3.10.3 The institution exercises appropriate control over all its financial resources.

The University of Louisville (UofL) exercises appropriate control over all of its finances. The Board of Trustees (BOT) oversees the university's system of internal control of financial resources. As specified in *The Redbook* 1.1.1, the Board adopts a budget annually [1]. *The Redbook* Section 2.1.2 states that the university president is the chief administrative and educational officer of the university [2]. The president prepares annual operating budgets [3] and recommends them to the BOT after consultation with appropriate university units and their administrators. The president also recommends a biennial budget [4] to the Kentucky Council on Postsecondary Education (CPE), with the approval of the BOT, and modifications of the budgets, as needed, to the Board of Trustees of the university.

In January 2017, Acting President Neville Pinto announced several interim appointments. To address the vacancy of the Senior Vice President for Finance and Administration, he established three interim positions: Chief Administrator Officer (CAO), Chief Financial Officer (CFO), and Chief Operations Officer (COO) [5]. The Chief Administrator Officer (CAO) reports directly to the president of the university and has oversight and managerial responsibility for all financial areas, including internal audit, and for human resources. The Chief Financial Officer (CFO) reports up through the CAO, and all of the unit-based Lead Fiscal Officers report up through the CFO. The Chief Operations Officer (COO) is responsible for Information Technology, Business Services, Facilities Management, and Public Safety. The Executive Vice President and University Provost also reports to the president and oversees strategic planning and budgeting in addition to academic duties [6].

Budget and Financial Planning

Since 1970 the university has employed a hybrid form of incremental budgeting to develop its annual general fund operating budget. General funds include state appropriations, tuition revenue, and other funds that can be used for any unrestricted purpose. Other components of the total operating budget for the university such as activities housed in the University of Louisville Research Foundation Inc. (ULRF), University of Louisville Foundation (ULF) Inc., and the University of Louisville Athletic Association Inc. (ULAA) are derived primarily using a "program budgeted" approach. This budgeting technique employs a projection of revenue for each activity with expenditures not to exceed revenues. The annual operating budget process includes meeting with university constituencies, identifying university-wide budget priorities and issues, and determining and disseminating overall budget guidelines to the university community [7].

The university's budget development and financial planning process includes preparation and oversight of the university's general fund and non-general fund budgets. The process includes the preparation and oversight of the budget for funds provided by the UofL Foundation (ULF). The ULF has been designated by the university to receive funds derived from gifts and other sources, including funds held in trust.

The president reviews the budget and presents it to the university's Board of Trustees with a recommendation for adoption. The Board of Trustees has final authority for approving all annual budgets.

Procurement and Expenditures

The university follows KRS 164A.560 [8], which authorizes public institutions of higher education and their affiliated corporations to perform the functions of acquisition of funds, accounting, purchasing, and capital construction. The department of purchasing derives its authority to sign contracts on behalf of the university from the Board of Trustees and from the Boards of the affiliated corporations, as regulated by KRS 164A.560.

External Audits

Per state statute KRS 164A.570 [9], the financial records for the university and its affiliated corporations are audited annually in accordance with Generally Accepted Accounting Standards (GAAS). Along with auditing the financial statements of the university and its affiliates, the external auditors evaluate the internal controls over financial activities. The results of the audit and internal control evaluation are communicated to the university and to the Audit Committee of the Board of Trustees. The Audit Committee reviews the results of the audit and recommends approval to the full Board of Trustees. Deficiencies that are considered significant, individually, or in the aggregate, are communicated in the form of a management letter. When control deficiencies are identified, the university administration reviews the issue and identifies the cause of the problem. Corrective action is identified and is included in the issued management letter and labeled as the "Management's Response," which is also communicated to the BOT committees. The university's most recent audit for the fiscal year ended June 30, 2016, did not identify any significant control deficiencies [10].

Internal Audit

The university maintains an internal audit function that reports functionally to the Chief Administrative Officer and administratively to the Board of Trustees Audit Committee. The function is governed by a board-approved charter and is charged with conducting routine and ad hoc reviews of internal controls of the university and its statutory affiliates, as well as assessing overall enterprise risk. The results of individual reviews, including findings, recommendations, management response, and action plans, are published to the Chief Administrative Officer, administration of the responsible department, and the Compliance Oversight Council (COC), a committee made up of senior administrators that provides an infrastructure to facilitate ongoing assurance that the institution is complying with internal and external laws, regulations, policies, and procedures. Pending issues are tracked until action plans are completed and the implementation is verified by internal audit staff. A summary of the status of pending issues is published bi-monthly to the Chief Administrative Officer and the COC.

