used for an identified project or program – or unrestricted and available for use for any of the charitable purposes for which the Foundation was formed.

Board response: The Board agrees to participate in "board training" as described below.

Agreed Corrective Action

In addition to the actions the Board is currently taking to address the issues raised above and recommendations made by the Foundation's independent auditor, the Board agrees, on a going-forward basis, to implement the following practices:

1. All current and future members of the Foundation board of directors shall receive "board training" to assure they fully understand their fiduciary duties under the Supervision of Trustees and Fundraisers for Charitable Purposes Act, the California Nonprofit Public Benefit Corporation Law and UPMIFA. Current directors shall receive training within six (6) months of the date of this letter and future directors shall receive training within six (6) months of election

to the board of directors. A certificate of completion of training shall be retained in the Foundation's files documenting that each current and future board member has completed said training.

2. The Board shall implement independent auditor recommendations when received, unless the Board disagrees with the recommendation. In that event, the Board or a sub-committee of the Board shall meet with the auditor to discuss the recommendation and reach a resolution which addresses and satisfies the auditor's concerns. The meetings, the participants, and resolutions must be documented in the Board's minutes.

3. The Board shall assure that all fiscal and governance policies and procedures are routinely and consistently followed.

4. The Board shall assure that all relationships with fundraisers comply with the requirements of Government Code section 12599, or section 12599.1 if employing fundraising counsel.

Thank you for your cooperation and that of your client during the course of this audit. Based on the documents provided and representations made in response to our inquiries during its course, we are closing the audit.

Sincerely,

BELINDA J. JOHNS
Senior Assistant Attorney General

For EDMUND G. BROWN, JR.
Attorney General

BJJ: