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June 2, 2016

Henry M. Huckaby
Chancellor
University System of Georgia
270 Washington St., SW
Atlanta, Georgia 30334
via hand delivery

Dear Chancellor Huckaby:

Our office has been reviewing an issue involving the administration of Kennesaw State University (KSU) and its executive compensation practices. We have found that KSU's executive compensation practices are out of line with the policies, procedures, and standards of the University System of Georgia (USG) with respect to certain payments made to KSU President Dr. Daniel S. Papp (Dr. Papp). Following please find a discussion of these issues.

<u>Executive Compensation</u>
The USG Office of Human Resources (OHR) conducts a regular survey of presidential compensation as part of its ongoing monitoring of personnel operations across the USG. Its most recent survey identified potential issues related to President Papp's pay that required follow-up review. OHR referred this matter to our office and our subsequent review identified the following issues.

> *Background*: Dr. Papp was appointed KSU president in 2006 after almost 33 years of service to the USG to include service as an interim president, service in various roles at Georgia Tech, and as a senior vice chancellor of academic and fiscal affairs with the USG System Office from 2000 to 2006. Dr. Papp announced his retirement in May 2016 effective June 30, 2016.
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> The USG Board of Regents established Dr. Papp's compensation as president on an annual basis pursuant to Board Policy 2.8. Board Policy 2.8 and its predecessor policies were revised in 2004 to specify that presidential compensation would be solely controlled by the Board of Regents (BOR) and paid with state funds. Foundations may, with approval, contribute funds to the institution as a means to help defray an institution's expenses. As noted in the August 2004 BOR meeting – "With regard to presidential compensation, foundations had been directly involved with presidents, and this certainly does create the potential for a conflict of interest." As such, the BOR's 2004 policy changes ensured that the Board charged with governance of the USG (i.e., the BOR) would also control the compensation paid to its employees, i.e., USG presidents.

The BOR also established its own 457(f) deferred compensation plan[1] in December 2004 for use by USG presidents in lieu of foundation-administered plans. The BOR's 2004 plan provided for a payout to a participating president of accrued deferred compensation upon vesting, i.e., upon separation from the USG or certain other limited conditions such as death or disability. The payout of funds also was at risk of forfeiture subject to the Chancellor and/or BOR's discretion.

Dr. Papp's compensation package was approved in February 2006 upon his appointment as KSU president. His compensation package incorporated $214,000 in regular compensation[2] in addition to $6,000 - $9,000 for a vehicle allowance and $30,000 per year in deferred compensation. The vehicle allowance and deferred compensation were to be funded by the KSU Foundation (KSUF) as noted in Dr. Papp's appointment letter from then Chancellor Erroll Davis.

A subsequent February 20, 2006 letter from Chancellor Davis to the former KSUF Chairman Holder states, in part:

> Dan has signed a letter agreement that says the Kennesaw Foundation has agreed to provide $6,000 - $9,000 for a car and $30,000 in deferred compensation for each of three years. The original signed agreement is attached. When the time is ripe, we will ask you to make the payments to the institution. Dan will participate in the Board of Regents approved deferred compensation plan. So that we may have a record of the Foundation's approval and agreement to this arrangement, would you please sign the extra copy of this letter and return it to me.

The letter was counter-signed by the KSUF Chairman and maintained in Dr. Papp's personnel file in the Office of the Chancellor. The letter, through at least mid-2010, was in the possession of KSUF personnel. Current KSUF personnel indicated no knowledge of the existence of the 2006 letter. Dr. Papp was not copied on the KSUF letter and stated he was unware of its existence.[3]

It is important to note that the System Office did not enroll Dr. Papp in the BOR's December 2004 Deferred Compensation Plan. Had the System Office enrolled Dr. Papp in the plan, this would have triggered periodic billings to KSUF by KSU for subsequent deferred compensation funding in the BOR plan. There also is no evidence that Dr. Papp, KSU, or KSUF contacted the System Office to determine the status of Dr. Papp's deferred compensation plan. Instead, KSUF maintained their expected contribution in an account held by KSUF while Dr. Papp stated he was not aware that he was supposed to be in the BOR's deferred compensation plan. The funds accumulated in this

1 A 457(f) deferred compensation plan is an arrangement by which an employer may create an account containing funds for future distribution to an employee. The employee is not entitled to the account's funds until the plan's vesting date and subject to certain conditions as outlined in the plan.