Cash and Short-Term Investments

Financial control of cash assets begins with receipt of any negotiable instrument throughout the university, including cash, checks, or credit card payments. The university has delegated the responsibility of establishing cash handling procedures to the Controller, currently reporting to the Chief Financial Officer. This responsibility includes enforcing these policies and procedures, requiring establishment and maintenance of appropriate records, and performing periodic audits. The Controller's Office also establishes and authorizes banking accounts to be used for university finances.

Internally managed short-term funds are those funds for which use and disbursement are anticipated to occur within one to three years. The objective is to achieve and maintain a high degree of safety and liquidity and to maximize investment income based on investment strategies for repurchase agreements, money market funds, mutual funds, United States Treasury bills, and certificates of deposits. All short-term investments are subject to documented limitations. The Short-Term Investment Policy is implemented in accordance with Kentucky regulations related to type and term of instruments purchased on behalf of the university [11]. The Controller's Office is responsible for the day-to-day management of the investment of short-term funds and reports to the board on the status of the funds when requested. The university's Short-Term Investment Policy was revised in the spring of 2016 with the provision that the BOT would be updated as requested. In response to the Kentucky State Auditor's review, the university is instituting a routine, annual reporting on short-term investments as part of overall financial reporting.

Gifts and Endowments

University Advancement is the university's fundraising unit. It solicits, receives, and records gifts from donors. Endowment donations are invested in various asset classes and are intended to last in perpetuity. After the funds have been invested for one calendar year a portion of the income is available for use by university units based on the annual spending policy for endowments approved by the UofL Foundation's (ULF) Board of Directors. The ULF Accounting Department calculates the spending policy, and the amount is available to the units beginning in July. This amount is communicated to the university and loaded into the budget system, which makes it available for spending. The university is reimbursed by the foundation as

the budget is spent. Amounts that are not spent remain invested by the foundation at the end of the year.

Financial Transactions (as listed in 1/27/17 letter)

Dr. Wheelan's letter referenced the Kentucky State Auditor's Report and identified items of concern related to Comprehensive Standard 3.10.3. Additional information related to the Voluntary Separation Plan and the two agreements with the University of Louisville Foundation and the University of Louisville Real Estate Foundation follow.

Auditor Finding #2: Voluntary Separation Incentive Program (VSIP)

In spring of 2013, UofL announced a Voluntary Separation Incentive Program (VSIP) that would provide eligible faculty and staff a financial incentive to separate from employment status with the University [12]. The primary goals of the VSIP were threefold:

- At a time when state funding had been reduced, it enabled the university to reduce salary expenditures, which in turn helped the university to limit tuition increases, support strategic investments, and support salary increases for faculty and staff.
- It rewarded dedicated faculty and staff who have worked for years in support of UofL and who were interested in retirement but needed some assistance in making a transition from active employment to retirement.
- It provided senior leadership with the strategic opportunity to reorganize and reallocate faculty and staff positions across the university.

Table 1 details the program's incentives and separation dates.

Table 1. Voluntary Separation Incentive Program for Eligible Employees

Voluntary Separation Incentive Program for Eligible Employees			
Employee Type	**Incentive Pay**	**Health Plan**	**Separation from University**
Faculty	12 Months of Annual Base Salary	All employees who have not reached age 65 may continue to participate in the University's health plan until they become Medicare eligible. University will pay 50% of the health plan subsidy that applies to regular full-time employees for up to three years.	Generally will separate within 12 months of VSIP Activation Date
Administrators and Staff	6 Months of Annual Base Salary	All employees who have not reached age 65 may continue to participate in the University's health plan until they become Medicare eligible. University will pay 50% of the health plan subsidy that applies to regular full-time employees for up to three years.	Generally will separate within 6 months of VSIP Activation Date

The projected total savings from the VSIP initiative to the university's general fund was about $7.3 million. The total savings are cumulative from FY 2013 to FY 2016.

