

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



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December 14, 2016

Dr. Neville G. Pinto, President
University of Louisville
102 Grawemeyer Hall
2301 South 3rd Street
Louisville, KY 40292

and

Brucie Moore, Board Chair
University of Louisville Foundation
102 Grawemeyer Hall
2301 South 3rd Street
Louisville, KY 40292

Dear President Pinto and Chairperson Moore:

The Auditor of Public Accounts (APA) has completed its governance examination of the University of Louisville Foundation (ULF) and its relationship to the University of Louisville (UofL). This report summarizes the procedures performed and communicates the results of those procedures.

As part of this examination, the APA reviewed information related to the governance and oversight of ULF, such as policies, procedures, and council board meeting minutes. The APA also analyzed financial information, such as budgetary processes and information, vendor contracts and related payments, financial statement audits, and other financial transactions; and interviewed relevant parties, including the former President of ULF and UofL, UofL and ULF chief financial officers, the former President's chief of staff, and various members of the UofL Board of Trustees and ULF Board of Directors. The initial examination period of this engagement was July 1, 2012 through June 30, 2015; however, due to significant events impacting ULF governance since June 30, 2015, the examination was expanded as needed in order to keep the analysis current.

The purpose of this examination was not to provide an opinion on financial statements, but to review specific issues brought to our attention related to governance practices and concerns related to limited accountability and transparency of certain aspects of the ULF operations. The purpose of the examination is also to provide

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Dr. Neville G. Pinto, President

Brucie Moore, Board Chair

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recommendations to address weaknesses discovered during the examination. Detailed findings and recommendations based on our examination are presented in this report to assist all parties involved in evaluating board governance and operational policies and practices to achieve appropriate accountability and transparency. Serious weaknesses were identified that impact the governing practices of ULF. These weaknesses included:

- Delays and inconsistencies in information provided, which, along with numerous open records violations, validated concerns of poor transparency;
- Poor segregation between the administrative operations between UofL and ULF, resulting in ineffective governance practices and management having too much influence without appropriate checks and balances;
- A dysfunctional governing climate due to excessive board conflicts;
- Endowment funds used for loans to ULF and an affiliate without appropriate notification to and approval of the UofL Board of Trustees;
- The appointment of an acting ULF Chief Administrative Officer without appropriate authorization from the ULF Board of Directors; and
- Compensation provided to the former UofL and ULF President greater than amounts approved by the UofL Board of Trustees.

We appreciate your assistance, and the assistance of your staff and members of UofL and ULF Boards throughout the examination. If you have any questions or wish to discuss this report further, please contact me or Libby Carlin, Executive Director, at (502) 564-5841.

Sincerely,

A handwritten signature in dark ink, appearing to read "Mike H", with a long horizontal stroke extending to the right.

Mike Harmon

Auditor of Public Accounts

cc: Dr. Laurence N. Benz, Chairman, University of Louisville Board of Trustees



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

Executive Summary (Continued)

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.

Executive Summary (Continued)

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-

Executive Summary (Continued)

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

Executive Summary (Continued)

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.

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Introduction and Background

Impetus and Timeline of Examination

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.

An initial documentation request was submitted to the then UofL and ULF President on July 24, 2015; however, several key items requested remained outstanding as of November 2015. On November 3, 2015, a new Auditor of Public Accounts was elected, taking office on January 4, 2016. Because the governance examination would not be completed prior to the end of the year, the APA's work was temporarily suspended to allow the new administration to consider the matter further.

On January 11, 2016, the ULF Board of Directors (ULF Board) Chair at the time requested the APA proceed with a review of governance practices between the Foundation and the University. On February 18, 2016, the APA submitted a letter to the former UofL and ULF President announcing it would continue with the examination, focusing on the existing oversight and operating procedures between the University and the Foundation. According to the letter, the primary objective of this examination was to evaluate whether the governance and oversight structure established between the UofL Board of Trustees (UofL Board) and the ULF Board is sufficient to ensure accountability and transparency of Foundation spending as it relates to UofL activities. In addition the APA would perform benchmarking research with other colleges and universities.

Through its letter dated February 18, 2016, the APA provided the University and Foundation with an estimated cost of the examination contingent upon the "complete and timely cooperation from the University and the Foundation." With fieldwork beginning in late February 2016, it was initially anticipated the examination report would be completed and released by early June 2016.

On May 3, 2016, the APA submitted a letter to the Foundation and University stating "the estimated timeframe for completion [of the examination] was dependent upon...full cooperation and no significant structural changes... [I]n many instances, information and documentation provided has been unclear or inconsistent, which creates the need to perform more follow-up, verification, and clarification procedures than is typically required. As a result, the early June report release date is no longer feasible."

**Scope and
Methodology for
Examination**

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, including both current and former UofL and ULF Board members, the former UofL President, who also served as the ULF President until September 16, 2016, and various other University and Foundation personnel. Thousands of documents, including emails; reports; supporting documentation and schedules; and policies provided by UofL, ULF, and others were examined and analyzed in relation to the objectives.

In addition to information obtained directly from the University and Foundation, we also 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.

**University of
Louisville**

UofL was organized in 1846 and became a state supported metropolitan research university in 1970. It is located in Kentucky's largest city of Louisville and is a component unit of the Commonwealth of Kentucky. The University is made up of 12 individual schools and colleges, and as of academic year 2015, had a student body of 22,922 and a faculty and staff of 6,863. The operating budget for fiscal year (FY) 2016 was \$1.2 billion. In 2012, the University became a member of the Atlantic Coast Conference.

UofL consists of three campuses: the Belknap Campus houses eight of the University's 12 colleges and schools; the Health Sciences Center is located in downtown Louisville and houses the University's health related programs and the University of Louisville Hospital; and the Shelby Campus, located in eastern Jefferson County, houses the National Crime Prevention Institute, the Center for Predictive Medicine regional bio-safety lab and the Division of Distance and Continuing Education. UofL also offers expanded campus courses off-site and at international locations.

***UofL Board of
Trustees***

The University is governed by a Board of Trustees (UofL Board) whose composition is prescribed by Kentucky state law. Kentucky Revised Statute (KRS) 164.821(1), states, in part:

The government of the University of Louisville is vested in a board of trustees appointed for a term set by law pursuant to Section 23 of the Constitution of Kentucky. The board shall consist of seventeen (17) members appointed by the Governor; one (1) member of the teaching faculty of the University of Louisville who shall be the chief executive of the ranking unit of faculty government; a member of the permanent staff of the University of Louisville who shall be the chief executive of the staff senate; and a student member who shall be the president of the student body during the appropriate academic year.

On June 17, 2016, the Kentucky Governor, by executive order, removed all 17 gubernatorial appointees to the UofL Board and reorganized the UofL Board with 10 gubernatorial appointees. At the same time, the now former UofL President agreed to resign his position as UofL president contingent on presenting his formal resignation to a newly appointed Board of Trustees. The Governor then, also by executive order, appointed three interim Trustees to serve until the 10 Trustees could be selected from a slate of 30 candidates to be submitted to him by the Council on Postsecondary Education Nominating Committee. On June 29, 2016, the Governor appointed 10 new Trustees to the UofL Board. On July 27, 2016, the newly formed UofL Board met and accepted the now former UofL President's resignation. As part of his resignation agreement, the former UofL President was provided a payout of \$690,542.

The Attorney General, on June 22, 2016, petitioned the Franklin Circuit Court for an injunction to block the UofL Board reorganization and challenged the Governor's authority to reorganize the board. The Franklin Circuit Court granted an injunction on July 29, 2016 which reinstated the original 17 Trustees removed by the Governor. The reinstated Trustees then proceeded to ratify actions taken by the previous 10 Trustees, including the acceptance of the former UofL President's resignation. The Franklin Circuit's decision has been appealed, and the appeal is pending as of the date of this report.

**University of
Louisville
Foundation**

ULF is an independent 501(c)(3) not-for-profit organization established in 1970, prior to the University becoming part of the state supported system of higher education. It is a fundraising corporation that holds, invests, and designates gifted and endowed funds on behalf of the University. As found in the Articles of Incorporation for the Foundation, Article III paragraph 1:

The Corporation shall conduct and carry on its work, not for profit but, exclusively, for the charitable and educational purposes of the University of Louisville, a body politic and corporate, in such manner that no part of the Corporation's income or property shall inure to the private profit of any donor, member, trustee, or individual having a personal or private interest in the activities of the Corporation.

According to its 2015 federal tax Form 990, the Foundation's mission is stated as:

The University of Louisville Foundation (Foundation) exists to support the academic, scholarly, research and community engagement activities of the University of Louisville (University) and to assist the University in becoming a national top tier metropolitan research university. Since its inception in 1970, the Foundation has supported the efforts of the University to attract outstanding students and to bring the world's top scholars and scientists to Kentucky. Investment in the University is increasingly critical as State support for higher education continues to decline. Although State budget cuts are challenging, the University remains a leader among colleges and universities in Kentucky.

*ULF Board of
Directors*

ULF is governed by a 15-member Board of Directors whose members each serve three-year terms. A majority of the ULF Directors are not also members of the UofL Board or officers or employees of the University. However, four trustees on the UofL Board are appointed by the UofL Board Chair to serve on the ULF Board in an effort to facilitate a cohesive direction for both Boards and communication between the two Boards. Although not a formal policy, to further support transparency and alignment with UofL goals, it has become practice that the Chair of the ULF Board also be a trustee of the UofL 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.

Foundation Support

The Foundation's policy is that all gifts and contributions received are held in trust for University benefit. Foundation funds received from donors are invested and managed in support of University education, research, and service goals. These contributions are to be used for scholarships, endowments, research chairs, grants and other academic initiatives. Gifts to the University are also managed by the Foundation and are to be used according to the wishes of the donor and the appropriate University departments. Gifts without restrictions are managed at the discretion of the ULF Board upon recommendation by the ULF President.

*Foundation
Financial Activity*

The Foundation's audited financial statements are consolidated and include financial activity for ULF, its affiliates, and amounts paid to or on behalf of the University. ULF affiliates included in the consolidated financial statements are explained later in the "Foundation Affiliates" section of this chapter.

Introduction and Background

The Foundation reported six sources of revenue in its FY 2015 audited financial statements: gifts, investment income, endowment income, residence hall income, real estate income, and other revenues. Also within its FY 2015 audited financial statements, the Foundation reported a loss on investments and an actuarial loss on annuity and trust obligations totaling \$4.8 million. The total revenues reported in FY 2015 were \$77,653,000. Gift revenue was the largest source of revenue for FY 2015, including \$27.8 million reported as unrestricted, \$10.8 million as temporarily restricted, and \$10.4 as permanently restricted. Both temporarily and permanently restricted gifts carry donor stipulations that limit their use.

The Foundation's FY 2015 financial statements reported \$10.5 million in other revenues and \$9.4 million in endowment income. Residence hall income and real estate income were reported as \$7.6 million and \$4.8 million, respectively.

The Foundation also reported six classes of expenses totaling \$124.2 million in its FY 2015 audited financial statements: contributions to various University departments, University of Louisville Real Estate Foundation (ULREF) and others; payments to or on behalf of the University; interest expense; residence hall operations; real estate operations; and general and administrative expenses. Contributions to various University departments, ULREF and others was the largest class of expenses at \$73.9 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.

Endowment

The University endowment managed by the Foundation had an approximate value of \$662 million, according to Foundation personnel, as of June 30, 2016. As of mid-September 2016, there were 117 individual investments that make up the endowment. In 1995, the ULF Board approved an investment change from a traditional 60% stocks and 40% bonds mix to a more diversified investment strategy. The Foundation claims this diversified portfolio of investments has led to their endowment pool of investments exceeding the returns of its peers and the S&P 500. Endowed funds consist of donor-restricted gifts, both permanently and temporarily restricted, and unrestricted gifts. The endowment is comprised of donations from various philanthropic individuals and groups, state funds, and unspent earnings. 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.

Initially, APA auditors were not able to confirm these totals using the Foundation’s audited financial statements. The annual market valuation of the endowment provided by the Foundation on September 22, 2016 was greater than amounts reported in the ULF audited financial statements for fiscal years 2010 through 2015. The Foundation’s Chief Financial Officer (CFO) explained the Foundation does not receive statements from its investment managers at the same time for all of the 117 individual investments making up the endowment. Therefore, some individual investments included in the financial statement audit valuation are not current market values. An explanation provided later by a liaison hired by the Foundation to assist with the examination explained that all investment statements are considered by the independent CPA conducting the Foundation annual financial statement audit, but the amounts are not revised as the variances are considered below the audit materiality levels. Although analysis of these discrepancies was outside the scope of our governance review, we felt it important to bring these inconsistencies to the attention of interested parties. See Table 1 for details.

Table 1: University Endowment Market Values

Fiscal Year ending June 30	Reported in Annual Audit*	Reported by Foundation CFO to APA*
2009	\$572	\$593
2010	644	673
2011	748	773
2012	703	721
2013	742	764
2014	824	845
2015	800**	801
2016	739	662

Source: Auditor of Public Accounts based on the Foundation’s audited financial statements for FY 2010 through FY 2016 and information provided by Foundation personnel. The audited financial statements for FY 2016 are pending approval of the full ULF Board as of the date of this report.

*All amounts are shown in millions.

**The FY 2015 audited financial statements reflected an endowment market value of \$792 million. This value was restated in the FY 2016 audited financial statements as \$800 million.

Endowment Spending

The Foundation spending policy is to annually calculate a spend rate, which will be used to determine the amount of endowment funds distributed to the University each year. The spend rate is applied to the endowment funds balance to determine the annual amount of earnings to be contributed by the Foundation to the University. According to the Foundation’s FY 2015 spending policy, the spend rate is based on a “three-year moving average of the market values of the endowment using the three previous calendar year-ends as recorded each December 31st.” For FY 2012, FY 2013, and FY 2014, the ULF Board modified the spending policy to offset adverse market performance in an effort to increase availability of funds to the University from the endowment. This modification allowed the Foundation to exclude the worst performing year from the calculation, and instead apply the spend rate to an average of the two highest market values of the past three years.

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.

Table 2 presents the amounts reported by the Foundation as available for spending and carryover funds available for use by the University between FY 2012 and FY 2016. The column labeled “Available for Spending” is the calculated 5.5% spend rate of endowment earnings made available for spending by individual University colleges and programs each year. The “Carryover Funds” column represents those cumulative funds from prior years’ endowment allocations that were not spent in those periods, and as such currently remain available for spending.

Table 2: Annual Amounts Available for University Spending and Annual Carryover

Fiscal Year	Available for Spending*	Carryover Funds*
2012	\$35.7	\$38.9
2013	33.5	49.3
2014	32.1	47.8
2015	38.5	37.5
2016	39.1	45.2

Source: Auditor of Public Accounts based on the Foundation’s 2015-2016 Operating Budget.

**All amounts are shown in millions.*

Foundation Affiliates

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

- ULH, Inc. established April 2001
- University Holdings, Inc. (UHI) established September 2007
- University of Louisville Development Corporation, LLC (ULDC) established September 2007
- Nucleus: Kentucky’s Life Sciences and Innovation Center, LLC established February 2008
- MetaCyte Business Lab, LLC established June 2002
- MetaCyte Equity Holdings, LLC established February 2006
- AAF-Louisville, LLC established February 2008
- KYT-Louisville, LLC established February 2008

- Phoenix Place-Louisville, LLC (PPL) established April 2009
- Louisville Medical Center Development Corporation (LMCDC) established October 2008
- Minerva-Louisville, LLC established September 2011
- The Nucleus Real Properties, Inc. (TNRP) established July 2013
- CCG, LLC established December 2013
- DCPA, LLC established May 2014

According to the Foundation's FY 2016 audited financial statements, certain entities listed above "were contributed to the University of Louisville Real Estate Foundation, Inc. (ULREF) during the year ended June 30, 2016 by assignment of membership interest." ULREF is reported in the Foundation's FY 2016 audited financial statement notes as "an unconsolidated affiliate of the University of Louisville."

*Tax Increment
Financing*

A tax increment financing (TIF) participation program is an economic incentive using the incremental increase in local and state tax revenues generated within a defined development district to finance certain costs of a qualified project. The Commonwealth of Kentucky implemented the TIF program by way of KRS Chapter 154.30. The TIF program is designed to assist with the economic development of identified areas of need. The TIF plans require investments of capital and improvements to a defined area to benefit that area economically. Future tax gains from the defined area resulting from the improvements are then earmarked and passed on to the investing entity of the TIF.

As noted above, the Foundation utilized TIFs to diversify into real estate investments. The purpose of the TIFs identified and activated by the Foundation is to encourage the University to become an economic driver for the city, state, and region by developing property within the defined areas of each TIF. Prior to drawing, or activating funds, there must be a certain amount of capital improvements within the defined TIF district. The Foundation currently has three Signature TIFs, as defined in KRS 154.30-050: Belknap Engineering and Applied Sciences Park TIF, Louisville Health and Life Sciences TIF, and ShelbyHurst Research and Office Park TIF.

Belknap Engineering and Applied Sciences Park Signature TIF, valued at \$1.2 billion and covering 980 acres, was approved in 2012. Capital improvements of \$200 million activated the TIF in 2014. According to its 2015-2016 operating budget, the Foundation will receive 80% of the incremental state and local tax revenues generated over the 30 year term of the TIF.

Introduction and Background

The Louisville Health and Life Sciences Signature TIF, approved in 2007 and located in downtown Louisville, is valued at \$2.5 billion and covers 210 acres. This TIF district has a 30 year term and includes the Health Sciences Campus and the J.D. Nichols Campus for Innovation & Entrepreneurship as well as the surrounding blocks in the downtown area. Capital improvements of \$150 million activated the TIF in 2012. Per its 2015-2016 operating budget, the Foundation has received over \$14 million from this TIF alone.

ShelbyHurst Research and Office Park Signature TIF was granted final approval in 2014 for a 253 acre area valued at \$450 million. The TIF required a \$200 million capital investment in improvements to activate, which has not yet been met. According to its 2015-2016 operating budget, the Foundation will receive 80% of the incremental city and state tax revenues generated over the 30 year term of the TIF.

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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. Additionally, during the examination period, these concerns regarding the lack of appropriate transparency were further illustrated by multiple recent decisions of the Office of the Kentucky Attorney General (OAG) indicating the Foundation did not comply with open records laws.

Difficulties in obtaining documentation began in the earliest stages of the examination. Discussions early this year with the former President, former President's Chief of Staff, and Foundation CFO emphasized the importance of submitting complete, accurate, and timely information to keep the examination timeframe and cost reasonable. Auditors also offered time saving guidance, such as providing auditors read-only access to computer systems for viewing information rather than processing reports or printing hard copies. However, these recommendations were met with explanations that the University is not as electronically advanced in its accounting and record keeping as might be expected for an entity of its size, and that much of the information being requested was only available via hard copy and financial reports would need to be generated from multiple sources and compiled manually to make them meaningful.

Audit staff communicated these concerns, both verbally and in writing. In a letter dated May 3, 2016, the State Auditor notified the former UofL and ULF President as follows:

While we appreciate the professionalism shown in the meetings we have held with staff, our requests for documentation and other information have not been filled as quickly as we hoped. The majority of the documentation requested since our February meeting is still outstanding. Also, in many instances, information and documentation provided has been unclear or inconsistent, which creates the need to perform more follow-up, verification, and clarification procedures than is typically required. As a result, the early June report release date is no longer feasible.

The letter further advised:

Once the flow of information becomes more consistent and outstanding requests for documentation and information are filled, we will have sufficient information to revise our estimated timeframe.

Findings and Recommendations

Discrepancies in Expenditure and Vendor Payment Reports

An official revised estimated timeframe was not provided to the University or the Foundation as the flow of information did not become consistent until after a new interim UofL President and new ULF Board Chair were named, at which time action was taken to address the majority of outstanding requests.

While not a financial statement audit, some information requested for the governance examination included financial data to allow auditors to gain an understanding of the types of financial activities of the Foundation and to identify whether certain activity was properly reported to the Foundation or UofL Board. However, obtaining complete and consistent reporting of certain Foundation financial activity proved overly difficult. Also, on more than one occasion auditors were questioned by current and former members of the Foundation administration as to the relevancy of Foundation expenditure information in the performance of a governance examination.

Initial vendor summary payment reports provided by the University and Foundation appeared to contain duplicate data for the same fiscal year. In following up with the ULF Director of Budget and Accounting, she stated that the Foundation report was “a subset of the other [University] report, not separate.” However, auditors noted the Foundation report included vendors that were not included in the University report referenced, and also found instances where the Foundation report reflected a larger total payment amount for some vendors than the University reflected for the same time period, indicating that the Foundation report could not be a subset of the University report. Auditors also questioned the absence of a known vendor from both reports. In response to these discrepancies, the Foundation CFO provided a second set of vendor summary reports. The second set of reports contained additional discrepancies, including larger payment amounts to certain vendors than had been reported on either of the previous reports. In light of continued report discrepancies, auditors requested a full report of all fiscal year 2015 expenditures. Ultimately the Foundation was unable to provide this information, attributing the problem to the complexity of its accounting functions during that period of time.

According to the Foundation CFO and Financial Affairs staff, accounting for the Foundation and its affiliate entities has undergone a significant transition over the last three fiscal years. The accounting function for many of the affiliate organizations, such as AAF, MetaCyte, Nucleus, and UHI, had been outsourced to local CPA firms until fiscal years 2014 and 2015 when they were transitioned in-house. Prior to July 1, 2015, the Foundation itself utilized UofL’s accounting system, delineating its activity through certain fund and program codes. In addition, some affiliates were managed by third-parties and any related financial data would have been maintained in a separate system. However, even with these obstacles, it remained unclear why the Foundation CFO was unable to provide a complete detail of expenditures, or why as the CFO, he would not have readily available access to such information himself. This concern in and of itself raises questions as to whether the Foundation CFO had sufficient information to properly manage the financial operations of an organization of this size.

Findings and Recommendations

When examining a sample of ULF vendor contracts and associated correspondence and payments, auditors again questioned the completeness of documentation provided by the Foundation. While most vendor payments in this request were limited to payments made in FY 2015, the request included earlier years for payments made to a former ULF Board Director, who became a consultant to the Foundation following his resignation from that board in 2013. Foundation personnel provided documentation associated with the vendor sample in increments to auditors over a period of four months, requiring repetitive requests for complete information.

Information found with the documentation raised additional questions as to the completeness of the vendor records provided. On May 17, 2016, the Foundation provided the APA with the first set of records relating to the vendor sample. Contained within these records was a note which stated, in part: “[i]f any more info to add on [former ULF Board Director], we have and need to add @ discretion.” While most of the records provided at this point were invoices and payments to various vendors, the Foundation had only provided a single contract and two letters of correspondence with the former ULF Board Director detailing contract deliverables. Even though all of the vendor’s payment records and supporting documentation had been requested, this note and the lack of information provided to that point led to concerns that the Foundation was being selective in the records provided to the APA. Though eventually auditors were provided with payments to the former ULF Board Director for services rendered, along with supporting documentation including invoices, work summaries, and a second contract, for the period December 2013 through June 30, 2014, it took repeated requests to obtain the information. Due to the difficulties in obtaining this information, APA auditors questioned whether the information was complete.

Lack of Detailed Budget-to-Actual Reports

Another concern was raised from the attempt to obtain complete and consistent reporting of certain Foundation financial activity. In an attempt to understand basic Foundation financial activity, auditors requested detailed budget-to-actual reports from the Foundation. Auditors requested this information assuming that an organization the type and size of the Foundation would have this information readily available. However, the file provided by the Foundation to meet this request took weeks to create and did not provide budget-to-actual analysis as is typically presented by such a report. Rather, the file provided by the Foundation contained four separate spreadsheets for each of the three fiscal years of the examination period and did not agree to other reports provided by the Foundation.

Findings and Recommendations

The Foundation CFO first provided a detailed budget-to-actual report for the conjoined accounting systems of the University and Foundation and explained the majority of the Foundation budget is expended by University academic units. The expenditures of those budgeted funds are tracked by employees at the University, not the Foundation. For that reason, the spreadsheets were compiled by Foundation and University personnel specifically to fulfill our request and did not already exist. Despite a conjoined accounting system, auditors anticipated the Foundation would have its own operational budget and the amount provided to the University would be a line item in the Foundation's budget. It is concerning that the Foundation did not appear to have a working budget-to-actual analysis for use by its Board and administration.

While attempting to confirm the accuracy and completeness of expenditure reports, auditors found expenditures in the Foundation's vendor report that were not included in the Foundation's detailed budget-to-actual report. The detailed budget-to-actual report contained expenditure data coded to a series of specific program codes; however, the Foundation's vendor report included expenditures coded to program codes not included in the budget-to-actual report. Therefore, the budget-to-actual report was considered unreliable and useless for further analysis during the examination.

Additional Requests for Information

In addition to Foundation financial information, auditors encountered delays in obtaining other records, including Attestation and Disclosure Forms (ADFs) for select University employees. Auditors requested this information directly from the former President's Chief of Staff in March 2016, and had requested and discussed previously with her under the administration of the previous State Auditor. The Chief of Staff was the designated liaison for all audit requests at that point during the examination. In May 2016, auditors contacted the UofL Associate Vice President for Audit Services and Institutional Compliance for assistance in gathering the information and received direct contact information for the University personnel who maintain these records. Auditors were given access to the requested sample of ADFs within a 24-hour period of making contact with these University personnel.

Open Records Violations

While conducting this examination, the Foundation was the subject of nine Open Records Decisions (ORD) issued by the OAG from February 2016 through November 2016. The Foundation was found to be in violation of some portion of Kentucky's open records law on eight occasions. The APA has statutory authority other than open records law to access public records, but these ORDs reinforce our concerns regarding accountability and transparency related to Foundation operations. This is a significant operational area that needs improvement in order for the Foundation to regain public trust that it is operating in the best interest of the University.

Findings and Recommendations

The information presented in this finding reflects only illustrative examples of issues encountered during the examination and serves, in part, to provide insight as to the timing of this examination. While delays and inconsistencies encountered during this examination do not provide clear evidence of questionable activity at the Foundation, such issues do raise red flags and appear to validate why concerns have been expressed by others regarding the transparency of the Foundation and its affiliates. It should be noted that the UofL and ULF Boards have recently taken action, collectively, to engage a firm to conduct a forensic accounting review of the Foundation.

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. As part of this process, we recommend the ULF Board review the APA Recommendations for Public and Nonprofit Boards, which can be found on the APA website, and consider those that may be applicable to the Foundation.

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. This internal audit function can identify and communicate risks to the Board, providing it an opportunity to be proactive in addressing concerns. In developing this function, the ULF Board should consider utilizing the UofL Audit Services Department as a resource for developing the new function.

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. Until recently, the former UofL President's Chief of Staff and the Foundation CFO were employed by UofL, but they had been appointed as ULF officers.

Findings and Recommendations

The growth of the Foundation over the last several years was repeatedly acknowledged throughout interviews with UofL and ULF board members. The UofL Board Chair specifically noted that despite the growth of ULF, no structural changes have been made to the governance of that organization since its creation in 1970, calling into question whether the governance structure is appropriate for an organization of its size. The former President's Chief of Staff acknowledged the tremendous growth of ULF in recent years, and indicated that some of the concerns raised throughout the examination may be attributed to growing pains. This growth, along with the increasing complexity of the Foundation's activities, resulted in historical operating practices of the Foundation that are no longer effective for meeting the accountability and transparency objectives needed for proper governance.

Dual Role of UofL and ULF President

The dual administration of UofL and ULF has reportedly existed for years, predating the service of the now former UofL and ULF President. As the president of both organizations, the former President served as the chief administrative officer of each entity, managing the day-to-day operations of these legally separate entities. This dual role created inherent conflicts by concentrating a significant amount of authority in one individual. In these roles, the President not only had the responsibility of managing the University, but also influenced the percentage of endowment earnings provided to the University by ULF, including endowment funds budgeted to the President's office. Given that the University President is evaluated at least in part on meeting annual performance goals, this influence over endowment spending was too broad for proper oversight. This influence is especially concerning given the circumstances described below.

In addition to serving as ULF President, the former UofL President also served as a voting member on the ULF Board that hired him under a separate employment contract. This position also afforded him undue influence in the selection of the majority of the ULF Board who would later participate in conducting his annual performance evaluation as the ULF President. Ineffective communications with the UofL and ULF Boards were compounded by weak board practices at ULF, which often led to the former President operating without appropriate compensating checks and balances.

In accordance with ULF bylaws, the UofL president serves as an ex-officio member of the ULF Board with voting rights and as a member of the ULF Executive Committee. The ULF Executive Committee has the power of the full board, except for specific actions stipulated in the bylaws. In addition, the Executive Committee has been designated by the ULF Board as the administrator of the deferred compensation plan established to provide retention incentives for key Foundation and University administrators. As administrator of the deferred compensation plan, the Executive Committee has the authority to authorize plan participation. After a participant was approved by the Executive Committee to participate in the plan, the former President then had the authority to award amounts he deemed appropriate to key personnel, other than himself.

Findings and Recommendations

In addition to serving on the ULF Executive Committee, the ULF bylaws provide for the UofL president to serve as the Chairman of the ULF Nominating Committee. Serving in this capacity, the UofL president has significant input in the selection of members to the ULF Board, which employs and evaluates the Foundation president and also calculates and approves the University endowment spending. Also, although the ULF bylaws do not require the UofL president to serve as the Foundation president, there is nothing in the governing documents of either organization to prevent this from occurring.

It was noted during interviews with board members and administration staff that having one individual serving in both presidential roles assisted with aligning the trajectory and vision of the University with the actions of the Foundation, as well as streamlining processes. Administrative staff noted difficulties in implementing projects and securing partners at the University, explaining that projects see a faster turnaround when they are managed through the Foundation.

The overarching authority of the former President within both organizations appears to have led to poor management and governing practices, such as bypassing the UofL and ULF Boards, thereby limiting the governing Boards' involvement in and knowledge of certain administration actions. While the former President and others in his administration had authority to initiate and approve many actions independently for both the University and the Foundation, the method followed in implementing some of these actions and the explanations for why these actions were not explicitly reported or shared with others in the governing structure of the organizations is questionable. These questionable actions have led to other findings within this report, including: loans of millions in University budgeted funds to the Foundation and an affiliate without notification to, or approval from, the UofL Board or UofL Senior Vice President (SVP) for Finance and Administration (see Finding 4), and excluding the SVP for Finance and Administration in discussions of significant cash management strategies or other financial matters involving University and Foundation funds even though his contract and the ULF bylaws indicate he should be involved in these matters (see Finding 7).

In the benchmarking presented in Chapter 3, none of the respondents identified a governing structure between their university and foundation that involved the same individual acting as president of both entities. However, there were instances noted in which university presidents acted as foundation board members and participated on foundation committees. Further, a representative of the Association of Governing Boards (AGB) confirmed that "it is very unusual for an institution president to also serve as chief executive of an institutionally related foundation." (See Observation 4.)

Findings and Recommendations

UofL and ULF Staff and Resource Sharing

While the role of the Foundation is to support the initiatives of the University through availing additional financial resources to it, it is imperative that UofL and ULF have clearly defined roles and responsibilities and a mutual understanding of how the two organizations share resources to accomplish their mission. While bylaws for UofL and ULF lay out the responsibility of the two Boards and an agency agreement from 1996 was identified, these resources were not effective in providing sufficient clarity to the governing structure. Further, the agency agreement had not been presented to the UofL and ULF Boards since its initiation in 1996, impairing their ability to properly monitor compliance with the agreements. To be effective, such an agreement needs to be shared openly and utilized in policy considerations.

In addition to the former President, his Chief of Staff, and the Foundation CFO, eight other UofL employees were assigned to ULF full time, serving in the ULF Financial Affairs Office. Recent administrative actions were taken to move select University personnel to the employment of ULF. This occurred through resignations and retirements and involved the Foundation CFO, members of the ULF Financial Affairs staff, and at least one previous staff member of the UofL President's Office.

According to the Foundation CFO, the transfer of University personnel to the Foundation would have no impact on the University because the positions were already funded by the Foundation, and therefore, no information about this transfer would be communicated to the UofL Board. He indicated the only thing that would need to be reported to the UofL Board would be the retirement or resignation of a UofL Board appointed administrator. He also explained that because most of the transitioned staff were not board appointed administrators, their retirements and resignations were not required to be reported to the UofL Board. However, the resignation of the Foundation CFO from the University in July 2016, as well as, the subsequent retirement of the former President's Chief of Staff in August 2016 would be expected to be formally reported through a personnel report to the UofL Board. After a request was made in mid-September 2016 for documentation of this reporting to the UofL Board, it was discovered that the resignation of the Foundation CFO and retirement of the former President's Chief of Staff had not yet been reported. According to the UofL Board Liaison, the exclusion of these personnel actions from this report was an error and the reporting would be made in the September Personnel Report to the Board, which was subsequently presented through email to members of the UofL Board on October 18, 2016.

On August 12, 2016, the Foundation provided the APA with an agency agreement between UofL and ULF dated September 30, 1996, which outlines the basic agreement between the two legally separate entities to allow the Foundation to utilize UofL staff and designated UofL to serve as the Foundation paymaster. Under this agreement, the Foundation would be able to utilize UofL personnel and reimburse UofL for the personnel costs. As paymaster, the University would then administer the payroll function on behalf of the Foundation, including the assembly of all payroll records, withholding the appropriate taxes, distributing the payroll checks, and issuing W2 tax statements each year.

Findings and Recommendations

Prior to August 12, 2016, auditors were unaware that the aforementioned formal written agency agreement between the University and Foundation existed, despite previous inquiries with UofL and ULF management as early as Fall 2015 requesting governing documents. When auditors presented the agreement to the UofL Board Chair and the now former ULF Board Chair, both indicated they had not seen the document before, although the former ULF Board Chair recalled hearing reference to an agency agreement.

The former Chief of Staff stated that the document was an administrative document and as such, was not something brought back before the boards. She noted that the document was routinely reviewed by the Foundation CFO and Foundation legal counsel. While this document has administrative impact, auditors noted that it was signed by the chairs of both boards when it was initiated. Also, being that it is an agreement outlining the terms of how the organizations will share human resources, it is relevant information for the governing boards, which are ultimately responsible for oversight and policy making. In light of recent controversies and concerns openly expressed by UofL Trustees, it is unclear why the administration would not openly share this document with the Board, at least during an orientation program. See Finding 3 relating to board dysfunction and Finding 8 relating to ULF Board orientation.

Furthermore, as this is a binding agreement in which the University is sharing its resources with the Foundation in exchange for reimbursement of personnel costs, it would be appropriate to involve the UofL SVP for Finance and Administration who serves as the University's chief operating officer and chief financial officer in the periodic review of this agreement to ensure the terms are appropriate and in the best interest of the University, especially since the document has remained unchanged since its initiation in 1996. However, auditors noted that the UofL SVP was also not aware of this agreement, and had little to no formal authority or involvement in activities between the University and Foundation.

Through research, auditors identified a resource available through the Association of Governing Boards of Universities and Colleges (AGB), a national organization assisting universities and colleges, which provides recommended principles and practices to assist institutions and their foundations. In 2005, AGB and the Council for Advancement and Support of Education (CASE) developed an illustrative agreement that could be considered by institutions. According to the *Illustrative Memorandum of Understanding* issued by the AGB, "[i]t should be emphasized that there is no definitive best model for foundation-institution partnerships; the illustrative MOU is presented as a starting point for a collaborative process of assessment and strategic thinking about how the foundation and institution can most-effectively work together." In response to the benchmark survey performed by the

Findings and Recommendations

APA, respondents from 15 different institutions indicated that the roles and responsibilities of the institution's university and its foundation were defined, in part, by a written contract or agreement, such as a memorandum of understanding (MOU). Although the 1996 agreement between UofL and ULF discussed above contains some elements regarding resource sharing, a working MOU could be expanded to address or clarify other operational policies and areas of responsibility between the two entities.

Compensation and Benefits Paid by ULF

Concerns regarding the dual administration of the University and the Foundation and the impact it had on the management of endowment funds were expressed by some UofL and ULF Board members interviewed. Specific areas of concern included compensation and benefits awarded to UofL personnel through the Foundation and its affiliate organizations, and the level of control by the former President and his staff. Interviews with University and Foundation administrators identified that the UofL and ULF Boards had delegated authority to the former President to act on behalf of the Boards on several matters, including negotiation of compensation and benefits to administrators. As a result, compensation and benefits for University administrators were handled directly by the President's Office rather than through the University Human Resources Department. Therefore, the compensation and benefits for these administrators were not scrutinized in the same manner for consistency with all other staff or to determine compliance with University policy. Additionally, this process reduced oversight and created transparency concerns among members of the UofL Board.

According to the interim UofL Executive Director of Human Resources (HR), her office handles standard benefits awarded to UofL personnel, including University administrators, faculty, and staff. However, her office is not involved in the contracting or compensation of administrators, as that is handled by the Office of the University President. Because of this practice, the interim Executive Director of HR stated she was not aware which administrators serve under a contract and which do not. Further, UofL Personnel Policy Per-1.05 indicates that the office of the interim Executive Director of HR will control access to all UofL personnel files, but she stated those files are maintained outside of her office in the Office of the University President and Office of Faculty Affairs.

The interim Executive Director of HR noted that such decentralization of the HR function was not what she was accustomed to, based on her years of previous higher education work experience. Further, she indicated that the decentralization was a concern to her and that "some of her efforts would be to gain more oversight and consistency around how" they managed those things at UofL. She believed there were certain things within the UofL HR function that were very transparent, such as health benefits, but other things are less transparent.

Findings and Recommendations

The interim Executive Director of HR was unaware of any policy allowing or disallowing the award of certain benefits to UofL personnel, such as vehicle and cellphone allowances. In practice, there was little consistency on the awarding of these fringe benefits. For example, according to personnel records and former Chief of Staff statements, the former Chief of Staff served as an at-will employee in the UofL Office of the President, and was assigned to work at the University, Foundation, and Foundation affiliates, until her retirement in August 2016 from the University. Salary letters provided to the APA for the examination period, and dating as far back as 2007, document the former UofL President routinely awarded his Chief of Staff an annual vehicle allowance of \$12,000.

In reviewing a list of all UofL personnel awarded a vehicle allowance in FY 2015, auditors noted that the benefit had been awarded in varying amounts, ranging from \$6,000 a year to \$12,000 a year, to 11 UofL administrators. The remaining personnel listed on the report were all affiliated with the UofL athletic programs. Without a policy in place, there are no established parameters or guidelines the University can utilize to ensure fair and impartial award of such additional benefits. The interim Executive Director of HR stated that she was not certain she would be aware of additional benefits to UofL personnel if awarded by the other entities.

According to the former UofL Chief of Staff and the Foundation CFO, the dual operating structure of the two organizations was intended to provide for efficiencies in administrative overhead costs. However, the significant compensation and benefits awarded to UofL administrators for their roles in the dual governance, as well as the outsourcing of some Foundation accounting functions, call into question whether those efficiencies existed. Furthermore, while the dual administration of the University and Foundation can allow for more effective lines of communication and ensure the two entities operate in “lock-step” as suggested by some, the relationship can also lead to undesired consequences as demonstrated throughout this report.

*Voluntary
Separation
Incentive Program
payments with ULF
funds*

The University used Foundation funds to make payments of over \$2 million to employees for a voluntary separation incentive program (VSIP). On March 7, 2013, the UofL Board approved the implementation of a VSIP and “authorized the President to make executive decisions needed to fully implement this program.” The program offered incentive pay, equal to 12 months of annual base salary for faculty and six months of annual base salary for administrators and staff, to eligible University personnel in exchange for their voluntary retirement. The primary objective of the program was to create cost savings for the University. According to the University, 285 faculty and staff participated in the incentive program with payouts totaling \$16,848,026 as of March 2016.

Findings and Recommendations

Of the total VSIP payouts, \$2,177,923 was paid with Foundation funds between November 2013 and March 2016. These payments were part of a University funding strategy to use Foundation funds to make a portion of the incentive payments to non-tenured University staff with the intent that the University would repay these funds to the Foundation at a future time. This plan was developed without the UofL Board's awareness that it would involve a repayment of funds to the Foundation. Even though the UofL Board gave the President broad authority to implement this program, this authorization did not comply with the requirement that all University indebtedness be approved by the UofL Board.

Additionally, it appears the use of Foundation funds was designed to circumvent advice from University legal counsel. The UofL Associate Vice President (AVP) for Budget and Planning indicated that they had done due diligence in planning the incentive program, noting a member of the UofL legal department had advised that while you can use general funds to buy out the tenure for faculty, certain restrictions exist on the use of general fund monies toward paying incentives for staff. Though UofL personnel understood University general funds could not be used to fund the portion of this incentive, the AVP for Budget and Planning notified the APA in the spring of 2016 of the intent to repay the Foundation for the funds it had paid to University employees.

More than two years after VSIP payments began, the UofL AVP for Budget and Planning indicated that the University was still planning to repay the Foundation in full and that she and the Foundation CFO were "working to set up an MOU on repayment terms." In June 2016, auditors requested a status update on this action and were advised on August 1, 2016 by the CPA hired to act as liaison between ULF and the APA during the examination (ULF liaison), that Foundation funds used for the VSIP would not be repaid by the University.

The ULF liaison understood consideration had been given to repaying the funds to the Foundation, but it was determined that doing so would be inappropriate as it "could be seen as running afoul of the rule that University funds cannot be used for voluntary separation payments to administrative personnel." When asked if this decision was reached after discussing the matter further with UofL General Counsel, the ULF liaison said he was advised by the Foundation CFO that the decision came after he and AVP for Budget and Planning spoke with the interim UofL President and that the University General Counsel was not consulted "as this was just a funding issue that had no legal ramifications." However, this characterization is not accurate as this funding situation certainly raises potential legal ramifications. The decision not to repay ULF for these funds was not made at the inception of the program, but almost three years after incentive payments to University staff began. Legal questions related to the VSIP and the intended repayment are beyond the scope of our governance examination, and therefore, we do not offer an opinion on these legal matters.

Findings and Recommendations

Furthermore, it should be noted that in the benchmark survey performed by the APA, participants having a separate 501(c)(3) not-for-profit organization managing their university endowments were asked whether their university is permitted to transfer funds to its foundation(s). The response from survey participants indicated that the majority, 71%, were not permitted to transfer funds to their foundations (see Chapter 3, Observation 14).

Given the role of the Foundation to support the University, the action to repay or transfer funds back from the University to its Foundation seems counterintuitive, and as such, it would appear consideration of such activity would be seen as something outside the course of normal business activity and something that could have legal ramifications. This situation highlights the additional risks of financial decisions being made without appropriate board notification and approval due to the dual management of the University and Foundation.

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. If the decision is made to continue this joint relationship, we recommend the UofL and ULF Boards seek consultation services from an independent expert to establish the appropriate parameters through which this role should operate to ensure the structure allows the president to operate in an effective, efficient manner, but with appropriate checks and balances.

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, such as those recommended by AGB and CASE.

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.

Findings and Recommendations

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.

All Trustees interviewed acknowledged the UofL Board was divided. The former ULF Board Chair, who serves as a trustee stated the UofL Board was "the most dysfunctional board" he has served on, noting "you can't glue this Board back together." Although opinions varied as to who or what was responsible, there was no disagreement on the existence of division and discord or the fact that this situation made it difficult for the UofL Board to function effectively.

In interviews with various UofL Trustees, it was noted some requests for specific information from the University and ULF were not fulfilled, adding to the feelings of mistrust. For example, the UofL Board Chair, who also serves as a ULF Director, stated he and others had requested from the administration a list of UofL employees who get additional compensation from the Foundation, as he still did not know who was actually employed by the Foundation despite serving on both boards. As of March 1, 2016, the date of his interview, the UofL Board Chair noted he had never received that list. Also, the UofL Board Treasurer stated, prior to the consultant's compensation report detailing the former President's compensation issued in July 2015, he had requested a one to two page summary detailing the complete compensation received by the former UofL and ULF President. The UofL Board Treasurer noted he had been told the matter was complicated, then later was told by both administration staff and the former ULF Board Chair that he could go out and obtain this information on his own. He indicated that he often received this kind of response to his requests for information. Due to his position as Treasurer on the UofL Board, it is unclear why the amount and composition of the President's compensation information would not be readily available for his review.

Findings and Recommendations

The former ULF Board Chair indicated he did not know what, if anything, had been provided in response to requests relating to the former President's compensation prior to the consultant's compensation report. He stated, "If I had to take an educated guess, it was probably a convoluted answer with the realization that it was going to be used as a weapon," speaking to the environment in which the UofL Board was operating at the time.

In line with the former ULF Board Chair's statement, the former UofL Board Finance Chair also expressed hesitation by individuals, including himself, in presenting information to the UofL Board. He noted while reports were being offered to the UofL Board, those offering the reports would be attacked. He stated individuals were "very tentative to even want to make a report for fear of any attacks." The former Finance Chair expressed he had UofL Board business to discuss with the UofL Board; however, he felt reluctant to present topics due to the constant media pressure related to UofL. The former Trustee went on to say "[meetings] became so disruptive, it became impossible to conduct a Board meeting without contention... reports are still made but you can tell they are no longer the open free flow of conversation."

Though all UofL Trustees and ULF Directors interviewed agreed there was conflict, no one could clearly identify the cause. Some Trustees indicated the absence of communication and unwillingness of the University and Foundation administration to provide certain information was evidence of veiled and secret actions, supporting the concern that a lack of transparency exists (see Finding 2). Other current and former Trustees indicated the questions posed of the administration, by some current and former Trustees, were accusatory statements and were a deliberate action to disrupt the administration, rather than an effort to gain better understanding of the workings of the institution, and as such, viewed the opposing faction as being disloyal to the institution and its administration.

Although during the examination, auditors observed attempts by UofL Trustees to address the poor governing climate, such as the creation of an Ad Hoc Governance Committee, those actions often were ineffective and did not result in change to the environment. Also, the frustrations and disagreements among Board members often resulted in high profile media reports, which heightened tensions and contributed to the distrust among the members. Overall, the climate was not conducive to proper governance, leading to difficulties in making key decisions, including disagreements among the UofL Board Finance Committee regarding the University's budget due, in part, to questions about the impact of a \$38 million loan between the University and Foundation. The details of this loan are further discussed in Finding 4.

Findings and Recommendations

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. It is incumbent upon all trustees, administrators, and staff attending board meetings to establish an atmosphere that is conducive to open discussion. It is the trustees' fiduciary duty to address the myriad of changing issues that confront the University. Trustees should not be concerned about how topics of discussion will be received, but rather ensure all relevant Board business is reported and discussed openly with a focus on finding ways to address topics and issues in a professional manner that furthers the mission and goals of the University.

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. The funds were loaned through two executed agreements implemented by members of the University and Foundation administration. While the former President and some administrators identified these loans as cash management strategies, this explanation ignores the fact that the University and Foundation are legally separate entities, and the effect of this transaction created a lending arrangement that bypassed the individuals with fiduciary responsibilities to authorize such activity. 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.

Each loan was executed through a memorandum of agreement (MOA). As discussed in more detail below, the Foundation CFO repeatedly referred to the arrangements as "receivable agreements" and disputed the characterization of the transactions as loans. Auditors were unable to obtain a clear differentiation between the Foundation CFO's terminology and a basic cash lending arrangement. Auditors were also unable to identify the terminology "receivable agreement" in professional literature. Therefore, due to the pattern of these transactions as temporary cash borrowings between legally separate entities, the transactions will be referred to as loans in this examination other than when citing contrary statements by ULF administrators.

Findings and Recommendations

The first MOA, in effect June 27, 2014, was a one-year agreement between the University and the Foundation in the amount of \$29 million. According to the Foundation CFO, the agreement allowed the Foundation to effectively postpone payment of funds budgeted for use by the University and use those funds instead for real estate activities, in support of the University. In return, the University would receive 1% interest from the Foundation, reportedly granting them more interest income than they would otherwise earn. This MOA was signed by the UofL AVP for Budget and Planning on behalf of the University, the Foundation CFO on behalf of the Foundation, and the former President on behalf of both the University and the Foundation. According to the University's FY 2015 audited financial statements, the loan was fully repaid as of June 30, 2015.

The second MOA, in effect July 1, 2015, was a three-year agreement between the University and the ULREF, an affiliate organization of UofL in the amount of \$38 million. The terms of this MOA again included a 1% interest return to the University. Pursuant to the MOA, more than half of the funds loaned would be used by ULREF to make a \$22 million line of credit principal payment to the Foundation. The Foundation CFO stated that the \$22 million was used as bridge financing until the Foundation could restructure a property loan for another affiliate, KYT – Louisville, LLC, and that the \$22 million was paid back to the University on June 22, 2016, after new financing was in place. This second MOA was signed by the former President in his capacity as the UofL President, and by the Foundation CFO in his capacity as the ULREF Assistant Treasurer. The Foundation CFO reported an outstanding balance of \$9.8 million on this loan as of June 22, 2016.

In discussing the loan with auditors, the Foundation CFO, noted the University, at any one-time, "has \$100 million in unspent cash sitting out there," referring to funds maintained in the bank earning interest. Though described as a loan in a footnote to the University's audited financial statements for FY 2014 and FY 2015, the CFO noted the Foundation's financial statement audit did not refer to the transaction as a loan and explained his position that the transaction was not a loan by noting that it did not have a security instrument, an amortization schedule, or "any elements that have to do with a loan." The former UofL President's Chief of Staff stated that the terminology used in the footnote of the University's audited financial statements incorrectly characterized the transaction. However, the UofL SVP for Finance and Administration, when interviewed, stated that the transaction was discussed by his staff when preparing the financial statement footnotes, and it was a conscious decision to describe the transaction as a loan. He did not know how anyone describes the transaction any other way and noted no one had advised that the financial statement footnote should be changed.

Findings and Recommendations

The Foundation CFO and the former President both describe these transactions as “cash management strategies.” The former President noted that the process followed by the administration was similar to that followed by Kentucky State Government, a process he was familiar with as former State Budget Director. However, the process to which the former President was referring is an internal lending process between funds of the same governmental entity; whereas in this situation the agreements related to the University-budgeted funds are being loaned to a legally separate entity and are not merely an internal transfer of funds. This is a prime example of how the dual administration of the University and the Foundation blurred the lines of legal separation between the two organizations, and at times essentially led to operating decisions being made as if they were a single entity.

In a September 21, 2016 email, the Foundation CFO, referencing the \$38 million loan from July 1, 2015, stated “The \$38M receivable agreement was a cash management initiative to better utilize the internally managed short-term funds of the University. It was structured in compliance with the Short-Term Investments Guidelines policy in effect for the University at that time,” and, “[t]he University guidelines do not require formal and/or recurring reporting to the Board of Trustees on short-term investments which is why it has only ever been incorporated into the University’s annual financial audit.” However, the Short-Term Investments Guideline referenced by the Foundation CFO lists permissible investments which do not appear to include loans such as those between the University and the Foundation or its affiliates. Further, the policy in place at the time of the loans did in fact require the UofL SVP for Finance to “report at least annually to the Board on the status of invested short-term funds.” University personnel indicated the policy was intended to require the UofL Board be advised of the status of invested short-term funds “when requested,” but the policy language was not actually revised until January 14, 2016.

These loans to the Foundation and its affiliate were not reported directly to the UofL Board. Rather, the majority of UofL Trustees who were interviewed acknowledged they were not aware of the agreements until auditors inquired about the loans. The former ULF Board Chair, who also served as Chair of both the UofL and ULF Board at the time of the second MOA, stated that he had only recently been made aware of the transactions after another UofL Board member discussed it with him following an interview with APA auditors. The former Board Chair had since understood the agreements were done in support of the University; however, he acknowledged there should be criteria requiring certain transaction amounts to be reported to the Board. The former ULF and UofL Board Chair was not aware of any requirement for loaned funds to be presented to the boards and suggested that a threshold of \$1 million may be appropriate. When asked whether loans were reported to or approved by the UofL Board, the Foundation CFO stated the agreements were reported to the UofL Board and approved in conjunction with the University’s audited financial statements, which contained a footnote describing the loan. By this statement, the Foundation CFO indicated the UofL Board’s action to approve the annual audited financial report constituted approval of the loans by the UofL Board, even though the footnote about the loans was not specifically pointed out or discussed.

Findings and Recommendations

While the practice of loaning University funds in this manner is concerning, further troublesome is the lack of transparency even with the University's financial management administrators. As noted previously, the Foundation CFO mentioned the University had an amount of unspent cash on hand at any given time, although that analysis or the resulting decision to loan University funds to ULF did not appear to involve the UofL SVP for Finance and Administration. The UofL SVP for Finance and Administration, who began working at the University in this position in January 2015, recalled that he first became aware of the second MOA when he was asked to transfer the funds from the University to the Foundation. Upon becoming aware of the request for transfer, the SVP stated that he sought advice from University legal counsel as to the legality of such a large transaction. He noted nothing was found in State statute that would prevent the transaction, and the individuals who signed the agreement were authorized to enter into agreements. He also noted that he had questions about the terms of the agreement and how it was structured, but at that point the agreement was already an executed document. He noted one of his concerns was the payback terms of the agreement, asking if he could call the money back if the University needed the cash for any reason. The Foundation CFO has stated that these funds are callable at any time, meaning the funds would be made available to the University, if needed. However, nothing in the terms of the MOA addresses this issue or guarantees the Foundation will make the funds available to the University upon request.

Though the ULF administration believes the terms of the agreements are beneficial to both the University and the Foundation, the governance question is whether it was appropriate for such transactions, particularly transactions of this size, to be loaned between legally separate entities in a manner that would be more consistent with an internal fund transfer of a single entity. Furthermore, while those involved in the approval process had signatory authority to enter into contracts on behalf of each entity, the manner in which these transactions were handled and the subsequent description and explanations provided for these transactions by current and former Foundation officers are concerning and lack appropriate transparency.

Additionally, it is unclear whether the University actually benefitted from the lending arrangement, at least in the manner expressed by the ULF administration. Although the terms of the two MOAs provided for 1% interest repayment on the borrowed funds, the interest was paid by ULF and ULREF, the managing entity for the University's endowment and one of its affiliates. Therefore, although the interest paid to the University could be seen as a short-term benefit, the University would ultimately have had long-term access to those same funds used by ULF and ULREF to pay the interest. In order for the University to gain additional benefit from this loan arrangement, interest income would have needed to be derived from an investment or financing arrangement with assets to which the University would not be otherwise entitled.

Findings and Recommendations

Because the University and Foundation administrations have operated in a conjoined manner for years, the governance role of the UofL and ULF Boards is vitally important and cannot be overlooked. While the role of each board is not to manage daily operations of the University or Foundation, sufficient segregation and reporting mechanisms need to be devised and implemented by these boards.

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-term investment funds by the UofL 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.

In a letter dated July 22, 2016, to the former UofL Chief of Staff, the former UofL and ULF President stated:

As the Executive Committee of the UofL Foundation, Inc. (Foundation) discussed earlier this summer, I am writing to appoint you as Acting Chief Administrative Officer (CAO) of the Foundation, in addition to your continuing duties as Chief of Staff to the President. As CAO, you will work for me as President and CEO of the Foundation on developing real property owned by the Foundation to maximize revenues to support the University’s mission.

Findings and Recommendations

The letter continued by listing a number projects requiring the attention of the new CAO and then stated:

This is an ambitious list of property development projects, but knowing you, they have a good chance of completion by July 31, 2017. Your responsibilities as Chief of Staff to the President will continue as long as I am President of the University and/or President and CEO of the Foundation.

ULF bylaws prescribe a process to be followed for appointment of officers to the ULF Board and corporation. Section 3.9(4) requires the ULF Nominating Committee to select and recommend to the ULF Board, candidates for officers of the Board and the corporation. Further, section 3.9(2) of the bylaws specifically identifies that the Executive Committee “shall not have the authority of the Board in reference to...electing, altering or removing any member of that Committee or any Director or officer of the Corporation....” In light of the bylaws and the public acknowledgement by ULF representatives that no formal board action was taken to approve this appointment, it appears the action was taken unilaterally by the former UofL and ULF President and as such may not be a valid appointment or binding agreement.

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. The letter does not define “for cause,” and ULF bylaws require compensation paid to “any person” due from ULF to be fixed by resolution of the ULF Board. While ULF policy allows the resolution to be taken in the “form of a resolution addressing a specific individual’s compensation or a resolution approving the Foundation’s operating budget,” the agreement to extend payment of compensation to the former UofL Chief of Staff in her capacity as acting CAO appears to further violate the intent of ULF bylaws.

On July 21, 2016, the day before the appointment letter to the former UofL Chief of Staff, the former UofL and ULF President had offered his resignation as UofL President to the UofL Board. His resignation as UofL President was discussed, accepted, and effective just a week later on July 27, 2016. As a result of this action, questions were raised as to whether the former UofL President would remain as president of ULF given that his Foundation contract provided “resignation from his position as President of the University” would be a potential basis for termination as ULF President. Given the significant events and concerns surrounding the University and the Foundation at the time of this letter to the former UofL Chief of Staff, the action by the former UofL and ULF President becomes even more suspect.

Findings and Recommendations

In discussing the action with a former ULF Director who served as ULF Board Chair in early 2016, the action to appoint the former UofL Chief of Staff to the position of acting CAO was not formally taken by the ULF Executive Committee as there was not a quorum of members when the matter was discussed around March 2016. He indicated the action to appoint the former UofL Chief of Staff as CAO was to be taken, in part, to address the 4.5% University budget cut enacted by the Kentucky Governor in the spring of 2016 by moving the former UofL Chief of Staff's salary from the UofL President's Office budget to being fully funded by the Foundation. The former ULF Director stated removing the salary of the former UofL Chief of Staff out of the Office of the UofL President was roughly in the 4% to 5% range, indicating that it served a purpose by addressing this budgetary issue. In addition, he explained that he and others felt the former UofL Chief of Staff had a valuable role to play in ULF projects to be completed and the action would put her in the capacity to complete these projects, whether the former UofL and ULF President was at ULF or not. As a result, the former ULF Director stated the Foundation's law firm was directed to draft a contract in March 2016 that would be signed by the former ULF Director, as the ULF Executive Committee Chair, and the former ULF President. However, he stated the contract was delayed, and ultimately the July 22, 2016 letter was prepared by the former President to cover matters until the contract could be finalized.

While some ULF Directors may have been aware of the intent to appoint the former UofL Chief of Staff as the acting CAO, the role of CAO is assigned by ULF bylaws as part of the job description of the ULF President. Section 4.4 *Duties of the President* states, in part:

He shall be the Chief Administrative Officer and General Manager of the Corporation.

Thus, the former UofL and ULF President was not only circumventing the process set forth in the bylaws for appointing an officer to the corporation and awarding extended compensation to the former UofL Chief of Staff, he was also altering his own official role at ULF in contravention of the bylaws. No action was taken by the ULF Board to remove the CAO position from duties of the ULF president or to reduce the former ULF President's compensation to account for the reduction in his official duties.

In discussing her role at UofL, ULF, and ULF-affiliated entities on August 23, 2016, the former UofL Chief of Staff did not identify her role as acting Foundation CAO, despite the action taken just a month prior. At the time of the interview, auditors were only aware of her official role as UofL Chief of Staff to the President, UofL Executive Director of Boards, and assistant Secretary to the ULF Board. The former Chief of Staff explained while serving as an at-will University employee she had been assigned by the former President to work with ULF affiliates. She noted during the interview that due to the recent departure of the former UofL President and the appointment by the UofL Board of an interim UofL President on July 27, 2016, she currently served two bosses as Chief of Staff.

Findings and Recommendations

The former UofL Chief of Staff also stated her compensation was divided between UofL and ULF and then acknowledged she also received compensation through UHI, an affiliate of ULF, as she serves as an officer at UHI and other Foundation affiliated entities. The former Chief of Staff offered to auditors her salary letters resulting from her annual evaluations noting that her role would be explained by those letters.

While the salary letters did document a great deal of involvement by the former UofL Chief of Staff at the University, ULF, and its affiliated entities, the documentation did not clearly identify her appointment as ULF Chief of Staff or as acting CAO. Auditors were advised of her appointment as the acting CAO on September 30, 2016 when the July 22, 2016 letter was forwarded to the APA from the former UofL Chief of Staff through the ULF Liaison. This document was provided after the former UofL Chief of Staff was suspended with pay by the new ULF Board Chair.

In discussing with the former ULF Board Chair the concern about whether the former ULF President acted without authorization in his appointment of the former Chief of Staff to the CAO position, he noted that the ULF Board reviews its bylaws as needed, but he did not remember the last time the ULF bylaws were reviewed. As discussed in Finding 8, the members of the ULF Board do not receive a formal orientation, and information such as ULF bylaws are not distributed to or discussed with new board members. This lack of information limits the opportunity of the Board to examine and discuss potentially needed updates to the bylaws. It also increases the likelihood that the Board will inadvertently ratify actions that are contradictory to the bylaws and which could be viewed as a breach of their fiduciary responsibility.

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. The report, along with any suggested revisions, should be fully documented in the minutes of the ULF Board meeting in which the presentation is made.

Findings and Recommendations

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.

It has been explained that the Foundation supplements the salary of the UofL President because of limitations set in KRS 164.013(6), which limits the compensation amount a president of a public university can receive from the university to be less than the salary of the President of the Council on Postsecondary Education. There is a concern that this limitation to the salary a Kentucky public university can legally give its president also limits the talent the university can attract. To work around this constraint and attract top talent to these positions, university foundations routinely supplement the compensation for university presidents, which was also supported in the benchmark survey performed by the APA (see Benchmark Observation 6 found in Chapter 3 of this report).

The employment contract between the former President and the Foundation states:

If the Foundation's Board of Directors determines that [the President's] performance of his services as President of the Foundation has been satisfactory, [the President's] base salary shall be adjusted ..., after receiving a recommendation from the Board of Trustees, by the same percentage as his salary as the University's President is increased.

In the July 2, 2014 UofL Board Compensation Committee meeting, a motion was approved to award a 2% merit increase to the UofL President's salary. The minutes of the meeting reflect that the Committee wanted to award a full 4% increase but rather chose to award a 2% merit increase "out of respect for the President's offer not to receive it."

In addition to awarding a 2% increase to the former UofL President's salary, the University Board recommended to the Foundation Board the former President receive a bonus equal to 25% of his 2013-14 total salary for last year's performance. The Foundation Board unanimously approved the University Board recommendation and further stated in a letter to the former UofL Board Chair on July 18, 2014:

Findings and Recommendations

[T]he Foundation Board approved a 4% merit increase for the President on his Foundation salary.... In recognition of the extraordinary achievement of the \$1B capital campaign, the Foundation Board directed an additional 2% merit increase, on [the President's] university salary, to be paid from Foundation funds as a public statement of the high regard the Foundation Board has for [his] outstanding performance. These actions ... were unanimously approved by the Board of Directors.

In discussing this matter with the former ULF Board Chair, who was serving only on the UofL Board at the time of this award as UofL Board Chair, he stated he did not think the ULF Board action had to go back to the UofL Board for approval. Also, he indicated the ULF Board is not bound by the UofL Board's salary recommendation. However, the Foundation contract with the former ULF President does specify the raise awarded to the ULF President is to be the same percentage as approved by the UofL Board, and nothing in the contract authorized the ULF Board to increase the President's university salary beyond what the UofL Board recommends.

In addition, UofL Board Bylaws require "all compensation for the President of the University" to be considered and recommended to the full UofL Board. While the Foundation action was communicated to the then UofL Board Chair in a letter from the then ULF Board Chair, the matter was not brought back to the UofL Compensation Committee for consideration. The AVP for Budget and Planning confirmed that the former UofL and ULF President accepted and received this additional 2% merit increase to his base University salary.

The two employment contracts for the former UofL and ULF President are from two legally separate entities. By its action, the ULF Board appears to have overstepped its authority and circumvented the governing authority of the UofL Board by altering the base pay for the UofL President. Further the ULF Board action is contrary to its own contract with the former Foundation President as the ULF Board awarded a salary increase in excess of the amount provided under the terms of the contract.

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

Findings and Recommendations

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.

The Foundation bylaws establish the Finance Committee membership as the University President, the University CFO, one Trustee Director, and four At-Large Directors. The Foundation bylaws further state the Finance Committee is to “have general supervision over the finances of the [Foundation] and over its budget.” Additionally, the Committee is to present a report including all gifts, trusts, and funds of the Foundation to the full ULF Board at the annual meeting. This ex officio requirement of his position was never discussed with the CFO or enforced by anyone within the UofL or ULF administration. The University CFO has contracts with both the University and the Foundation that provide him compensation and benefits. The requirement for the University CFO to assist and support the Foundation is expressly stated in the employment contract between the Foundation and the University CFO. In the contract under the terms and duties, it states, “[he] will assist the Foundation’s fundraising and property management activities and provide such support and assistance consistent with the Foundation’s By-Laws, as may be appropriate to his position with the University.”

The University CFO stated he was not informed of his status as an ex officio member on the ULF Board Finance Committee. He was never notified of or included in the Committee’s scheduled meetings and has never been requested to assist or support any actions or functions of the Foundation. He further stated he had no association in practice or responsibility with the Foundation or its affiliates and provides no role operationally at the Foundation. He indicated he was aware of the terms of his contract with the Foundation and stated he only fulfilled the fundraising portion of his duties. He also stated “it became clear early on that I was not going to be empowered with a role at the Foundation.” He was never provided a copy of the Foundation bylaws; however, he took it upon himself within the last year to seek out those bylaws.

Findings and Recommendations

The former ULF Board Chair indicated he was unaware of the requirement stated in the ULF bylaws of the University CFO's inclusion on the Finance Committee of the ULF Board. The former ULF Board Chair went on to say he did not know of the contractual requirements between ULF and the University CFO found in the ULF employment contract. When questioned who was responsible at ULF for ensuring the required persons were properly notified of board or committee meetings, the former ULF Board Chair believed it would be either the former ULF President or the former UofL Chief of Staff, who also served as the ULF Board Assistant Secretary, as "she usually was the logistical person in terms of making sure all the appropriate people were there."

Furthermore, the University CFO confirmed that his participation in University financial activity involving transactions with the Foundation was limited; though, as University CFO he is responsible for managing such activity on behalf of the University. For example, as presented in Finding 4 of this report, the University CFO was not informed nor aware of a \$38 million loan of University funds to the Foundation prior to execution of the loan. The loan was signed only by the former UofL President and the Foundation CFO, who reported to the former UofL President at the Foundation. The University CFO became aware of the loan only when he was asked to transfer the money from the University to the Foundation. After he became aware of the loan he questioned the terms and conditions of such an action. This lack of inclusion of a key University official in committees and significant actions concerning the University and the Foundation further hinders the transparency that should exist 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.

The Foundation has grown substantially since its creation in 1970. The Foundation is made up of approximately 14 affiliates, manages three tax increment financing (TIF) areas within the University campuses, and manages an endowment with a market value of nearly \$685 million as of August 2016. The three TIFs are expected to generate \$4.15 billion in revenue to the University through the Foundation over 30 years. The Foundation recorded a net worth of \$1.05 billion in the fiscal year 2015 audited financial statements.

Findings and Recommendations

Despite its expansion and growth, along with its diversification of interests, the Foundation Board members do not receive a formal orientation upon appointment to the Board. One board member interviewed clearly recalled receiving an orientation upon joining the board around 2005, but was not sure it was “formal.” Board members interviewed who were appointed to the Foundation Board over the last few years, including the former ULF Board Chair, the current ULF Board Chair, and the current UofL Board Chair expressed they had not received an orientation upon initial appointment to the Foundation. When asked whether basic governing documents, such as ULF bylaws and articles of incorporation are given to new members, in the absence of an orientation, the former Board Chair said he could not recall but noted he had read the information on the web.

The former ULF Board Chair was questioned about actions taken by the former President and the exclusion of specific UofL personnel from the ULF Board proceedings (see Finding 7). The former ULF Board Chair admitted he was unaware of some of the requirements concerning these actions found in the bylaws of ULF. However, he informed the APA he had become more familiar with the ULF bylaws in the last two or three months after administration upheaval at both UofL and ULF. He was also unaware of the ULF contractual requirements for the University CFO to be involved with the ULF Board. Such a lack of knowledge by ULF Board members increases the risk that actions of the board could not only violate the bylaws but could also result in a breach of fiduciary duty or other action with legal ramifications affecting both UofL and ULF.

Additionally, a former ULF Director expressed while serving on the ULF Board he personally had “zero comfort level” he knew what was going on at the Foundation. Another ULF Director in discussing a specific meeting of the Foundation, described it as “perfunctory” and brief. Both instances are strong indicators that a formal orientation is needed to allow ULF directors to fulfill their fiduciary duties to the organization.

The former ULF Board Chair suggested the reason for not having a formal orientation may stem from the fact several ULF Board members have either been on the UofL Board or interfaced with the Foundation. While this may be the case, every entity is unique and even with prior dealings with the entity and a general understanding of how governing boards function, it is a fiduciary duty of each board member to gain an understanding of the scope of the business performed by the entity, a knowledge of the duties of the governing board, and basic knowledge of the rules governing that board and entity. Knowing and understanding the basic mission and vision of an entity can also help facilitate the governing board’s ability to move the entity forward.

Findings and Recommendations

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.

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Benchmark Methodology and Results Analysis

Methodology

As part of the examination, the APA determined a benchmarking survey would assist in identifying best practices concerning governance between universities and their independent fundraising entities. When initiating this effort, the APA requested UofL and the Foundation provide a list of peer institutions, along with contact information, for inclusion in this survey process. The Foundation CFO provided a list of institutions with comparably-sized endowments, though contact information was not provided. Some institutions from this listing were considered in the survey process, along with others identified as having possible commonalities to UofL and others that could help provide a broader perspective for best practice considerations.

Using this information, an initial list of universities and colleges to survey was developed that included all Atlantic Coast Conference (ACC) schools, all Kentucky public universities, a sample of Kentucky private universities and colleges, post-secondary institutions identified by the Foundation during the examination, as well as institutions identified through media reports as being similar to UofL based on certain factors including enrollment, endowment size, and SAT scores.

This initial list identified 39 universities and colleges that were asked to participate in our benchmark survey. After inquiries, the survey was then sent to 34 institutions using the contact information collected. Upon completion of the survey, the APA received 36 separate responses. However, of those 36 responses: one was incomplete and had no institution identified and seven were duplicate responses, leaving 28 unique responses for analysis.

The institutions providing unique responses were:

- Berea College
- Clemson University
- Duke University
- Eastern Kentucky University
- Florida State University
- Georgia Institute of Technology
- Indiana University
- Louisiana State University
- Midway University
- Mississippi State University
- Morehead State University
- Murray State University
- North Carolina State University
- Northern Kentucky University
- Purdue University
- Transylvania University
- University of Arizona
- University of Arkansas – Fayetteville
- University of Cincinnati
- University of Kentucky
- University of Notre Dame
- University of Pittsburgh
- University of Virginia (responded twice, once for each of their main foundations)

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- Virginia Polytechnic Institute and State University
- Wake Forest University
- Western Kentucky University (responded twice, once for each of their main foundations)

Of the 28 unique responses, seven respondents indicated that their endowment was not managed by a separate 501(c)(3) not-for-profit corporation, but rather was managed internally by the institution. Two of those seven respondents were public institutions. The University of Kentucky and the University of Pittsburgh were the only public universities in the survey managing their own endowment. For comparison to UofL and ULF, any respondent not having a separate 501(c)(3) managing its endowment was removed from further analysis. The APA concluded institutions that internally manage their own endowment would not provide meaningful comparative data to help evaluate the governance relationship between two legally separate entities such as UofL and ULF. Therefore, responses from a total of 21 respondents were considered to be useable for comparative analysis. Of the 21 respondents considered useable for comparative analysis, not all respondents answered all survey questions. Because certain questions permitted multiple responses, the number of responses represented in the analysis of individual questions may not always total 21.

Auditors utilized a combination of methodologies to obtain the comparative data for UofL. First, information known to auditors from evidence or statements made during the examination were used to prepare a draft of UofL's survey responses. The draft responses were then provided to the Foundation CFO for input. In some cases, the CFO presented responses that differed from those identified through other means. In those instances, auditors worked with the Foundation CFO to try to identify and resolve discrepancies. When the discrepancies between the CFO's response and other evidence obtained during the examination could not be resolved, the analysis addresses both the CFO's response and conflicting information obtained during the examination. To permit better comparison, responses for UofL are not co-mingled with responses from other colleges and universities. The following are survey results and comparative analysis related to key questions posed in our benchmark survey.

Survey Results and Comparative Analysis

Observation 1

Does a non-profit 501(c)(3) organization or foundation manage your university's endowments and gifts?

<i>Answer</i>	<i>Number of responses</i>	<i>Percentage of response</i>
No	7	25%
Yes	21	75%

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions.

As reflected in the table above, the majority of respondents to this survey question indicated their endowments and gifts are managed by a non-profit 501(c)(3) organization. While there are advantages and disadvantages to each method, UofL's endowments and gifts are managed by a 501(c)(3) organization like the majority of the survey respondents.

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Observation 2

How is your foundation governed?

<i>Answer</i>	<i>Number of responses</i>	<i>Percentage of response</i>
Foundation board is completely independent from university board (no like members)	5	24%
Foundation board is independent from university board but includes members from the university board	13	62%
Other*	3	14%

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts.

*One respondent indicated their endowment is owned by the board of trustees and managed by the university investment office, the board then appoints an investment committee to oversee the office and set policies for the management of the endowment. Another respondent stated the foundation board is completely independent but includes the university president and two members of faculty/staff. The third respondent indicated their foundations were governed by a combination of the two scenarios found in the table above. However, their endowment is managed by a separate board and, somewhat similar to ULF, its board is independent from the university but includes members from the university board.

Based on the survey responses above, it appears the ULF Board structure is similar to the majority of survey respondents, as the ULF Board is considered independent from the UofL Board but includes members of the UofL Board.

Observation 3

How are the foundation board members appointed?

<i>Answer</i>	<i>Number of responses</i>	<i>Percentage of response</i>
Foundation board self-appoints its members	17	81%
University board appoints	1	5%
Other*	3	14%

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts.

* Two universities indicated their foundation board was appointed by a combination of university appointments and foundation board self-appointments. One university stated their foundation board was made up of self-appointees, a university president appointee, and a university board appointee.

According to its bylaws, the ULF Board is comprised of 15 members. Of these members, 10 are self-appointed by the ULF Board and are referred to as at-large members, four are UofL Board members referred to as Trustee Directors, and the last member per the by-laws is the UofL President, who serves as an ex-officio voting member on the Board. It is not policy but rather practice at ULF for one of the UofL appointed Trustee Directors to serve as Chair of the ULF Board.

Benchmark Methodology and Results Analysis

Observation 4

What is the role of the university president in relation to the foundation? (Can have multiple responses.)

<i>Answer</i>	<i>Number of responses</i>	<i>UofL's response</i>
The university president is a voting member of the foundation's board	6	1
The university president is a non-voting member of the foundation's board	8	-
The university president is the president / CEO / executive director of the foundation	-	1
The university president serves on committees of the foundation's board	3	1
The university president chairs one or more committees of the foundation's board	-	1
Other*	5	-

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts, including UofL responses.

* One response stated that the president of the university appoints a representative to serve on the foundation board, two stated the president was the chair of the foundation board, one response noted that the president was a voting member for one of 10 foundations that serve the university, and one response indicated that the president has no formal appointment or relationship with the foundation.

Because multiple responses were allowed, it should be noted that of the 18 responses to this question, four respondents indicated multiple answers. However, those multiple responses were compatible responses. For example, a university president may be a voting member of the foundation's board and serve on committees of the foundation board.

As indicated by the survey results above, the dual role of the former UofL and ULF President is unique among respondents, as UofL is the only institution that identified its president as also serving as the president or executive director over the separate 501(c)(3) foundation managing its endowments and gifts. Though not prohibited, the dual role of the former UofL President serving also as the ULF President created both opportunities and challenges. See APA Finding 2, relating to this unique role. Although two respondents stated the president was the chair of their foundation board, no other university indicated the daily management or executive authority over both the university and its independent fundraising entity is concentrated in one individual.

Another item to note from these results relates to university presidents serving on committees of the separate 501(c)(3) foundations. Per the ULF bylaws, the UofL president serves as chair to the ULF Board Nominating Committee. While ULF bylaws establish this role, no other respondent indicated that its university president chairs one or more foundation board committees.

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Observation 5

Do the foundation's bylaws or other governing documents specify the university president's role? If yes, please list the documents that define the president's role with foundation.

<i>Answer</i>	<i>Number of responses</i>	<i>Percentage of response</i>
No	5	28%
Yes	13	72%

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts.

Of the 13 “yes” responses above, five indicated the bylaws of the foundation specified the role of the university president with the foundation; two listed the role was addressed in the bylaws and a memorandum of understanding (MOU); one identified the university president’s role was addressed in the bylaws as well as statutes; and, one indicated the bylaws, the articles of incorporation, and a MOU addressed the role of the university president with the foundation. Four respondents that answered “yes” did not identify what governing documents addressed the role of the university president at the foundation.

UofL indicated that the role of the UofL president at ULF was addressed in the ULF bylaws only.

Observation 6

Does the foundation provide compensation to university employees? (Can have multiple responses.)

<i>Answer</i>	<i>Number of responses</i>	<i>UofL's responses</i>
University president	6	1
University faculty/staff	2	1
Other university executives	4	1
Other*	7	-

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts, including UofL responses.

* Of the seven “Other” responses above: three institutions indicated endowed chair and/or professorships are paid by foundation funds; one institution indicated the foundation president received a stipend; one respondent replied “only awards”; one indicated the foundation reimburses salaries for specific advancement positions; one indicated the foundation provides or has provided a one-time bonus to the president after eleven years of service, reimbursement for a portion of the dual role of vice president of advancement and CEO of the foundation, three development positions in support of university, and endowed faculty/professorships.

UofL responses are in line with other institution responses.

Observation 7

Does the university board approve the foundation's compensation provided to the university employees?

<i>Answer</i>	<i>Number of responses</i>	<i>Percentage of response</i>
No	2	12%
Yes	9	53%
Foundation does not provide compensation to university employees	6	35%

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts.

Benchmark Methodology and Results Analysis

The UofL Board does not approve compensation provided by ULF funds resulting from ULF employment contracts. However, the UofL Board does approve compensation governed by employment contracts for UofL employees paid by ULF funds. The majority of respondents indicated that the university board has approval authority for compensation provided by the foundation.

Observation 8

Who is involved in determining the foundation's annual endowment spending policy? (Can have multiple responses.)

<i>Answer</i>	<i>Number of responses</i>	<i>UofL's responses</i>
Foundation board	14	1
Foundation president	7	-
University board	1	-
Joint decision by the foundation and university boards	3	-
Other*	2	1

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts, including UofL responses.

* One respondent indicating "other" stated that an investment committee in conjunction with the foundation board is involved with determining the annual endowment spending policy. While another respondent indicating "other" stated that the foundation investment committee, finance committee, and executive committee were involved in determining the foundation's annual endowment spending policy.

The majority of respondents identified that their foundation board is involved in determining the foundation's annual endowment spending policy. UofL's response is in line with this practice. Further, UofL's response of "other" denoted the ULF President submits the recommended endowment spend rate to the Foundation Board for its formal approval.

Observation 9

Does the university board approve the foundation's annual endowment spending rate used to calculate the amount distributed to the university?

<i>Answer</i>	<i>Number of responses</i>	<i>Percentage of response</i>
Yes	4	21%
No	15	79%

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts.

UofL's response indicated the ULF Board receives a recommendation from the ULF President as to the annual endowment spending policy. It is this recommendation that the ULF Board will vote on whether to accept. After the annual spending policy has been approved, it is enacted with no further input from the UofL Board. Not having the UofL Board approve the annual spending policy is in line with the majority of respondents based on responses above. Although this practice is common, the element that raises concern in the case of UofL is that the same individual acted as both the UofL and ULF President. This circumstance is addressed further in Finding 2.

Benchmark Methodology and Results Analysis

Observation 10

What is your target annual endowment spending rate (percent) for FY 2016?

<i>Answer</i>	<i>Number of responses</i>
3.00%	2
4.00%	4
4.20%	1
4.50%	2
4.60%	1
4.62%	1
4.75%	1
4.90%	1
5.00%	1
5.25%	2
5.35%	1
6.00%	1
7.25%	1

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts.

