

2. Current Status of SACSCOC Review of the University of Louisville

Background

The University of Louisville was continued on accreditation and placed on probation in December 2016 because SACSCOC's Board of Trustees determined that UofL had failed to demonstrate compliance with Core Requirement 2.2 (Governing board), Comprehensive Standard 3.2.1 (CEO evaluation/selection), Comprehensive Standard 3.2.4 (External influence), and Comprehensive Standard 3.2.5 (Board dismissal) of the *Principles of Accreditation*. The Board of Trustees of SACSCOC authorized a Special Committee to visit the institution. The university was tasked with submitting a monitoring report in September of 2017.

The Special Committee charged with assessing the university's compliance with the *Principles of Accreditation* visited the institution from September 19-21, 2017. The Special Committee submitted its final report on October 9. The committee's assessment of UofL's compliance with the relevant standards is summarized in this document.

The report of the Special Committee indicates that UofL has a legal governing body in its Board of Trustees; the Board of Trustees has specific authority over the institution; and the Board of Trustees meets all of the compliance expectations specified in the language of Core Requirement 2.2.

- The Board has at least five members.
- The Board is the legal body with authority over the institution.
- The Board is an active policy-making body of the institution.

- The Board is responsible for the financial resources of the institution.

Also, as documented by the Special Committee, the university has demonstrated that it is in compliance with the Comprehensive Standards outlined in the probation action: Comprehensive Standard 3.2.1 (CEO evaluation/selection), Comprehensive Standard 3.2.4 (External influence), and Comprehensive Standard 3.2.5 (Board dismissal) of the *Principles of Accreditation*.

Standards Cited in the Probation Action

Core Requirement 2.2 (Governing board)

The Special Committee report states:

The UofL has a governing Board of Trustees of 13 people, including ten individuals appointed by the Governor via a process described below. The board also has specific authority over the U of L.

The U of L Board of Trustees as presently constituted appears to be an active policymaking body for the U of L and appears to be ultimately responsible for ensuring that the financial resources of U of L are adequate to provide a sound educational program. This conclusion was reached as a result of: 1) KRS 164.830 (Powers of the Board), granting to the U of L Board of Trustees *“the usual corporate powers, and ... all the authorities, immunities, rights, privileges, and franchises usually attaching to the*

governing bodies of Kentucky public higher educational institutions. 2) KRS 164.830, also stating that the board is responsible for "Receipt, retention, and administration, on behalf of the university, subject to the conditions attached, [of] all revenues accruing from endowments, appropriations, allotments, grants or bequests, and all types of property": and 3) the U of L's The Redbook, the U of L's basic governance document, Sec. 1.1.2, (Powers of the Board), declaring:... the Board shall actively engage in policy making, be responsible for aiding the University to perform at a high level of excellence, adopt an annual budget and ensure that the financial resources of the University are sufficient to provide a sound educational program, and periodically evaluate the University's progress in implementing its missions, goals, and objectives.

A review of the newly-appointed U of L trustees indicates that the trustees appear to have been appointed in compliance with SB 12 and SB 107, and that the board appears not to be controlled by a minority of board members or by organizations or interests separate from it.

All U of L trustees including the presiding officer of the board have signed conflict of interest statements. A review of those statements shows that the presiding officer of the board and a majority of the voting members of the board are free of any contractual, employment, or personal or familial financial interest in the U of L.

Comprehensive Standard 3.2.1 (CEO evaluation/selection)

The Special Committee report states:

Both the Kentucky Revised Statutes (KRS) and the basic governance document of the U of L, *The Redbook*, make it abundantly clear that the U of L Board of Trustees is responsible for the selection and periodic evaluation of the U of L president.

The newly revised Bylaws of the U of L's Board of Trustees also make it evident that the board is aware of and understands these responsibilities. Indeed, the Board of Trustees has recently initiated the search for the new U of L president, with itself serving as the search committee.

Comprehensive Standard 3.2.4 (External influence)

The Special Committee report states:

The Governor's executive order to abolish the former board, and subsequently make new appointments, was inconsistent with SACSCOC expectations that institutions be able to operate without undue political influence in institutional governance. Legal changes have now partly insulated the board against this kind of interference in the future, with a process to insure proportional representation of the two largest political parties and of minorities. Moreover, the use of staggered terms insures against future governors achieving the same level of influence.

In the future the Governor may still unilaterally remove the entire board "for cause" by executive order..... In all cases, the Governor cannot act without prior review by the CPE [Kentucky Council on Postsecondary Education] and the issuance of a recommendation by the CPE. Additional protection against undue influence is found in the amendment requiring Senate confirmation of board members, (State Senate Confirmation of Governor-Appointed Board Members: SB 12, Section 1 [52], and SB 107, Section 8(1) [53] amended KRS 164.821); this confirmation requirement did not exist previously.

Comprehensive Standard 3.2.5 (Board dismissal)

The Special Committee report states:

In early 2017 the Kentucky General Assembly enacted SB 12 and SB 107 establishing a process for the Governor to remove at-large individual trustees and to remove the entire at-large board for cause and to remove at large trustees if proportional representation on the board required by law is not in compliance, compliance being relative to minority representation and political affiliation. The legislation also allows a majority of the board of trustees to recommend to the governor the removal of a member for cause.

The U of L Board of Trustees' dismissal policy is aligned with the legislation enacted by SB 12 and SB 107 and makes provision for the removal of board members for appropriate cause and by fair process.

Additional Standards

The five standards identified by the SACSCOC staff after the probation action and added to the scope of the Special Committee review are:

Comprehensive Standard 3.2.3 (Conflict of Interest)

The Special Committee report states:

The governing board has numerous policies in its bylaws and in *The Redbook* addressing conflict of interest for its members. The new U of L Board of Trustees has engaged in a comprehensive review of policies related to conflict of interest, many of which existed prior to compliance being questioned. For example, a Code of Conduct which includes "promoting a culture of compliance" was approved by the board in 2009.

Existing policies have been reviewed and revised and new policies such as a new board statement affirming the board's intention to maintain a robust policy on conflicts of interest was adopted on May 18, 2017, effective June 1, 2017. Each board member is also required to sign and return a statement that either affirms that he or she has no conflict of interest, or identifies potential and actual conflicts of interests. Each board member has complied with this policy. There is also a stringent conflict of interest review during the Senate confirmation hearings.

Related item - The Special Committee report stated in their review of CR 2.2:

All U of L trustees including the presiding officer of the board have signed conflict of interest statements. A review of those statements shows that the presiding officer of the board and a majority of the voting members of the board are free of any contractual, employment, or personal or familial financial interest in the U of L.

Comprehensive Standard 3.2.8 (Qualified Administrators)

The Special Committee report states:

Although, the Board of Trustees has established term limitations and procedures regarding interim appointments, the proportion of leadership that is interim poses a challenge. Per the U of L's narrative, "nine of the 12 senior-level positions within the Office of President are interim appointments. This may make the kind of planning and decision-making that this difficult time requires particularly challenging. Moody's Credit Opinion (November 2016) also notes under "Credit Challenges" that "Ongoing transitions in Governance and leadership distract from strategic priorities and created reputational risks. It is in the fiscal interest of the university to address the need for permanent leadership quickly.

Recommendation 1: The committee recommends that the institution provide evidence that it has qualified administrative and academic officers with the experience and competence to lead the institution.

Special note [From the Committee]: Although the Special Committee is making a recommendation related to Comprehensive Standard 3.2.8 (qualified administrative and academic officers), we wish to acknowledge that Interim President Postel has made significant progress since assuming the interim presidency and appears poised to make additional meaningful progress in the near future. We also acknowledge that U of L has several searches underway to fill positions that are currently filled on an interim basis, including the presidency.

Comprehensive Standard 3.2.13 (Institution-related Entities)

The Special Committee report states:

During calendar year 2017, the institution initiated changes to demonstrate that the President is in control of fund raising in regards to the University of Louisville Foundation. The committee reviewed the July 1, 2017 Memorandum of Understanding (MOU) with the University of Louisville Foundation, and the March, 2017 revised University of Louisville Foundation by-laws. The changes to the by-laws of the University of Louisville Foundation clarified the relationship between the parties. Clear lines of separation of activity are articulated in both of the documents. Prior concerns with the relationship and influence of the University of Louisville Foundation were addressed in the MOU.

The forensic audit conducted of the University of Louisville Foundation identified significant weakness in operating controls and leadership. The committee confirmed the nature of the findings in interviews with members of the forensic audit team.