The pool of funds that could be used to support the VSIP buy-outs differed based upon the classification of the individuals who participated in the VSIP program. Faculty tenure rights could be bought out using either general or restricted funds; however, the university could not expend general fund dollars for the staff portion of the VSIP buy-outs, beyond payments for accrued sick and/or vacation leave, based upon the strict interpretation of Section 3 of the *Kentucky Constitution* (specifically, the private emoluments clause), which prevents the payment of state dollars to individual employees without receiving consideration in turn, either in the form of services or something else of value such as a release. In the case of faculty, the purchase of contractual tenure-rights meets that requirement. Specifically, the text of Section 3 is as follows, with the relevant language underlined:

> Section 3. Men are equal – No exclusive grant except for public services – Property not to be exempted from taxation – Grants revocable. All men, when

> they form a social compact, are equal; and no grant of exclusive, separate public emoluments or privileges shall be made to any man or set of men, except in consideration of public services; but no property shall be exempt from taxation except as provided in this Constitution, and every grant of a franchise, privilege or exemption, shall remain subject to revocation, alteration or amendment. *Text as ratified on: August 3, 1891, and revised September 28, 1891. History: Not yet amended. Private and local legislation prohibited, Const. 59; Property exempt from taxation, Const. 170.*

For this reason, the university employed ULF funds to achieve the goals of the staff portion of the VSIP.

Auditor Finding #4: Financial Transactions between UofL and ULF and ULREF

As noted in the Kentucky State Auditor's report, there were two agreements involving UofL and the UofL Foundation, one in 2014 and one in 2015.

The University of Louisville Board's of Trustees (BOT) regularly delegates and assigns signature authority to the university president and other officers to execute contracts on behalf of the university. The resolution approved by the BOT on February 16, 2017, granting this authority states:

> **WHEREAS,** the Interim President, or his designee (appropriately documented), Acting Executive Vice President/Provost, Interim Chief Administrative Officer, Interim Chief Financial Officer, Interim Chief Operating Officer, Interim Associate Vice President for Finance/Controller, and Director of Purchasing are officers or agents of the University of Louisville and are empowered to execute contracts on behalf of the University of

Louisville pursuant to their respective administrative duties, including contracts with federal and other governmental agencies.

The BOT resolutions for the signature authority of President James Ramsey, 2001 [13]; Acting President Neville Pinto, 2016 [14]; and Interim President Gregory Postel 2017 [15] and their respective deputies are provided.

As discussed in note 4 of the UofL and Affiliated Corporations Auditor's Report and Financial Statements for FY 2013-2014 [16], the university entered into a Memorandum of Agreement for a loan of $29 million to the ULF. This agreement, dated June 27, 2014 [17], was a one-year loan and was signed by former UofL president Dr. James Ramsey; Jason Tomlinson, ULF Chief Financial Officer (CFO); and Susan Howarth, the UofL Associate Vice President for Finance. In the agreement, the university loaned funds to the Foundation to support real estate activities related to the university's strategic goals as outlined in the UofL 2020 Plan and Tactical Goals [18]. In return, the university received 1 percent interest from ULF. According to the university's FY 2015 audited financial statements, the 2014 loan was fully repaid as of June 30, 2015 [19].

As discussed in note 5 of the UofL and Affiliated Corporations – Auditor's Report and Financial Statements for FY 2015-2016 [20], the university entered into a memorandum of agreement for a loan of $38 million to the ULREF, an affiliate organization of ULF, in the amount of $38 million. This agreement, dated July 1, 2015 [21], was a three-year loan and was signed by Dr. James Ramsey and Mr. Jason Tomlinson. Mr. Tomlinson also served as assistant treasurer to the UofL Real Estate Foundation (ULREF). The terms of this MOA included a 1 percent interest

return to the university. The ULREF repaid $28.2 million of the loan during fiscal year 2016, leaving a balance of $9.8 million as of June 30, 2016 per the repayment schedule.

The ULREF was established in 2014 to provide infrastructure for future acquisition, development, and management of real estate, primarily on the university's Belknap campus but also throughout the city, in support of the university. It also was established to help shield the endowment from potential liability for injuries or claims arising out of or on any of the properties.

Each agreement included an analysis of the financial benefit [22] to the university and to the foundation. The university always has cash reserves and must determine what, if anything, to do with that cash. There are times in which the loaning of the cash on a short-term basis is a good investment. In the case of the two separate loans of $29M and $38M respectively, the money was loaned to the ULF to enable the ULF to purchase properties for the ultimate benefit of the university. Some of the property the university already occupied under lease agreements through the ULF, and the loans allowed for the purchase of the property. The university was able to loan the money at a lower rate than the ULF would otherwise pay to a lending institution. In return the university not only collected interest but it also had the ability to use the land purchased for its benefit.

