



EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

December 3, 2003

James R. Ramsey, Ph.D., President
University of Louisville
Louisville, Kentucky 40292

RE: September 25, 2003 University of Louisville Audit Services Reports:
Executive Expenditures of the University of Louisville general funds, University of Louisville Research Foundation, Inc., and University of Louisville Foundation, Inc.

Dear President Ramsey:

We have reviewed the referenced audit reports and their associated working papers. As part of this review, we interviewed the principal internal auditors from the University of Louisville's Audit Services (Internal Auditors) and reviewed certain University of Louisville (University), University of Louisville Research Foundation, Inc., (Research Foundation), and University of Louisville Foundation, Inc. (Foundation) records examined by Internal Auditors in the course of their audits. The purpose of our review was to determine whether the work performed by Internal Auditors was in compliance with applicable standards, accurate and complete, and whether the resulting reports fairly represent any issues discovered during the audit.

We express our thanks to you and other University employees for your cooperation during the course of our work. Following are the results of our review.

BACKGROUND

In July 2003, Internal Auditors began two routine audits of executive expenditures. One audit examined University of Louisville and Research Foundation funds. The other examined the Foundation. When allegations arose concerning former University of Louisville President John Shumaker's expenditures while at the University of Tennessee, the scope of Internal Auditors' work was expanded. In a letter dated August 27, 2003, the Foundation directed that its audit "should cover Dr. Shumaker's travel and entertainment expenses paid for by the Foundation...and should include those expenditures documented as credit card charges and other forms of travel and entertainment expenses." (Emphasis added.) The University President, in a separate letter to Internal Auditors dated August 28, 2003, directed that the audit of University general funds and Research Foundation "should follow the parameters of previous audits, but should include credit card transactions...for the Foundation credit card used by Dr. Shumaker for **travel related expenses**" and "a review of all **expense reimbursements** paid to Dr. Shumaker...." (Emphasis added.)



We were informed by Internal Auditors that the scope of the Foundation's audit was limited to Dr. Shumakers' credit card transactions and expense reimbursements, despite the more expansive authorizing language in the Foundation's August 27, 2003 letter. Internal Auditors stated that in conversations with University and Foundation representatives it was made clear that the scope of the Foundation audit was to be limited to these two areas. Both audits therefore excluded all other forms of travel and entertainment expenses which may have been incurred by Dr. Shumaker and paid by the University, the Research Foundation, and the Foundation.

Both audits examined the period January 1999 through June 2002. Although Internal Auditors issued two separate reports, the audits were performed simultaneously because

- The same Foundation credit card was used for travel and entertainment expenses paid by University general funds, the Research Foundation, and the Foundation.
- Expenses were presented together on the monthly credit card transaction report and on the quarterly expense report to the University and Foundations Boards.
- The University accounting system also processed Foundation transactions.
- University travel and expense reimbursement policies were the same, regardless of funding source.

We confirmed that Internal Auditors examined one hundred percent (100%) of Dr. Shumaker's credit card transactions and expense reimbursements for the period audited. While offering recommendations to improve the policies and practices governing the use of the Foundation credit card and reimbursements, Internal Auditors opined that "Dr. Shumaker's credit card and reimbursed expenditures were adequately supported." Internal Auditors' opinion was driven by the conclusion that available documentation was sufficient to support the business purpose of the expenditures.

FINDINGS

Internal Auditors stated the audits were "performed in accordance with the Institute of Internal Auditor's [IIA] *Standards for the Professional Practice of Internal Auditing*." Our review of Internal Auditors' compliance with applicable standards identifies the two following areas of noncompliance:

1. IIA Implementation Standard 1110.A1 states, "[t]he internal audit activity should be **free from interference in determining the scope of internal auditing**, performing work, and communicating results." (Emphasis added.)
2. IIA Implementation Standard 2220.A1 states, "[t]he scope of the engagement should include consideration of **relevant** systems, **records**, personnel, and physical properties, including those under the control of third parties." (Emphasis added.)

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As to the areas of noncompliance, the scope of each of the audits was curtailed in derogation of the cited standards. Furthermore, this scope limitation is contrary to Internal Auditors' Statement of Authority, approved by the University Board of Trustees on November 27, 2000 as part of Internal Auditors' Charter, which states "[Internal Auditors] is authorized to review all records of the University and related organizations and has full and complete access to all University activities, records, and property and personnel reasonably necessary to perform the responsibilities of this function."

Neither Internal Auditors' report of University general funds and Research Foundation nor the report of Foundation includes actions plans. Furthermore, as part of Internal Auditors' normal process followed during completion of the review, management's responses are incorporated into the report prior to final release. According to Internal Auditors, time constraints did not allow for management responses to be incorporated into either report. Official minutes of the October 9, 2003 meeting of the Board of Trustees reflect that the Board accepted all recommendations of the Internal Audit.

