

American University
Report/Meeting Materials for the U.S. Senate Finance Committee
Monday, February 27, 2006

The materials that follow summarize actions related to governance, trusteeship, and internal management at American University since the last formal communication to the United States Senate Committee on Finance on December 1, 2005. We will provide additional information as needed to assist the committee staff in its preparations for the roundtable discussion on March 3, 2006. We look forward to the opportunity to address at the session the matters outlined below.

I. Board Governance

To ensure that it conducts itself in accord with best practices of leading university boards, the American University Board of Trustees initiated a comprehensive examination, advised by outside experts, of its governance of the university. This major project, actively underway since November 2005, is scheduled to result in governance reform recommendations for adoption at the May 2006 board meeting. Although deficiencies in the board's past oversight of President Ladner precipitated this effort, the examination is not limited to such issues and reaches the full range of board governance.

The board appointed a trustee committee ("Board Governance Committee") to oversee the project and to consult interested and informed persons outside and inside the university. The committee is meeting often and in depth, and has taken many other steps to date, including these:

- Martin Michaelson, Esq., a nationally regarded advisor on university board governance, was engaged as principal consultant to the board on the project. (His background is set out in Attachment 1). Mr. Michaelson has worked on this project nearly every day since he was engaged and is expected to maintain that level of involvement until the project is completed.
- Mr. Richard ("Tom") Ingram, a leading authority on university board practices and the former President of the Association of Governing Boards of Universities and Colleges, also was engaged to advise the board. (His background is set out in Attachment 2).
- The committee, following consultation (described below) with university constituents and others, established a demanding and intensive work-plan that covers essentially all aspects of university board governance. The main subjects of the plan are:
 - (a) The entire board governance framework, that is, specification of the board's proper role in the life of the university, and review and, where indicated to achieve best practices, revision of university bylaws;

- (b) The structure and operations of the board, its Executive Committee, and other committees, as well as the board's and board leadership's interaction with the university president and other university constituents;
- (c) The qualifications and characteristics wanted in university trustees;
- (d) Specification of standards for ongoing evaluation of, and university expectations for, trustee performance;
- (e) Review and, where indicated to achieve best practices, revision of pertinent university policies. For example, the board recently adopted a new written policy with respect to review, authorization, and approval of the compensation of the president at its February 17 meeting (Attachment 3). Obviously, this critically needed policy reform is directly related to the mistakes made with respect to supervision and contracting practices regarding Dr. Ladner. Similarly, the board recently reviewed the university's policies regarding trustee conflicts of interest and whistleblower complaints.

Mindful that extensive consultation of university faculty, staff, students, trustees, alumni, and donors is essential to the success of this endeavor and because of the university's tradition of shared governance, the board committee and Mr. Michaelson have met, in some cases a number of times already, and are scheduled to meet in coming weeks regarding the foregoing issues with:

- AU faculty, including the Faculty Senate Ad Hoc Committee on Governance and former Faculty Senate chairs;
- Administrators, including Interim President Kerwin, Interim Provost Broder, the deans of AU's schools and colleges, university vice presidents, and representatives of the Staff Council;
- Undergraduate and graduate student leaders;
- Alumni representatives;
- Donors;
- Trustees.

The board governance committee, with support from the consultants, is assembling an array of data on practices of leading university boards in each of the areas identified above, to inform the committee's and the board's deliberations in its governance reform initiative.

A threshold question that faced the board governance committee was whether to conduct the project in haste with the apparent benefit of taking quick corrective actions, but with the considerable disadvantage of limiting the board's ability to address the issues in depth; or to consult carefully with affected constituencies such as faculty, deans, students, alumni, and staff. The committee concluded that effective reform will happen only if there is a broad, penetrating understanding of the issues and understanding within and outside of the university. That takes time, no matter how great is the energy brought to the task. Careful judgment is needed. For instance:

- What are the pros and cons of a significantly larger board?
- To what extent should potential for gifts and dedicated good work for the university figure in the selection of new trustees?
- How should work be allocated between the board Executive Committee and the full board?
- What should be the limits of the board chair's authority?
- When are bilateral relations between the board (and board committees) and university administrators constructive, and when do such relations undermine the president's authority and effectiveness?
- How is the board to draw a clear line between obtaining necessary input from university administrators, on the one hand, and micro-managing, on the other?
- Should constituent groups, such as alumni, faculty, and students, be entitled to elect trustees (or otherwise have mandatory representation on the board)?
- How are geographical, vocational, alumni-status, gender, racial, ethnic, and other forms of diversity of trustees to be best achieved?

