



Examination of the Governance of the University of Louisville Foundation and its Relationship to the University of Louisville

Examination Impetus

On February 18, 2016, the Office of the Auditor of Public Accounts (APA), in response to numerous concerns expressed to this office regarding certain governance issues between the University of Louisville (University or UofL) and the University of Louisville Foundation (Foundation or ULF), decided to continue an examination initiated by the former State Auditor on June 25, 2015. The examination focused on specific governance issues between the two entities. Since its inception, this governance examination of the Foundation and the University has been met with numerous delays.

Examination Scope and Objective

The purpose of this examination was not to provide an opinion on the financial statements or to duplicate work of annual financial statement audits of either the University or the Foundation. The scope of this examination included examining records, activities, and other information for the period July 1, 2012 through June 30, 2015, unless otherwise specified; however, the time period of certain documents reviewed and issues discussed with those interviewed may have varied. Additionally, due to significant events impacting the Foundation since June 30, 2015, the examination was expanded as needed to keep the examination current and to understand the impact of those events on its governance.

To address the objectives of the governance examination, the APA interviewed over 20 individuals, and examined and analyzed thousands of documents, including emails; reports; supporting documentation and schedules; and policies provided by UofL, ULF, and others. In addition, we performed a survey of peer higher education institutions for benchmarking purposes. Further

information regarding the selection of peer higher education institutions and benchmark results can be found in Chapter 3.

Foundation Background

ULF is an independent 501(c)(3) not-for-profit organization established in 1970. It is a fundraising corporation that holds, invests, and designates gifted and endowed funds on behalf of the University. ULF is governed by a 15-member Board of Directors. Four trustees on the UofL Board are appointed by the UofL Board Chair to serve on the ULF Board. The former UofL President also served as President of the Foundation and a voting member of the ULF Board, a member of the ULF Board Executive Committee, and Chair of the ULF Board Nominating Committee during the examination period.

The Foundation reported total revenues of \$77,653,000 in its FY 2015 audited financial statements, with gift revenue being the largest source of revenue for the year. That same year, the Foundation reported expenses totaling \$124.2 million, and reported a loss on investments and an actuarial loss on annuity and trust obligations totaling \$4.8 million. Payments to or on behalf of the University totaled \$24.7 million for the fiscal year 2015. Real estate operations made up \$12.8 million of the total expenses. Interest expense, residence hall operations, and general and administrative expenses were \$5.2 million, \$5.4 million, and \$2.2 million respectively.

The Foundation has grown substantially since its creation in 1970. According to the audited financial statements for FY 2015, ULF has consolidated current total liabilities and net assets valued at approximately \$1.05 billion. The Foundation has diversified into real estate with the utilization of tax

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increment financing (TIF). According to its FY 2015 audited financial statements, the Foundation has 14 affiliates to assist with the implementation and management of such growth.

Endowment Background

The University endowment managed by the Foundation had an approximate value of \$662 million, according to Foundation personnel, as of June 30, 2016. According to information provided by ULF personnel, the endowment has grown from approximately \$593 million as of June 30, 2009 to \$662 million as of June 30, 2016. The current annual spend rate is 7.48%. Of the spend rate, 5.5% is allocated for use by individual University colleges and programs, and 1.5% is allocated for fundraising efforts and used to pay the overhead incurred by the University Advancement and Development Office. Additionally 0.48% is allocated to the ULF President to support high-strategic initiatives and program enrichment, including fundraising activities.

Findings and Recommendations

Finding 1: Requests for documentation and other information were met with continued delays and unclear or inconsistent responses.

Throughout most of the examination process, requests for documentation and other information were met with continued delays and unclear or inconsistent responses. The delays and inconsistencies in information created redundancies in requests, postponed examination procedures, and provided auditors little assurance as to the completeness and accuracy of the information provided. The difficulties encountered in obtaining consistent, complete, and accurate information timely during the examination exemplify the need for improved accountability and transparency within the Foundation and University operations.

Recommendations: We recommend the ULF Board review Board policies, ensuring that accountability and transparency of the organization is a clear expectation of both officers and staff. We recommend all ULF employees receive training on

Board policies, Open Records/Open Meetings laws, and professional ethics.

We further recommend the ULF administration review current operational processes and ensure records are organized to meet the accountability and transparency objectives of the ULF Board, including the implementation of a budget-to-actual analysis for its operational costs. Finally, we recommend the ULF Board consider creating an internal audit function to report directly to the ULF Board or a committee of the Board.

Finding 2: Administrative operations of the University and its Foundation were at times indistinguishable and led to ineffective governance.