Internal Auditors' opinion that Dr. Shumaker's expenditures were adequately supported appears to be inconsistent with the objective stated in the audit report "to provide reasonable assurance that executive expenditures are properly authorized and compliant with University policies." No process was in place to authorize or approve Dr. Shumaker's travel and entertainment expenditures; however, quarterly informational reports of expenditures were presented to the Boards. Also, Internal Auditors clearly documented a pattern of noncompliance with established University policies regarding retention of original receipts. Internal Auditors' statement that the expenditures were adequately supported is misleading in that it ignores their stated objectives regarding approval and compliance.

Internal Auditors' reports show that more than \$62,000 of Dr. Shumaker's credit card and reimbursed expenses for the period examined were not supported by original receipts. This includes \$8,663 in reimbursed expenses to Dr. Shumaker from the Foundation, which is 34 percent of the total Foundation reimbursements. We believe the lack of original receipts for reimbursements to be a material noncompliance with the University's Travel and Expense Reimbursement Policy, which states, "[o]riginal receipts are required for airfare, lodging, car rental, and registration fees claims, showing the date of the service. Any other items in excess of \$30 must also be documented by dated receipts." While Internal Auditors were satisfied with the business purpose of the credit card and reimbursed expenditures, they recommended the retention of original receipts be improved. They cited a previous internal audit that had made a similar recommendation.

Regarding airfare, Internal Auditors stated that documentation was insufficient to support upgraded airline travel associated with more than forty percent (40%) of President Shumaker's total airfare during the four years examined. University policy states, "[a]dditional expense for first-class travel will not be reimbursed." Internal Auditors said they could not determine the financial impact of the upgraded travel over the allowable business or coach class. Internal Auditors recommended documentation be maintained to support any airline upgrades obtained with personal frequent flier miles.

Internal Auditors reported that \$35,716 in personal expenses was charged by Dr. Shumaker to the Foundation credit card. This represents approximately ten percent (10%) of the total credit card charges during the period examined. Internal Auditors found that Dr. Shumaker routinely reimbursed the University or directly paid these credit card charges. A previous internal audit had recommended using the credit card for business purposes only.

Our review of Internal Auditors reports and working papers revealed weak University internal controls in several respects, including the following:

- No approval procedure existed for President Shumaker's travel and entertainment expenditures. Dr. Shumaker reported these expenditures quarterly to the University's Board of Trustees and the Foundation Board of Directors. These reports included a budget update but were informational only, requiring no Board action.
- Except for the limitation consisting of a line item in the University's annual budget, policies did not restrict the travel and entertainment expenses of Dr. Shumaker. By policy, lodging, meals, and most airfare were reimbursed at actual cost. The policy to restrict reimbursement for upgraded airfare was routinely ignored.
- Specific written policies did not exist for use of the Foundation credit card by Dr. Shumaker.
- Dr. Shumaker frequently ignored the University policy of requiring original receipts for reimbursements. This noncompliance was not routinely reported to either Board except through infrequent internal audit reports.
- Routine operational expenses paid by the Foundation for Amelia Place, the president's home, were not reported to the Foundation Board but were limited only by budgetary constraints.

AREAS FOR FURTHER EXAMINATION

We noted several areas where Dr. Shumaker may have incurred expenditures that were not examined by Internal Auditors. These areas include:

- Procurement card (ProCard) transactions of President Shumaker's office;
- Direct payments from University accounts to vendors for travel, entertainment, or other expenses;
- Expenses related to Amelia Place, the president's home, and
- Personal service contracts that may have been initiated at President Shumaker's request.

None of these areas appears outside of the direction provided by the Foundation's letter of August 27, 2003; however, the August 28, 2003 letter from the University President limited the scope of Internal Auditors' work to only credit card transactions and expense reimbursements.

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RECOMMENDATIONS

We recommend strengthening the following control areas:

- The Boards should review and approve or disapprove the expenditures listed on the quarterly reports.
- The quarterly reports should include a statement from the President that original receipts are on file for each item listed on the quarterly reports.
- The quarterly reports should include expenditures made for Amelia Place, the president's home.
- The Travel and Reimbursement Policy requiring original receipts prior to approving the reimbursement of expenses should be enforced.
- The Travel and Reimbursement Policy should specify approval procedures applicable to the President.
- The Travel and Reimbursement Policy should be reviewed to formally include a policy to address the use and documentation of airline frequent flyer miles.
- The areas of possible expenditures by Dr. Shumaker that were excluded from the scope of these audits should be examined.
- The Boards should ensure that all expenditures are reasonable in cost, necessary, and nonpersonal in nature.

We did not review, audit, or test any changes to policies, procedures, or practices that occurred after the audit period ending June 30, 2002.

Very truly yours,



Edward B. Hatchett, Jr.
Auditor of Public Accounts