It is important to note that the balance the board is attempting to strike between prompt action and consultative deliberation has not foreclosed significant actions. The board significantly expanded the number of its committees that include representatives of the deans, faculty, students, staff, and alumni as non-voting members. These changes were implemented at the February meeting. The board has taken action to ensure that circumstances that led to the termination of the former president are not repeated. Specifically, the board has adopted policies related to review of presidential performance and compensation that includes requirements for input from university constituencies. It has restated its commitment to strong whistleblower policies, including consideration of an overarching statement to supplement the many forms of encouragement and protection already in place. Described below are actions with regard to internal controls and reporting to the Audit Committee of the board that provide strong checks against inappropriate expenditures by any university official or employee, including the president.

II. Board Transparency and Communications

A number of steps have been taken to enable the board to communicate more effectively with and be more accessible to the AU campus, to establish trust, openness and dialogue. These have included:

- Board Governance Webpage – In early November, a web-page dedicated to board governance was created. It is a depository for official memos, board actions, resolutions, and student government actions. This reference site for persons interested in the governance improvements and board changes is linked to the AU main page. On the governance site, links are also provided to other relevant sites, such as the President's Office, Board of Trustees, Campus Life, Student Government, Graduate Leadership Council, Student Bar Association, Faculty Senate, Staff Council, and the Alumni Association. The site provides ongoing updates for

any of the AU constituencies interested in board governance. Since its creation, we have had close to 14,000 visits to the site.

- Board Communications to Campus – In autumn 2005, the board initiated direct communications, memos, and updates to the campus and constituencies regarding board actions. All board and board committee communications to campus are posted on the “Governance site” and are widely distributed to the campus community. Agendas are posted prior to the full board meeting, and a summary is provided after the full board meeting.
- Board Webpage – A web-page for the board was created to assist the board in becoming more visible to the various AU constituencies. In addition to listing board members by name and profession, it includes links to recent board communications; the Bylaws and Act of Incorporation; and the most recent meeting summary. Future development of this resource is planned.
- Board Contact – A dedicated e-mailbox, AUBoT@american.edu, was created for those who wish to contact the board. This e-mailbox was particularly valuable during the height of the fall semester controversy; an estimated 70% to 80% of e-mails sent to AUBOT were from alumni and parents.

III. Trusteeship

Actions on board composition and the nomination and selection of trustees are summarized here. While the governance review will result in a more integrated and holistic series of governance improvements for the AU board and the university, the Trusteeship Committee has recognized the desire of the board itself and the campus constituencies to augment significantly board membership by attracting and adding new trustees with diverse experience and backgrounds. Consequently, the Trusteeship Committee committed itself in November to soliciting names of potential trustee candidates from a very broad range of sources including the deans, faculty, students, staff, and alumni. The following points summarize the process being followed which we hope will yield at least six new trustees for the AU board by the May 2006 meeting, to be followed by further action by the Trusteeship Committee.

- Process -- A process for nominating trustee candidates was developed formally and announced to the AU community on January 26, 2006. That process encourages anyone to submit names together with a brief statement of credentials or qualifications to the secretary of the board. The process provides that those names will be vetted by the chief financial officer and general counsel for potential conflicts of interest, or other reasons for possible disqualification, and will also be reviewed for comment by the development office for indications of past involvement with the university. Those names will be conveyed to the Trusteeship Committee for evaluation. The committee will make an initial determination of which individuals to move forward in its consideration, and review those names in confidence with the full board and with the representatives of the United Methodist Church, which also

must pass on and approve appointments to the AU board. Following such further review, which will include direct personal conversations with each candidate, the committee will make recommendations to the full board and to the General Board of Higher Education and Ministry of the church.

At its November meeting, the Trusteeship Committee also decided to invite a representative of the deans and a representative of the faculty to attend and participate in its meetings as it reviewed potential candidates and their qualifications. The Trusteeship Committee had previously adopted a set of criteria for assessing potential trustee candidates, and an "interim" set of substantially similar criteria was developed early in the governance review process. The committee refers to both lists of criteria when evaluating candidates. In addition, the committee has had in place for some time criteria to assess whether incumbent trustees should be reappointed at the expiration of their three-year terms. Copies of the nominating process currently in place and of the criteria used are attached.

- New Trustee Candidates -- Opening the nominating process to all university constituencies has proven highly beneficial. The committee heard from a number of individuals regarding qualities that should be represented on the board as well as individual candidates who were thought likely to make excellent board members. The committee heard from various interested individuals and groups that they would like to see a sizeable number of new trustees brought onto the AU board. There is interest in adding individuals with high-level experience in higher education; individuals who increase board diversity not only with respect to gender and race, but also diversity of experience and background; individuals of national stature, including persons currently or formerly in high government office; and individuals who have an international perspective or background.