The annual spend rate of survey respondents ranged between 3% and 7.25%; the ULF current spend rate is 7.48%. The ULF spending policy currently in place is the highest of all respondents. However, the ULF spend rate includes fundraising costs paid from the endowment. The ULF spend rate includes 1.5% for fundraising efforts of ULF and an additional 0.48% allocated to the ULF President to support high-strategic initiatives and program enrichment, including fundraising activities. When adjusted for these amounts, the ULF spend rate provided for other UofL purposes is 5.5%. Of the 19 respondents who provided their endowment spend rate, 68% stated the reported target spend rate did not include overhead fees (See Observation 12). The second highest spend rate was Morehead State University (MSU) at 7.25%. Similar to ULF, MSU indicated that overhead costs are calculated as part of the target endowment spending rate.

Observation 11

Does the university receive any other revenue from the foundation in addition to the spending rate distribution?

<i>Answer</i>	<i>Number of responses</i>	<i>Percentage of response</i>
Yes*	14	78%
No	4	22%

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts.

* Seven of the fourteen “yes” responses indicated current use gifts are also given to the institution per the donor’s wishes. Also noted, revenues for development operations, university strategic needs, president compensation, earnings on non-endowed funds, payment for program services, and discretionary funds.

Similar to the majority of respondents, UofL receives additional revenues from ULF beyond the 7.48% spend rate. The additional revenue received from ULF includes gifts, direct allocations arising from other revenue streams, and interest payments from a loan agreement between UofL and ULF (see Finding 4).

Benchmark Methodology and Results Analysis

Observation 12

How are overhead costs to manage endowments paid?

<i>Answer</i>	<i>Number of responses</i>	<i>Percentage of response</i>
Calculated as part of the target endowment spending rate	6	32%
Other fees applied to the endowment but not part of the target spending rate	13	68%

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts.

Approximately one-third of respondents calculate overhead as a portion of the annual spend rate of endowed funds. UofL's spend rate includes overhead, as identified in Observation 10.

Further analysis of target endowment annual spend rates reported by survey participants:

	Target endowment spend rate with overhead included	Target endowment spend rate without overhead included
Number of survey respondents	6	13
Percentage of respondents	32%	68%
Average target endowment spend rate	5.25	4.36

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts.

According to analysis performed, universities including overhead costs as a component of their annual spend rate have average spend rates 0.89% higher than those which do not. UofL's spend rate is reported as 5.5% without the overhead component, which puts its rate as the second highest among spend rates reported without overhead included. As previously stated, MSU did not indicate how much of the annual spend rate is used for overhead.

Benchmark Methodology and Results Analysis

Observation 13

*What are the financial reporting and approval requirements of the foundation(s) to the university board?
(Can have multiple responses.)*

<i>Answer</i>	<i>Number of responses</i>	<i>UofL's response</i>
Foundation board consists of university board members, so formal reporting is not required	1	1
A foundation board member or employee is required to report the foundation's activities to the university board	6	-
The university board has approval authority of all foundation board activities and budgets	0	-
Foundation board only reports the amount to be provided to the university for budgeting purposes	3	-
Foundation board and university board work in conjunction to approve spending levels and goals	2	-
Foundation and university board are totally independent and reporting is not required	4	-
Other*	8	-

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts, including UofL responses.

* One respondent stated certain defined "reportable events" require disclosure to the university board, if no "reportable events" occur, the foundation is required to report that fact annually. One respondent indicated close administration collaboration on shared goals happens in addition to required reports. One respondent indicated only reports made directly to the university president were required. Five respondents indicated audited financial statements are provided to the university as a reporting mechanism. Of those five submitting audited financial statements to the university, three of those indicated this was the only means of reporting required.

As noted in the table above, the response for UofL indicated that formal reporting of ULF activities is not required since the ULF Board includes four UofL Board members. However, it is important to note that this view has been under significant scrutiny, as UofL Board members, including some who also serve on the ULF Board, have indicated ULF activities are not transparent. This concern is discussed further in Finding 3.

Observation 14

Is the university permitted to transfer funds to its foundation(s)?

<i>Answer</i>	<i>Number of responses</i>	<i>Percentage of response</i>
Yes	5	29%
No	12	71%

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts.

UofL allows for the transferring of funds from UofL to ULF. This practice is not the norm among other universities responding to the survey, as indicated in the responses above. This practice has also been under scrutiny due to concerns about whether such transfers are properly approved. (See Finding 4)

Benchmark Methodology and Results Analysis

Observation 15

Is the university permitted to loan funds to its foundation through a loan or receivable agreement?

Answer	Number of responses	Percentage of response
Yes	1	7%
No	14	93%

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts.

Loans between a university and its foundation, as indicated in responses above, are rare among universities surveyed. The one university responding “yes” to this question stated that it was allowed to loan funds to its foundation, but indicated no loans had actually been initiated between the two entities. Through two separate transactions, in FY 2014 and FY 2015, UofL loaned \$67 million in university-budgeted funds to ULF and a ULF affiliate. Though a portion of these funds have since been repaid to UofL, the practice and process followed to loan funds have come under scrutiny. See Finding 4 for further discussion of these two loans.

Observation 16

Are loans from the university to the foundation reported to or approved by the university board?

As noted in Observation 15, only one respondent identified its university is permitted to loan funds to its 501(c)(3) foundation, and therefore, it was the only respondent for which this question was applicable. However, that respondent also indicated that no loans had actually been provided.

Observation 17

Related to employees, select the situation applicable to your university.

Answer	Number of responses	UofL's response
The university's foundation has its own employees	10	-
The university's foundation shares employees with the university	8	-
Other*	1	1

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts, including UofL responses.

* The one institution having a structure different than our supplied responses stated the foundation had no employees and those persons doing work for the foundation were state employees. Its university was reimbursed for services rendered for the foundation. UofL also answered “other” and its response is explained below.

Until July 1, 2016, ULF was managed primarily by UofL personnel assigned to support the Foundation. On July 1, 2016, the Foundation CFO and eight other UofL personnel assigned to work as ULF Foundation Financial Affairs personnel either resigned or retired from UofL and were rehired directly by ULF. See Finding 2, which addresses concerns regarding staff sharing.

Benchmark Methodology and Results Analysis

Observation 18

Is the foundation subject to review by the university's internal audit function?

<i>Answer</i>	<i>Number of responses</i>	<i>Percentage of response</i>
Yes	7	39%
No	11	61%

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts.

Refer to analysis below with Observation 19.

Observation 19

Does the foundation have its own internal audit function?

<i>Answer</i>	<i>Number of responses</i>	<i>Percentage of response</i>
Yes	5	28%
No	13	72%

Source: Auditor of Public Accounts based on surveys of a sample of higher education institutions having a separate 501(c)(3) not-for-profit corporation managing their endowments and gifts.

In its response, the Foundation CFO indicated ULF does have an internal audit function provided through external accounting firms. However, after auditors requested internal audit reports issued by the external accounting firms, it was indicated that no such reports existed as the firms were merely advising the Foundation on various financial matters. Auditors concluded ULF is not subject to UofL's internal audit function nor does it actually have its own internal audit function. See Finding 1 for recommendation that ULF establish an internal audit function.

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**UNIVERSITY OF LOUISVILLE AND UNIVERSITY OF LOUISVILLE FOUNDATION
JOINT RESPONSE**



Office of the President

Dec. 9, 2016

Honorable Mike Harmon
Auditor of Public Accounts
209 St. Clair Street
Frankfort, Ky. 40601

RE: Preliminary Response to Examination of the Governance of the University of Louisville Foundation and its Relationship to the University of Louisville

Dear Auditor Harmon:

We appreciate the Auditor's Office responding to our request for an examination of the University of Louisville Foundation and agree overall with your findings. We also thank you for the considerable time and effort expended by the Auditor of Public Accounts team in reviewing information.

The University of Louisville Foundation has a critical mission to support the University of Louisville in its efforts to maintain its distinction as a premier, nationally recognized metropolitan research university. The foundation fulfills that mission in many ways, including through the funding and support of the university's education, research and service goals through such things as student scholarships, research chairs, endowed professorships, faculty grants and salaries and other academic initiatives. It is an invaluable asset.

We recognize and appreciate that many in the community—including UofL faculty and staff, students, alumni, supporters, donors and other stakeholders—have concerns about whether the foundation has adhered to best practices in its governance, accounting and financial record keeping. We can assure you that considerable time and energy have been and will continue to be spent addressing the issues that you have identified.

More specifically, we believe it is important to note that needed changes to the leadership of the foundation and some of its policies and procedures have occurred in recent months. We have pledged to operate in a spirit of transparency and openness while maintaining our commitment to advance the intellectual, social and economic development of our community.

We can report that substantial change and corrective action are already underway to address many of the findings in your governance review. These measures include:

- Hiring outside counsel through a University of Louisville Foundation Board resolution to help establish processes that have ensured we are now in compliance with our legal obligation to fulfill Open Records Requests in a timely manner.
- Creating a vastly improved working relationship between the University of Louisville Board of Trustees and University of Louisville Foundation Board. As one example, the two entities are

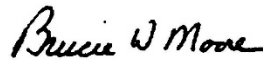
working cooperatively on a Joint Audit Oversight Committee that recently selected Alvarez & Marsal Disputes and Investigations LLC to conduct a forensic audit of the foundation.

- Establishing a new foundation committee to oversee the foundation's governance and organizational structure and to suggest any needed modifications.
- Joining the Association of Governing Boards of Universities and Colleges (AGB), a premier organization focused on governance in higher education and assisting institutions with instilling best practices. Both the University of Louisville and the University of Louisville Foundation are now members.
- Hiring Keith Sherman as interim executive director/chief operating officer of the foundation to improve operations of the foundation and to implement best practices.
- Establishing a board orientation program. The first session will be held at the Dec. 21 board meeting focusing on foundation By-Laws, Open Record Request procedures and Conflict of Interest statements.
- Determining that the current interim president of the university would not serve as president of the foundation during this transition period.
- Ensuring that the university's senior vice president of finance and chief operating officer will serve on the foundation's Finance Committee.

Again, we thank you for the invaluable work by your team. This audit provides a roadmap for further improvements in the oversight and daily operations of the foundation, and we look forward to continuing the work necessary to ensure that public confidence and trust in this important resource is fully restored. We will provide a more detailed Corrective Action Plan to your office within the next 60 days. While much of that work remains, as we've stated above a tremendous amount has been accomplished in a short amount of time. It is truly a new day for the University of Louisville and the University of Louisville Foundation.



Neville Pinto, Interim President
University of Louisville



Brucie Moore, Chair
University of Louisville Foundation

FORMER PRESIDENT DR. JAMES RAMSEY'S RESPONSE

Dr. James R. Ramsey

December 9, 2016

Hon. Mike Harmon
Auditor of Public Accounts
209 St. Clair Street
Frankfort, KY 40601

Re: Response to Examination of the Governance of the University of Louisville
Foundation and its Relationship to the University of Louisville

Dear Mr. Harmon:

Thank you for the opportunity to review your report: Examination of the Governance of the University of Louisville Foundation (ULF) and its Relationship to the University of Louisville (UL). Your examination rightly notes ULF's incredible growth in recent years, and notes the increased centrality of its role in supporting UL. The examination fails, however, to adequately acknowledge how UL and ULF's relationship — and the procedures governing that relationship — allowed for and facilitated that growth, and thus allowed for the amazing academic trajectory that the University has achieved since 2002, despite repeated state budget cuts. In fact, many of the procedural defects you describe are a consequence of UL and ULF's remarkable growth and progress.

Specifically, the examination fails to note how ULF's support has been critical in helping the University meet its statutory mandate to be "a premier nationally recognized metropolitan research university." We've done that. As a result of the UL/ULF collaboration, UL has achieved unprecedented growth and academic success on campus and in our community in critical areas such as:

- Student success, as evidenced by a) better academically prepared freshman classes; b) dramatically improved graduation rates; and c) recognition of UL as a national leader in the production of Fulbright Scholars;
- Dramatically increased philanthropic support to the University;
- Significant increases in research funding and the development of internationally recognized research programs;
- A successful partnership among the University, the Commonwealth, and the city of Louisville. For instance, between 2015 and 2020, UL will have created nearly 20,000 jobs and generated nearly \$1.5 billion for the area's economy;

- A dramatically changed campus, with new facilities that in many cases are second to none. Today, UL's campus is a great source of pride to students, faculty, staff and alumni.

These are the reasons the University exists and this progress occurred in large part because of ULF's support for the University's academic mission. This success also explains why every Board evaluation of the President, including the final evaluation in July 2015, found that the University and the Foundation met or exceeded the annual goals set by both Boards. Indeed, the President's 2014 evaluation praised him for "his transparency and continued willingness to make changes at the University." And *every* year the University received "clean" financial audits from outside independent auditors.

It is important to note in your examination that, despite cumulative state budget cuts (\$339m), the University has never been academically stronger while maintaining absolute financial integrity.

With respect to your specific findings, or combinations of findings, I offer these observations:

- Finding 1: Your examination found that UL and ULF were slow to respond to your requests for information, and that some information provided was inconsistent. This observation fails to acknowledge that we had a small staff seeking to respond to multiple outstanding Open Records Act requests, and to simultaneously cooperate with your office. That our responses were slow, or sometimes inconsistent, does not reflect a lack of transparency, as you suggest, nor an unwillingness to cooperate. (Indeed, any inconsistency in our responses means that we were not seeking to sanitize any answers.) Our highest priority was the academic function of the university and for that I accept responsibility. Contrary to your finding, UL and ULF did its best to meet massive document and information requests with limited staff. (As you noted, our very low overhead could not accommodate the enormous demand). Indeed, to meet your requests, the Foundation hired a private CPA devoted solely to managing your demands.
- Finding 2: Your examination found that the UL and/or ULF Boards acted in conflict with one another, or without sufficient training or information, or in violation of governing principles, and that they allowed institutional officers (including me) to act without proper checks and balances. I strongly disagree. Your examination does a great disservice to the outstanding individuals who served on those boards. Neither I, nor — to my knowledge — other institutional officers, acted without Board authority. Board members had full access to governing documents and records, and unfettered ability to discuss, digest, and affect the outcome of institutional options and policies. This was never a concern in any of my annual evaluations and only in the last year or so was it raised as an issue, primarily in the media.