[2] The $214,000 was comprised of $181,2000 in base salary, a $19,400 housing allowance, and a $13,400 subsistence allowance that were funded entirely with state funds.

[3] A former KSU/KSUF senior officer referenced the KSUF letter in a 2008 email to Dr. Papp; however, the reference was in passing and there is no evidence that Dr. Papp was provided an actual copy of the letter.

account from 2006 through 2012 were later distributed to Dr. Papp when KSUF established its own KSUF deferred compensation plan.

The BOR increased Dr. Papp's compensation in future years to include additional base salary, a salary supplement, and additional deferred compensation contributions. The annual compensation letters to Dr. Papp specified that the KSUF would provide funds to support Dr. Papp's salary supplement, a portion of his deferred compensation, and vehicle allowance. Dr. Papp indicates he did not provide copies of these letters to the KSUF. Instead, he assumed that the KSUF was directly coordinating with the Chancellor's Office on compensation arrangements pertaining to his (Dr. Papp's) compensation.

Dr. Papp indicated in discussions with him that he was not aware of the System's Deferred Compensation Plan as he indicated he did not participate in presidential salary discussions when he served as USG Senior Vice Chancellor for Academics and Fiscal Affairs.

Deferred Compensation. As stated previously, Dr. Papp was not enrolled and never participated in the BOR's approved deferred compensation plan as specified in the Chancellor's February 2006 letter to the KSUF chairman. Instead, Dr. Papp was enrolled and participated in a variety of plans established and controlled by the KSUF. Under the KSUF plan, Dr. Papp was eligible for and received a payout of accrued deferred compensation of $260,000 and an annual retention payment or bonus of $45,000 in 2012. Dr. Papp received additional payouts of $45,000 retention bonuses in 2013 and again in 2014 followed by $182,500 in 2015 incorporating both an annual retention bonus and a longevity payment.

The amounts paid to Dr. Papp were consistent with the amounts of *deferred* compensation authorized by the BOR; however, neither the BOR nor the Chancellor authorized or was aware of the distribution of deferred compensation to Dr. Papp. In point of fact, distribution of deferred compensation funds would not have been authorized until Dr. Papp's separation from USG service under the BOR's deferred compensation plan in which Dr. Papp should have been enrolled. Furthermore, the payment of an annual retention payment effectively transitioned a portion of the BOR's authorized deferred compensation to current year salary. Dr. Papp received $577,500 in accrued "deferred compensation" from 2012-2015 resulting from contributions to his deferred compensation accounts from 2006-2015.

Dr. Papp indicates he was not aware of the requirement to participate in the BOR's plan and that he believed the KSUF had coordinated with the Office of the Chancellor with respect to his deferred compensation arrangements. Our office reviewed available records of email conversations between the KSUF and the Office of the Chancellor in addition to interviewing both the prior and current Chancellor. No record exists indicating that the KSUF informed the BOR or either Chancellor that they had distributed accrued deferred compensation funds to Dr. Papp. Several emails were available detailing the KSUF's desire to increase Dr. Papp's compensation package to include proposals to payout deferred compensation to award a successful, future capital campaign. Subsequent communications make clear that these proposals were to be discussed with the BOR.