University by-laws provide that the board should consist of 25 to 50 trustees. The governance review is considering issues of size and composition as part of its process. However, with the resignation of several valued trustees last year, and the decision of one incumbent not to stand for re-election, the board will have 19 trustees as of the May meeting unless new trustees are elected. Consequently, the Trusteeship Committee with the concurrence of the board intends to identify and recruit at least six (6) new trustees by the May 2006 meeting and sooner if feasible.

By opening the nominating process to the entire AU community, the Trusteeship Committee has received approximately 60 suggestions of individuals for consideration as new trustees. These include several academics of distinction; a number of women and individuals of color; persons who have served in significant governmental posts (both elected and appointed); people with a record of accomplishment in diverse fields including international activities; and many who have already demonstrated their commitment to AU by volunteering their time and giving of their resources to support particular university schools and programs. From this group, the Trusteeship Committee has refined the list to approximately a dozen individuals whom it intends to advance for consideration and to better ascertain their interest and qualifications. Behind this group are another dozen individuals of

distinction and merit who also appear likely to be fine trustees if they can be induced to join the board and help it implement robust governance processes and further strengthen its governance culture. The committee will enlist the assistance of university personnel, including deans and faculty, to help recruit such individuals.

- Orientation and Attendance -- Another element of trustee service that continues to be a Trusteeship Committee responsibility is the orientation of new trustees. The board has had such programs in the past but, they have not been well attended. The committee intends, subject to the outcome of the governance review process, to require each new trustee to go through an orientation in order to learn about the university, its strengths, priorities, and challenges as the trustee comes onto the board. Similarly, the Trusteeship Committee recognizes the importance of gaining a commitment from each trustee to make room in his or her schedule to prepare for and attend not only board meetings, but other functions on campus which will give the trustee a deeper knowledge of the university, its faculty, students, staff, and other resources. The Trusteeship Committee and the Governance Committee have recognized the need for balance on the board so that all individuals are selected not primarily for their gift-giving potential, but all trustees are selected on the basis of commitment to the university and trustee service.
- Reappointment -- At its February meeting, the Trusteeship Committee considered reappointment of current trustees whose terms were expiring effective this May. One trustee decided not to stand for reappointment. The other five trustees eligible for reappointment were considered against the criteria established for reappointment and, upon recommendation of the committee, were approved by the board for a new term. The five trustees had substantial giving records relative to their means, had excellent attendance at meetings, and had actively participated in or led board committees. The current criteria for reappointment are also attached (Attachment 4).
- Coordination with United Methodist Church -- Under AU's organic documents, the General Board of Higher Education and Ministry of the United Methodist Church has a right of approval of individuals nominated to be trustees of the university. Through the church's representatives on the AU board, Jerome Del Pino and Bishop John Schol, the Trusteeship Committee is aware of the General Board's intent to be thoughtful about the qualifications of individuals so nominated and the composition of the AU board itself. It has been agreed that the Trusteeship Committee will provide the General Board the names and biographies of individuals who are being seriously considered for nomination, so that the General Board can have input in the vetting process, and will coordinate with the General Board with regard to timing of nominations, so there is no undue delay in approving new trustees. The church's representatives have made clear that they regard the university to be the primary agency for identifying and vetting potential trustees, and that the General Board will respond to requests for consideration or action when made by the Trusteeship Committee. It should be noted that the United Methodist Church has a long and distinguished history of supporting colleges and universities that have ties, historical or current, to the church.

IV. Review of Internal Controls – Sarbanes-Oxley and Audit Committee

The Ladner issues illustrated certain weaknesses in the university's generally strong financial controls. Historically, the university has received unqualified audit opinions for more than 60 years, and no significant financial improprieties have been identified or reported. The university is striving to ensure the most effective internal audit coverage, being one of the very first institutions of higher learning to outsource the function to an outside, professional organization (Protiviti) that could provide the most contemporary and skilled services.