Your finding that there is an “inherent conflict” in having the President of UL also serve as the President of ULF is wrong. The University’s President is best qualified to determine academic priorities and thus direct the funding of ULF resources, and for the vast majority of my years of service, the UL and ULF Boards agreed. While procedures can always be improved, the dual role of the President has served UL very well since 1970, and certainly during my fourteen-year tenure. (Your report omits stating that the President’s contract with ULF *requires* that he also be UL’s President.) And your finding that the UL/ULF President exerted “undue influence” on the ULF Board is unsupported and an affront to those Boards. The individuals who serve the ULF are recognized community and business leaders who gave countless hours to issues of portfolio management, real estate development, etc. Their expertise was valued and relied upon.

Neither the UL nor the ULF Board was “bypassed.” This complaint stems from a lack of engagement by certain members of the UL Board, some of whom exhibited little or no connection to the Commonwealth or the University. Again, the alleged lack of transparency could more accurately be deemed a lack of inquiry and diligence by certain Board members. Lack of transparency was never an issue in the UL Board’s evaluations of me; indeed, quite the contrary: I was praised for my transparency.

Finally, regarding Finding 2, your examination criticizes the way in which the UL and/or ULF Boards operate, but fails to note that their actions conform to the *current* operating guidelines. In other words, there is a marked difference — one that often is lost in your report — between institutional boards that should consider structural changes, and those that adhere to current structural requirements. We conformed to the current structural requirements.

- Finding 3: Your examination found a conflict among the members of the UL Board and found that the administration created an environment of distrust in a dysfunctional governing climate. I completely agree with the first assertion. There was a conflict among members of the UL Board. Much of that conflict arose in recent years. If the administration was at all responsible for this newly-developed dysfunctional governing environment, it was a by-product of the administration’s focus on enhancing the academic environment of our students and not dwelling on the “governing climate.”

I agree with your recommendation that the UL Board should operate in an atmosphere that welcomes forthright discussion; boards should act civilly and be forthright. Indeed, this lack of civility and the Board’s dysfunction contributed to my offer to Governor Bevin to retire once the Board was statutorily compliant.

- Finding 4: Your examination found that the University made two transfers of endowment funds, totaling \$67 million, to the Foundation without prior notice to, or approval by, the UL Board. You noted that the first, \$29 million, transfer has

been repaid with interest in full, and that more than three-fourths of the second, \$38 million, transfer had been repaid with interest as of June 2016. Most significantly, you noted that I had full authority to enter into these transparent contractual transfers on behalf of both the University and the Foundation. In other words, these transfers (and resulting repayment) were transparent, aboveboard, and did not conflict with state law or internal UL or ULF policies. Rather, as you noted, the *process* by which UL and ULF entered into these transactions apparently “caused concern” among some officials and donors. Those concerns were never expressed to me. I was always provided assurance by the former CFO for UL and ULF that this inter-fund cash management strategy has been in place since 1970. University counsel assured me in 2014 that there were no issues with this strategy. These transactions were always provided to the UL and ULF external auditors and they raised no issue. All of this aside, had either the UL or ULF Board wanted me to obtain prior approval or notify them of these transactions — which were well documented and readily discernable — they simply could have directed that the CFO or I do so. An audit was not necessary.

I disagree with your recommendation that UL refrain from transferring funds between ULF or its affiliates; this is a judgment better made by UL and ULF Boards (or the officials in whom the Boards vest that judgment), whose members have a fiduciary duty to make sound financial judgments for their institutions.

- Finding 5: Your examination found that my decision to appoint an acting Chief Administrative Officer (CAO) for the Foundation “appears to violate ULF Bylaws.” That conclusion elevates form over substance. As you reported, the decision effectively moved the salary of UL’s Chief of Staff from UL (the President’s office) to ULF, a move deemed advisable in light of budgetary needs and consistent with duties she actually performed. Moreover, committees and officials of the ULF Board were fully aware of and supported the move, which was entirely transparent. The only reason that the ULF Board did not approve it was that it lacked a quorum. That is why I appointed her as *acting* CAO, especially — as you noted — while we awaited the formal drafting of a contract by our legal counsel. (Nothing in the ULF Bylaws prohibits the temporary filling of positions pending ratification which occurred September, 2016. All Presidents have had authority to make temporary appointments.) Based on your view of what transpired, you recommended that the ULF Board and President abide by the Bylaws. I agree, and did so. Foundation counsel also agreed.
- Finding 6: Your examination found that the ULF Board compensated me “beyond the amount approved by the U of L Board of Trustees and beyond the amount provided” in my employment contract. You correctly stated the underlying facts, and the rationale for ULF’s decision, but reached a fundamentally flawed conclusion. As you stated, UL and ULF are separate legal entities, each of which has a contract with its President. (The President of UL and ULF has for four decades been the same person.) As you also recognized, in 2014 the UL Board wanted to give me a 4% merit raise, but acceded to the faculty

trustee's request to limit it to 2%. The ULF Board then gave me a 4% merit increase for exemplary performance; as you noted, "foundations routinely supplement the compensation for university presidents" so as to allow public universities to "attract top talent to these positions ...". All of this would be uncontroversial, but for your focus on the provision in my employment contract that, if the ULF Board deems my job performance "satisfactory," it will increase my base salary "by the same percentage [as my UL President salary] is increased." From that contractual language, you conclude that the ULF Board was barred from increasing my base salary by more than 2%. You are simply wrong. This is a provision in an employment contract between the ULF and me. The parties are free to alter the terms if they choose. Without any agreed alteration, I was to receive a salary increase only if the Board deemed my job performance satisfactory, and then only in a percentage equal to my UL salary increase; similarly, without any agreed alteration, the Board was obligated to increase my base salary by the same percentage as my UL increase, so long as it deemed my performance satisfactory. But, as with any other contract, the parties were free to modify its terms. I was free to accept a lower-than-contracted-for salary increase; ULF was free to provide a higher-than-contracted-for salary increase. The decision was transparent, open, consensual, and perfectly proper. Your recommendation that the ULF Board "refrain from taking any actions that exceed its authority" mistakenly deems it to lack the authority to modify its employment contracts. And your recommendation that the ULF Board "compensate its president in compliance with established contract terms" exceeds the scope of your mission; it is for the ULF Board, not your office, to determine whether ULF's interests are best served by modifying the terms of its contracts.

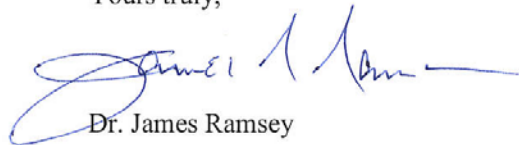
Further, over the fourteen years that I was President, I never requested an increase in compensation from either UL or ULF. I repeatedly refused to accept bonuses, after which the UL and ULF Boards decided that they would deposit my earned performance bonuses into my retirement account.

- Finding 7: Your examination found that, in violation of ULF Bylaws, the University's CFO was not included in the ULF Board Finance Committee's meetings. Of course, all ULF Board meetings are public. The University Sr. VP/CFO referred to in this finding was new to the University at that time, and also served as the COO of UL. The allocation of his time during his first 12-18 months at UL was better spent on operational issues, in areas such as human resources and organization management.
- Benchmarks: Your use of benchmarks to assess UL and ULF's current structure and operating policies — while helpful in many respects — fails to note one key feature: many of the universities to which you compare UL (such as Clemson, Duke, Georgia Tech, Purdue, Notre Dame, and the University of Virginia) are already considered top-tier academic institutions. UL has sought to join those ranks, and has pursued policies — through UL and ULF — in an effort to do just that. Those universities' governing bodies understandably pursue goals, and

adopt strategies, that differ from UL's. UL's remarkable record of growth and progress, summarized above, stands as testament to its structural and operational decisions.

Again, I appreciate the opportunity to offer these brief comments in response to your draft report. Please convey my appreciation to those in your office who spent countless hours on this review. I agree with recommendations that directors and trustees should get along better, have orientations and trainings, and follow internal rules. The structural controls and altered chains of authority that you recommend also merit serious consideration. But, candidly, this extensive research and evaluation was not needed to tell us this. What really is at stake here is the independence of the ULF Board from political influence. I continue to believe that a professional board like that at ULF knows how to achieve its mission, which simply put is to be a full partner with the UL Board to help the University achieve its academic goals.

Yours truly,

A handwritten signature in blue ink, appearing to read "James Ramsey", with a long horizontal flourish extending to the right.

Dr. James Ramsey

AUDITOR'S REPLY TO FORMER PRESIDENT DR. JAMES RAMSEY'S RESPONSE

Auditor's Reply to Former President Dr. James Ramsey's Response

Although not a current member of management for the University of Louisville (UofL) or its Foundation (ULF), the APA offered Dr. Ramsey an opportunity to respond to this report to honor a professional pledge made earlier this year that he would have a chance to respond to the governance examination findings. In evaluating his response, however, certain comments warrant additional clarification or correction.

In response to Finding 1, Dr. Ramsey points to the limited staff size and the significant number of requests for information from our office and others as the reason for slow and inconsistent responses. Also, Dr. Ramsey's response indicates the Foundation hired a private CPA to manage the requests from the APA. However, Dr. Ramsey's response does not take into consideration multiple suggestions made to alleviate the burden on the UofL and ULF staff related to the APA's request. For example, the APA requested a "data dump" of financial information in order to generate reports and analyze financial information ourselves. Additionally, audit staff repeatedly requested that copies of information not be made, but instead auditors preferred to review original documentation, whether it be in electronic format or hard copy format. However, the APA's recommendations to improve the situation were largely rejected or ignored. Also, Dr. Ramsey's response does not address the appearance of sanitizing information, such as the note included in documentation provided to auditors that is discussed on page 12 of the examination report. Finally, while we were pleased with the communication and cooperation provided by the private CPA liaison hired by ULF, it should be noted that the delays and inconsistencies continued throughout the process until there was a change in management, at which time the majority of outstanding requests were quickly addressed.

Dr. Ramsey's response to Finding 2 indicates that the APA's examination does a disservice to Board members by reporting on the lack of appropriate board orientation, and actions taken in violation of governing principles or without appropriate checks and balances. Additionally, the response indicates Board members had full access to governing documents and records. The APA believes its examination provides Board members with an understanding of information and processes needed for improved board governance. The APA's examination was based, in part, on information obtained directly from members of both UofL and ULF Boards. The Board members interviewed varied in their support of the former President, in their roles, and in their views of the Board dynamics. Also, auditors attempted to obtain access to documentation identified as being readily available to Board members. Unfortunately, those requests for information were delayed significantly, and when access was provided to a website used to transmit information to the Board members, pertinent information was either limited or no longer available. As noted in the examination, certain governing documents, such as a resource sharing agreement between UofL and ULF, were initially not identified by management. Dr. Ramsey's response to this finding also indicates that actions conformed to "current structural requirements." To clarify, the examination identifies instances in which current requirements in contracts and the bylaws were not followed, as well as recommending a review of certain structural components, such as the role of the UofL president.

In his response to Finding 4, Dr. Ramsey points out that loans between UofL and ULF have been in place since 1970. Although outside the timeframe of this examination, auditors were told that such loans did precede Dr. Ramsey's employment at UofL. However, the APA disagrees with Dr. Ramsey's assertion that such loans did not conflict with internal UofL or ULF policies, as the UofL Board of Trustees requires indebtedness to be reported to the Board. Although external auditors may not have raised concerns, the lack of board reporting and authorization identifies governance concerns, not necessarily matters relevant to a financial statement audit. Additionally, based on interviews with Board members, it is not an accurate depiction that the transactions were

well documented or readily discernable. In fact, no UofL Board member interviewed about the loans was aware of them at the time they were made, and media reports indicated at least one Trustee was not provided documentation regarding the loans when requested.

Dr. Ramsey's response to Finding 5 disputes the finding as being a matter of "form over substance" and identifies that the appointment of his former Chief of Staff to the position of ULF Chief Administrative Officer (CAO) was a temporary appointment until the position could be ratified. However, the response does not recognize that the position of CAO was not a vacant officer position, since as discussed in the examination, it was a role assigned to the ULF president per the ULF bylaws. Additionally, failing to follow the protocol for officer appointments is more than a form over substance matter given the additional benefits awarded in the temporary CAO appointment letter. Although the former President indicates the ULF Board's authorization is evident through the ratification of the action at the Board's September 2016 meeting, auditors were not able to confirm the ratification.

In his response to Finding 6, Dr. Ramsey focuses on the salary changes the ULF Board approved related to his ULF contract. However, this fails to address the additional 2% the ULF Board approved related to the former President's UofL base salary.

In responding to the APA's benchmarking, Dr. Ramsey fails to acknowledge that he and his staff were provided an opportunity to give input on the institutions they believed to be fair selections for comparative analysis. In fact, the former Chief of Staff and Foundation CFO both recommended at least one of the institutions Dr. Ramsey questions. The purpose of the benchmarking was to gather comparative information for best practices and also help identify uncommon practices. We believe the benchmarking assisted in meeting those objectives.