The committee requested a copy of the Memorandum of Understanding or similar document with the University of Louisville Real Estate Foundation, Inc. The University of Louisville Real Estate Foundation Inc. has been separated from the University of Louisville Foundation since the beginning of the reaffirmation process. The institution could not provide an appropriate document. It was not possible to assess the compliance with the criteria for this entity.

Recommendation 2: The committee recommends that the institution demonstrate that it has a signed, clear, formal written agreement with the University of Louisville Real Estate Foundation. Inc, that conforms to all the expectations of the standard.

Comprehensive Standard 3.10.1 (Fiscal Stability)

The Special Committee report states:

The Committee reviewed the institution's last five audited financial statements, 2016-2017 draft financial statements approved by the institution's Board of Trustees on September 15, 2017, the foundation's draft 2016-2017 financial statements, and the

institution's and foundation's 2017-2018 Operating Budget. The committee also held interviews with the institution's personnel, foundation personnel, and both institution and foundation external auditors.

In FY 2017, the institution and foundation implemented steps to ensure that support provided by the foundation did not exceed foundation funding sources. As a result, and as indicated by the draft financial statements noted above, contributions from the foundation to the institution were reduced by \$39.5 million compared with the prior year and resulting in foundation and affiliates' consolidated unrestricted net assets increasing by \$5.6 million to a total of \$8.9 million. During FY 2017, the net position of the institution and the net assets of the foundation increased by \$28.7 million and \$42.9 million respectively. During an interview with the committee, the institution's auditor (Crowe Horwath) indicated, without solicitation, that it did not expect a material difference between draft version and the final audited versions. The audited financials are expected to be presented to the institution Board of Trustees October 18, 2017. Contributions from the foundation have been limited to \$30.2 million in the institution's FY 18 budget.

The institution's financial stability also benefits from diversified revenue streams, with no single source accounting for more than 34 percent of revenues from FY 2012 to FY 2016, and from stable enrollment. Multiple interviews confirmed that new procedures are being implemented; an example is tighter controls on filling faculty positions.

Comprehensive Standard 3.10.3 (Financial Control)

The Special Committee report states:

During calendar year 2017, the institution initiated changes to demonstrate that it is in control of its finances. Prior specific concerns with the relationship and influence of the University of Louisville Foundation were addressed in a revised Memorandum of Understanding (MOU) that became effective in July 2017. The committee reviewed minutes and other documents demonstrating that the understandings in the MOU are being carried out. Specifically, the fiscal 2018 budget contains an amount of Foundation support that was agreed upon in meetings between the parties. The institution Is receiving a 4.09% spend rate on endowments based on the three-year moving average of the market values of the endowment as of the three previous calendar year-ends, recorded each December 31st. This should allow the Foundation to protect the corpus of its endowments.

The committee was presented with draft 2017 financial statements for both the Institution and the Foundation. The committee also interviewed the external auditors of both the institution (Crowe Horwath) and the Foundation (Ernst and Young.) The institution's auditor indicated, without solicitation, that they did not expect a material difference between draft version and the final audited versions. The audited financials are expected to be presented to the Institution Board of Trustees October 19, 2017. The preliminary financial statements for the institution show an increase in net position of \$28.7 million.

Internal controls, both general and specific, are in evidence. The committee reviewed minutes of the March 16, 2017 Board Resolution entitled "University Financial Transactions." The item described the process by which the president is to submit the annual operating budget to the Trustees, and for its review and adoption by the board. It also provided, among other reporting requirements, that "The full Board of Trustees and appropriate Board of Trustees committees shall receive a report annually on: (a) the University's audited annual financial reports; (b) a budget-to-actual analysis; (c) the financial support provided by the University of Louisville Foundation, Inc. and its affiliates; (d) the status of the University's long-term debt obligations; (e) any change in the rating or outlook assigned to the University's debt by any rating agency; (f) [and] the receipt of gifts and pledges ... " The committee review of the 2018 budget process and subsequent Board minutes seemed to provide evidence of the institution's compliance with Board of Trustees expectations.

There is acceptable separation of duties for financial transactions. Eighty-five percent of all accounts are reconciled monthly. Automated controls over payroll are relied upon by the external auditors for control based testing. Training and written procedures support existing controls.