- Internal Audit Plan -- In fall 2004, the Board of Trustees Audit Committee approved the 2005 Internal Audit Plan, which included using a significant portion of internal audit's time to begin a Sarbanes-Oxley type review of the university's internal controls of financial processes. Although Sarbanes-Oxley essentially does not apply to not-for-profit institutions, the Audit Committee concurred with a recommendation from management that the university should be highly proactive in applying rigorous internal control standards across the enterprise. This began an 18-month process during which Protiviti has been reviewing, documenting, and performing detailed testing of the university's internal controls. To date, Protiviti has reviewed and documented the following processes, finding no significant internal control or material weaknesses: Procurement and Accounts Payable; Payroll and Benefits; Investments and Cash Management; Auxiliary Services; Registration; Student Accounts; Financial Aid; and overall Financial Reporting. Testing of these processes is now underway and should be completed by May 2006. To date, no material weaknesses have been identified. Protiviti has provided the Audit Committee regular updates on their review. Significantly, Protiviti, a leader in this field, has noted they are aware of only a few not-for-profit organizations that have proactively undertaken such a review. This process, initiated well before any issues regarding the former president arose, demonstrates that those issues did not reflect the university's overall financial control environment.
- Audit Committee -- At the November 2005 Audit Committee meeting, two new procedures, designed to enhance the committee's oversight of presidential expenditures, were implemented. First, the committee directed the chief financial officer to provide the chair of the Board of Trustees and chair of the Audit Committee a quarterly report of travel and entertainment expenses for the president and each vice president. Second, the committee authorized a formal, independent reporting structure to allow the chief financial officer to meet independently with the committee at regular intervals to facilitate discussion of any unusual financial matters that may have come to the CFO's attention.

Attachment 1

Martin Michaelson

Partner, Hogan & Hartson, (Washington, D.C. and New York offices)

Martin Michaelson's practice focuses on representation of universities, colleges, higher education associations, medical centers, research institutes, foundations, firms in the distance education field, and other clients located throughout the United States and overseas. He returned to Hogan & Hartson in 1989 following six years of service at Harvard University, initially as deputy general counsel, then as university counsel. Before joining Harvard, he was with Hogan & Hartson for ten years, handling federal regulatory matters, including litigation, counseling, and legislative work.

After law school (during which he was a member of the winning team of the National Moot Court Competition), Martin practiced in New York City. He then served as legislative assistant to U.S. Congressman Robert Drinan, who had been his law school dean.

Martin has spoken and written widely on legal risk management at, and regulation of, universities. In 1999 he taught the course "Higher Education and the Law" at the Harvard Graduate School of Education. His views have been published by, among others, *The Journal of College and University Law*, *The Chronicle of Higher Education*, the American Council on Education, and the Association of Governing Boards of Universities and Colleges. He is a consulting editor of *Trusteeship* magazine, and for seven years wrote its regular column, "Legal Standpoint." He is a fellow of the National Association of College and University Attorneys. He is a graduate of the University of Chicago (1965) and Boston College Law School (1968), and is admitted to practice law in New York, the District of Columbia, and Massachusetts.

Representative Experience

Has advised more than 100 universities on regulatory, governance, litigation and transactional matters.

AREAS OF FOCUS

- College and university legal risk management
- Federal regulation of higher education
- Corporate governance of universities

Attachment 2

Richard T. Ingram

Until retiring in January 2006, Richard “Tom” Ingram was the president of the Association of Governing Boards of Universities and Colleges (AGB). He had served as president since 1992.

In existence for more than 80 years and devoted to volunteer education and board development in public and private higher education, AGB is a national organization in the service of college and university trustees, chief executives, and senior executive and academic officers totaling 34,000 individuals, 1800 institutions, and 1150 boards. The organization’s mission is to advance the practice of citizen trusteeship and help ensure the quality and success of our nation’s colleges and universities.

Dr. Ingram has served on the boards of two private institutions and other enterprises including an insurance company and a private school. Currently, he serves on the University of Maryland College of Education Board of Visitors. Dr. Ingram is an active writer in the field and has conducted scores of workshops to assist boards of trustees with self-studies of their effectiveness. His *Ten Basic Responsibilities of Nonprofit Boards* for BoardSource (formerly the National Center for Nonprofit Boards founded by AGB) has sold more than one million copies. A native of the Pittsburgh, Pennsylvania, area, Dr. Ingram holds a doctorate in higher education administration from the University of Maryland, College Park, Maryland.

Additional Publications

Trustee Responsibilities: A Basic Guide for Governing Boards of Independent Institutions

Trustee Responsibilities: A Basic Guide for Governing Boards of Public Institutions

A Guide to Conflict of Interest and Disclosure

Executive Committee

New Trustee Orientation: A Guide for Independent Colleges and Universities

New Trustee Orientation: A Guide for Public Colleges and Universities

The Board Chair’s Responsibilities: A Basic Guide for Board Chairs in Independent Higher Education

The Board Chair’s Responsibilities: A Basic Guide for Board Chairs in Public Higher Education

Presidential and Board Assessment in Higher Education: Purposed, Policies and Strategies (with William A. Weary)

Effective Trusteeship: A Guide for Board Members of Private Colleges and Universities

Effective Trusteeship: A Guide for Board Members of Public Colleges and Universities

Attachment 3

American University Board of Trustees Policy Regarding Presidential Compensation and Contracts

This policy applies to contracts with, and compensation for the President of American University (the "University").