See Comprehensive Standard 3.2.13 for a discussion of the use of the funds and the relationship of the loans to the university's mission.

Summary

The institution's control over its financial resources is extensive and comprehensive. UofL's financial position is strong. As mandated by KRS 164A.570, the university hires a qualified firm of certified public accountants to perform an annual examination of the institution, which ensures a regular cross-check of stability. Institutional revenues continue to grow despite recurring reductions in state general fund appropriations. As illustrated in Table 2, the university's total net position is positive.

Table 2 –University's Net Position from FY 2014 to FY 2016

Statements of Revenues, Expenses and Changes in Net Position

The statements of revenues, expenses and changes in net position present the University's results of operations. Condensed statements of the University's revenues, expenses and changes in net position for the years ended June 30, 2016, 2015 and 2014, are summarized on the following page:

Condensed Statements of Revenues, Expenses and Changes in Net Position
Years ended June 30, 2016, 2015, and 2014
(In Thousands)

	2016	2015	2014	2016 - 2015 Change	2015 - 2014 Change
OPERATING REVENUES					
Student tuition and fees, net	$ 209,503	$ 209,834	$ 209,442	$ (331)	$ 392
Clinical services and practice plan	269,305	252,446	227,858	16,859	24,588
Grants and contracts	103,416	90,135	91,886	13,281	(1,751)
Facilities and administrative cost recoveries	24,611	22,596	21,965	2,015	631
Other	102,734	93,329	81,262	9,405	12,067
Total operating revenues	709,569	668,340	632,413	41,229	35,927
OPERATING EXPENSES					
Depreciation	51,295	53,339	56,333	(2,044)	(2,994)
Other	959,370	911,024	817,350	48,346	93,674
Total operating expenses	1,010,665	964,363	873,683	46,302	90,680
NONOPERATING REVENUES (EXPENSES)					
State appropriations	142,213	140,744	147,256	1,469	(6,512)
Other nonoperating revenues	171,794	168,052	92,164	3,742	75,888
Total nonoperating revenues	314,007	308,796	239,420	5,211	69,376
Increase/(decrease) in net position	12,911	12,773	(1,850)	138	14,623
Net position - beginning of year	706,580	693,807	695,657	12,773	(1,850)
Net position - end of year	$ 719,491	$ 706,580	$ 693,807	$ 12,911	$ 12,773

Source: UofL Consolidated Financial Statement FY 2015-16

As it relates to financial control at the institution, the UofL BOT regularly delegates and assigns signature authority to the university president to execute contracts on behalf of the university. As discussed earlier in 3.10.3, the president and authorized university administrators regularly sign financial agreements beneficial to UofL based on this delegated board authority. Also, UofL and the ULF conduct regular board orientations to ensure that members are aware of their legal and fiduciary responsibilities [23] [24].

Supporting Documentation

[1] *Redbook* 1.1.1, Board Adopts Annual Budget

[2] *Redbook* 2.1.2, Powers and Duties of the President

[3] UofL 2015-2016 Operating Budget – Table of Contents

[4] 2016-18 UofL Biennial Budget Request to the State

[5] Pinto Email on Interim Appointments

[6] UofL Organizational Chart 2017

[7] UofL FY 2017-18 Budget Development

[8] KRS 164A.560, Purchasing

[9] KRS 164A.570, Annual Audit

[10] UofL Audited Consolidated Financial Statement FY 2016

[11] Short Term Investments Guidelines

[12] Voluntary Separation Incentive Program (VSIP)

[13] Signature Authority 9-24-2001 (Ramsey)

[14] Signature Authority 9-22-2016 (Pinto)

[15] Signature Authority 2-16-2017 (Postel)

[16] Note 4 –FY 2013-14 UofL Audited Financial Statement, Page 37

[17] 2014 Memorandum of Agreement – University Receivable from ULF

[18] UofL 2020 Plan and Tactical Goals: 2014-15

[19] Note 4 –FY 2014-15 UofL Audited Financial Statement, Page 34

[20] Note 5 - FY 2015-16 UofL Audited Financial Statements, Page 37

[21] 2015 Memorandum of Agreement - University Receivable from the UofL Real Estate Foundation

[22] MOA Financial Benefits to the University Resulting from Loans to ULF/ULREF

[23] UofL Board of Trustees, Orientation

[24] ULF Board of Directors Orientation