Ultimately, changes to the level of Dr. Papp's deferred compensation and a salary supplement (both to be funded entirely or in part by KSUF) were approved by the BOR; however, actual distribution of deferred compensation was approved by neither the BOR nor the Chancellor. Furthermore, KSUF staff report that Dr. Papp requested KSUF to process his deferred compensation payout through the KSUF payroll. KSUF staff indicate Dr. Papp may have requested this method so as to ease the process of adjusting his withholdings (a process that also could have been accomplished on his state payroll). The payouts were properly recorded for tax purposes and KSUF made the proper withholdings of applicable taxes.

The processing of payment through the KSUF is a direct violation of Board Policy and also impairs the USG's ability to have visibility of the payment. There was no mention of a deferred compensation payment to Dr. Papp in the KSUF annual financial report provided to the USG system office other than a general reference to the fact that KSUF has a deferred compensation plan and changes in the plan balance. "Incentive and bonus compensation" to Dr. Papp was recorded in various Form 990s filed by KSUF with the Internal Revenue Service; however, these reports are neither provided to nor reviewed by the USG system office as a matter of its normal processes.

The following table outlines some of the key dates and changes to Dr. Papp's compensation.

Date	Discussion	Action
2/16/2006		BOR appoints Dr. Papp KSU president effective June 2006 with compensation of $214,000 plus $6,000-9,000 vehicle allowance and $30,000 in deferred compensation for the next three years.
6/13/2007		Chancellor Davis sends letter to Dr. Papp indicating BOR increased Dr. Papp's base compensation increased from $214,000 to $234,436 effective January 1, 2008.
3/11/2008	KSUF email discussion references support for Dr. Papp's performance and desire to increase total compensation to $300,000; email also references that Chancellor advised a deferred compensation plan could include a bonus for reaching capital campaign goals.	

6/11/2008	(Note: Increases to Dr. Papp's compensation appear to be at least partially in response to KSUF's proposal to improve Dr. Papp's compensation.)	Chancellor Davis sends letter to Dr. Papp indicating BOR increased Dr. Papp's base compensation from $234,436 to $280,000 effective 1/1/09 and increases annual deferred compensation contribution from $30,000 per year to $50,000 per year. Both the increased deferred compensation and $30,000 of the increased base compensation to be funded by the KSUF per a separate letter from KSUF Chairman to Chancellor Davis.
12/17/2008		Chancellor Davis sends letter to Dr. Papp indicating BOR revised downward previous salary increases in response to state budget challenges. $280,000 approved compensation reduced to $269,477 through reduction in state-funded base salary. Approved increase to deferred compensation totaling $50,000 per year is maintained.
6/12/2009		Chancellor Davis sends letter to Dr. Papp indicating BOR approved no changes to Dr. Papp's FY 2010 compensation due to state budget challenges.
6/16/2010		Chancellor Davis sends letter to Dr. Papp indicating BOR approved no changes to Dr. Papp's FY 2011 compensation due to state budget challenges.
9/16/2010	Chancellor Davis indicates in email that the USG is considering a KSUF proposal to improve Dr. Papp's pay and queries whether Dr. Papp was aware of the discussion. KSUF Chairman indicates Dr. Papp approached KSUF for compensation review due to a projected increased annual payment of $25,000 in 2011 with respect to a personal matter and having received an unsolicited offer for more money at another (unknown) entity.	