Any University contract with the President, including his employment agreement, shall be in writing and shall contain all material financial terms. A contract with the President shall be disclosed in full to the Board and must be approved by the Board prior to its execution on behalf of the University.

The terms of any contract with the President, and the compensation to be paid the President, shall be reviewed periodically by the Compensation Committee of the Board, which may engage counsel and compensation specialists as the Committee deems advisable to assure that the compensation paid is appropriate in relation to that paid by comparable institutions of higher learning for similar services, as well as other relevant considerations including performance. To be effective, any report, recommendation or finding of the Compensation Committee, or any other Committee, regarding the President's compensation, must be approved by the Board and recorded in the minutes of the Board meeting at which such vote occurred.

The Board will receive a periodic evaluation of the President's performance from the Compensation Committee, which will consult with the various University constituencies in preparing its report.

On an annual basis, the compensation information reported by the University to the Internal Revenue Service will be shared with the University community.

The Vice President of Finance of the University shall serve as the contracting officer for each contract with the President. The Vice President of Finance shall sign each contract as approved by the Board and maintain the original copy for the University. The Vice President of Finance and the General Counsel shall be consulted by the Board before such a contract is executed, and thereafter the Vice President of Finance, in consultation with the General Counsel, shall oversee compliance with the contract.

Attachment 4

From American University Board of Trustees Policies November 7, 2003

Criteria and Information for Screening Potential Trustees

- a. understanding of and willingness to work actively to promote the interests and quality of the university;
- b. local, national, or international influence;
- c. capacity and willingness to make significant contributions and assist in fund-raising efforts;
- d. leadership ability;
- e. special skills, talents, or interests;
- f. ability to attend and be involved regularly in Board and committee meetings and university activities;
- g. ethnic and gender diversity; and
- h. demonstrated match with the target profile formulated by the Trustee Committee for a given year.
- i. relationship, if any, to the university
- j. potential conflicts (e.g., Board membership at a competing university)
- k. personal references

Criteria for Evaluating Trustee Performance for Re-election

- a. demonstrated active involvement in Board and university activities in ways that promote the welfare and quality of the university;
- b. regular attendance and effective participation in Board and committee meetings;
- c. involvement in university activities other than Board meetings;
- d. use of special talents, abilities, or professional relations to benefit the university;
- e. financial support of the university with payments kept current;
- f. assistance in development and fund-raising programs; and
- g. compliance with the Trustee Conflict of Interest policy.

The process for evaluating the performance of individual trustees takes place formally at least every three years at the conclusion of a Board member's term. The Trusteeship Committee notifies trustees that their terms will be concluding and meets to review their suitability for reelection in light of the criteria for trustee performance.

Attachment 5

Chronology of Governance-related Meetings

December 2005 to Date

Date	Meeting Host(s)	Groups/ Individuals	Topics
12/02/05	Board of Trustees	Martin Michaelson, Esq.	Discussion on forward-looking Board governance
12/05/05	Governance Committee	Provost and VPs, deans, faculty senate, student leaders, Staff Council	University governance & related issues
12/12/05	Governance Committee	Governance Committee	Update on activities
12/19/05	Governance Committee	Governance Committee	Assignment of responsibilities
01/12/06	Executive Committee	Executive Committee	Board-related issues
01/13/06	Governance Committee	Governance Committee	Update on activities and assignments
01/26/06	Governance Committee	Faculty Senate Ad Hoc Committee on Governance	University governance & related issues
02/01/06	Governance Committee	Governance Committee	University governance & related issues
02/02/06	Executive Committee	Executive Committee	Board-related issues
02/07/06	Governance Committee	Governance Committee	University governance & related issues
02/08/06	Trusteeship Committee	Trusteeship Committee	Class of 2006 review and nominee review process
02/10/06	Mark Huey	Alumni Association Executive Committee	University governance & related issues
02/16/06	Governance Committee	Deans, Faculty Senate's Ad Hoc Committee on Governance, student leaders, Staff Council	Committee update and university governance & related issues
02/17/06	Board of Trustees	Campus representatives	Governance Committee update
02/22/06	Bishop John Schol, faculty liaison, Governance Committee	Co-chairs of the Faculty Senate's Ad Hoc Committee on Governance	Discussion of issues before the Governance Committee

***Meetings of the Executive Committee and the Governance Committee are next scheduled for Thursday, March 2, 2006.**