The administrative operations of the University and its not-for-profit 501(c)(3) fundraising foundation, ULF, were at times indistinguishable despite being legally separate entities. The dual role of one individual acting as both the UofL and ULF President and other comingled administrative operations, coupled with the growing complexity of ULF operations and ambiguous lines of authority and responsibility, created an enigma leading to confusion and questions of transparency. This confusion and the concentration of authority led to ineffective governance practices that resulted in management having too much influence and a lack of checks and balances. During the examination period, the administrative authority of the Foundation rested primarily with three individuals: the former University and Foundation President, the former President's Chief of Staff, and the Foundation CFO.

Recommendations: We recommend the UofL and ULF Boards discuss together, through designated committees of each board, the need and potential benefits and disadvantages of having the president of the UofL serve as the president of the Foundation.

We recommend the UofL and ULF Boards consider developing a MOU to establish an effective set of operational and governing policies. The MOU should be the result of a collaborative process between the two boards and should include a review of recommended principles and practices.

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We recommend the UofL administration review its human resource processes and management structure to determine whether they are appropriate for its organization and whether they provide fair and consistent treatment of UofL personnel. After the review is complete, we recommend the administration update its personnel policies to be consistent with the approved changes. As part of this policy review, we recommend the UofL administration develop administrative policies to establish guidance and parameters by which additional benefits, such as vehicle and cellphone allowances, may be awarded. This policy should be formalized in writing and approved consistent with UofL policy.

We recommend the University administration involve its General Counsel when considering matters that will result in any legal agreements or arrangements transferring funds from the University to the Foundation, and in any matters that could appear to be noncompliant with existing agreements, regulations, or laws.

We further recommend the UofL Board, or a committee of its body, consider creating a policy to address the University's ability to transfer funds to the Foundation. We recommend any consideration of such a policy be discussed with the appropriate University administrators, including the University's General Counsel. If a policy is created, we recommend the policy be formalized in writing, approved by the full board, and distributed to all appropriate University personnel.

Finding 3: Conflict among members of the UofL Board and the administration created an environment of distrust resulting in a dysfunctional governing climate impacting both the University and the Foundation.

Conflict among members of the UofL Board and the administration created an environment of distrust resulting in a dysfunctional governing climate. UofL Trustees and ULF Directors consistently described a damaged and divisive working relationship among members of the UofL Board and the administration of the University and the Foundation. This division and constant public

attention to the situation at the University and Foundation reportedly discouraged some Trustees and administrators from discussing necessary board and University business in UofL Board meetings. Therefore, the climate not only created disagreements and tension, but also led to withholding information at Board meetings in attempts to avoid further problems. Although this justification may be understandable given the climate, the lack of transparency and reporting of valid business-related information draws into question whether UofL Trustees were able to perform their fiduciary duties.

Recommendations: We recommend the UofL Board of Trustees operate in an atmosphere that welcomes open and forthright discussion of issues the University faces. Discussions at Board meetings should be civil and respectful even if there are disagreements.

Finding 4: Endowment funds totaling \$67 million, budgeted for use by the University, were loaned to the Foundation and an affiliate organization without prior notification to, or approval by, the UofL Board.

The concentration of authority over the University and Foundation resulted in transactions between the two entities occurring without the administration first going through the appropriate processes to communicate and gain approval from the governing boards. Specifically, endowment funds totaling \$67 million, budgeted for use by the University, were loaned to the Foundation and an affiliate organization without prior notification to, or approval by, the UofL Board. Although the former President had authority to enter into contracts on behalf of both the Foundation and the University, unilaterally authorizing loans to ULF or its affiliate organizations, without prior notification or approval from the UofL Board caused concern among UofL Trustees, ULF Directors, and donors.

Recommendations: We recommend the University refrain from loaning its funds to the Foundation and its affiliates.

We recommend the UofL Board consider revising its Short-Term Investment Guidelines policy to again require annual reporting on the status of short-

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term investment funds by the UofL Senior Vice President (SVP) for Finance and Administration. We further recommend the University administration ensure any discussion involving “cash management strategies” and short-term investments be vetted by the SVP for Finance and Administration.

We recommend the ULF Board and the UofL Board each establish a policy establishing criteria for reporting financial activity to each board. The policy should include criteria such as the type of activity, dollar threshold, and limitations. The policy established by each board should be formally documented in writing, along with details noting the purpose of the presentation, the frequency, the level of detail to be reported to the board, and by whom reports should be presented.

Finding 5: Action taken by the former UofL and ULF President to appoint an acting Chief Administrative Officer appears to violate ULF Bylaws.

Action taken by the former UofL and ULF President to appoint an acting Chief Administrative Officer (CAO) for the Foundation, as well as the action to provide for additional post-employment benefits associated with this appointment, appears to violate ULF bylaws. Without formal action taken by the ULF Board, the former UofL and ULF President appointed the former UofL Chief of Staff to the position of acting CAO, a position the president is assigned in the ULF bylaws. Though it was indicated that members of the ULF Board Executive Committee were aware of the intended appointment, such action had not been formally introduced or acted upon by the full ULF Board or any ULF committee. Taking such action without following proper protocol is particularly questionable in light of ongoing public concerns regarding the accountability, transparency, and governance of ULF. Although the letter does not award the former UofL Chief of Staff with additional salary to perform these CAO duties, the former President awarded the former Chief of Staff six months of administrative leave at her current salary plus her deferred compensation if she leaves ULF involuntarily for reason other than for cause.

Recommendations: We recommend the ULF Board and President abide by the ULF bylaws in all matters, including the appointment and compensation of ULF officers. The ULF Board should ensure appropriate checks and balances are put into place to avoid situations in which a single individual has the ability to take actions beyond those authorized. As such, we recommend the ULF Board not knowingly approve, ratify, or allow its president to take actions that are in contravention of the bylaws.

We recommend the ULF Board designate a committee of its body to annually review the ULF bylaws to determine whether updates are needed. After the review is performed, the committee responsible for performing the review should report the review results to the full ULF Board.

Finding 6: The ULF Board compensated the former UofL President beyond the amount approved by the UofL Board and beyond the amount provided under the terms of his contract.

The ULF Board compensated the former UofL President beyond the amount approved by the UofL Board and beyond the amount provided under the terms of his contract. During an annual review of the UofL President’s progress in meeting board-established goals in July 2014, the University Compensation Committee recommended a 2% merit increase to the UofL President’s salary. This same 2% merit increase was communicated and recommended to the Foundation as part of its compensation review of the President. Rather than accepting this recommendation by the UofL Board, the ULF Board then approved a 4% merit increase for the President in his ULF capacity and an additional 2% increase to the President in his UofL capacity, all to be paid by Foundation funds.

Recommendations: We recommend the ULF Board refrain from taking any actions that exceed its authority, such as increasing the President’s university salary without an official recommendation from the UofL Board. Further, any offer from the ULF Board to assist beyond what was requested from the UofL Board should be considered and acted upon by the UofL Board in compliance with University Bylaws. We further

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recommend the ULF Board compensate its president in compliance with established contract terms.

Finding 7: The University CFO was not included in meetings of the ULF Board Finance Committee in violation of its bylaws and in direct conflict with his contract with the Foundation.

The SVP for Finance and Administration, who also serves as the University CFO, was not included in meetings of the ULF Board Finance Committee in violation of its bylaws and in direct conflict with his contract with the Foundation. The Foundation bylaws establish the University CFO as an ex officio member of the ULF Board Finance Committee. In addition, his contract with the Foundation requires the University CFO, during his term of employment at the University, to provide assistance and support as indicated by the Foundation bylaws. The failure to involve the University official primarily responsible for the financial affairs of the University further impaired the accountability and transparency between the two entities.

Recommendations: We recommend the ULF Board structure its committees in accordance with the requirements established by its bylaws and that all ex officio members be properly notified of meetings. All committee members should review and be aware of their responsibilities. We further recommend the University CFO be appropriately involved in financial decisions directly impacting the University.

Finding 8: ULF Board members do not receive an orientation despite the growing complexity of Foundation operations.

ULF Board members do not receive an orientation despite the growing complexity of Foundation operations. The Foundation consists of approximately 14 affiliates with operations covering real estate holdings and developments, deferred compensation management, and management of a multi-million dollar endowment, yet there is no formal or defined board orientation provided for new Foundation Board members.

Recommendations: We recommend the ULF Board, in consultation with the Foundation administration, develop and implement a formalized orientation for new and returning board members. This orientation should provide members with a clear understanding of the Foundation and its affiliated entities, their role, as well as their legal and fiduciary responsibilities as board members.

We recommend the ULF Board consider having an independent party involved in the organization, structure, and content of the board orientation, with involvement from the board attorney to ensure topics such as legal agreements, conflicts of interests, open records and open meetings, and ethics are sufficiently covered. We recommend the material for the orientation be written and formally presented as a manual to assist the orientation process and serve as a useful resource tool to board members. Because of the dynamic nature of the Foundation, the orientation should be reviewed periodically to ensure all materials are current and applicable. This orientation should be made mandatory for all new directors, and the materials should be available to all directors.