12/24/2010	Chancellor Davis floats possibility of stay bonus or other deferred comp in an email to the KSUF Chairman; indicates potential will be raised with BOR at upcoming BOR meeting.	
3/2/2011	Chancellor Davis indicates in email to KSUF Chairman that he will seek approval for a total compensation package of $375,000 but that amount is not yet approved.	
6/3/2011		KSUF executes agreements effective January 1, 2011, resulting in distribution of $260,000 in accrued deferred compensation to Dr. Papp effective 2012. No record could be identified that indicated BOR or Chancellor awareness or approval.
6/6/2011	Chancellor Davis sends email to KSUF Chairman breaking out proposed compensation package for Dr. Papp inclusive of amounts to be supported by KSUF totaling $375,000. Total includes increase of salary supplement from $30,000 to $40,523 and deferred compensation increase from $50,000 to $95,000.	
6/9/2011		Chancellor Davis sends letter to Dr. Papp indicating BOR approved no changes to Dr. Papp's FY 2012 compensation due to state budget challenges.
3/5/2012	Chancellor Huckaby invites KSUF Chairman to present KSUF proposal with respect to increase compensation for Dr. Papp to BOR Executive & Compensation Committee.	
6/22/2012		Chancellor Huckaby sends letter to Dr. Papp indicating BOR approved increase in total compensation from $269,477 to $280,000 and increase in deferred compensation from $50,000 to $90,000 effective July 1, 2012.
10/3/2012		KSUF executes agreements effective July 1, 2012, creating annual retention bonus payment in addition to a longevity payment to be distributed every three years.

5/30/2013		Chancellor Huckaby sends letter to Dr. Papp indicating BOR approved no changes to Dr. Papp's FY 2014 compensation due to state budget challenges.
6/6/2014		Chancellor Huckaby sends letter to Dr. Papp indicating BOR approved increase in total compensation from $280,000 to $293,267. Letter clarifies that deferred compensation is to be funded $40,000 from KSUF funds and $50,000 from KSU funds. Changes are effective July 1, 2014.
6/2/2015		Chancellor Huckaby sends letter to Dr. Papp indicating BOR approved increase in total compensation from $293,267 to $301,040. Letter clarifies that deferred compensation is to be increased to $94,500 with $42,000 from KSUF funds and $52,500 from KSU funds. Changes are effective July 1, 2015.
11/30/2015		KSUF executes agreements effective July 1, 2015, increasing annual retention bonus to $47,500 and amount to be funded for longevity payment to $47,500 annually with distribution every three years.

Annual Leave. Dr. Papp received an annual leave payout to which he was not entitled. Specifically, Dr. Papp received a payout of $13,981.63 from the Georgia Institute of Technology (Ga. Tech) in 2011 when Ga. Tech paid him for 200 hours of accrued annual leave. The Ga. Tech annual leave had been carried over from 2000 (when he initiated a leave of absence from Ga. Tech to serve at the System Office) until 2011 (when Dr. Papp retroactively resigned his tenured position effective 2006). Dr. Papp has refunded the overpayment.

Dr. Papp's annual leave from Ga. Tech should have been forfeited or "zeroed out" soon after Dr. Papp transferred to the System Office insofar as he was carrying over annual leave hours each year at both Ga. Tech and the System Office. Only 360 hours may be carried over from one calendar year to the following year: i.e., any unused leave over 360 hours is forfeit after midnight, December 31 of each year. Dr. Papp could have transferred his 360-hour leave balance to the System Office in 2000 and received a payout of 200 hours at that time.[4] However, Dr. Papp chose to maintain his employment status at Ga. Tech so as to not resign his tenured position during his tenure at the System Office.

[4] Board Policy requires employees moving between institutions with no break in service to transfer a minimum of 160 hours of accrued annual leave to the gaining institution. Any annual leave hours in excess of 160 hours up to 360 hours may either be transferred to the gaining institution or the previous institution may pay out the non-transferred, accrued annual leave as an additional salary payment.

As noted above, Dr. Papp earned and carried over annual leave hours at the System Office while he was assigned there from 2000 through 2006. Dr. Papp appropriately received a payout of 200 hours ($20,006.70) in annual leave when he transferred from the USO to KSU in 2006. Additionally, 160 hours of accrued annual leave was transferred from USO to KSU. Both of these practices were consistent with Board Policy.

Upon Dr. Papp's appointment in 2006, Dr. Papp believes that he took action to resign his tenured position at Ga. Tech; however, no record could be located indicating said resignation took place. Instead, he executed a resignation in 2011 retroactive to 2006. At that point in time, Ga. Tech offered Dr. Papp the option of transferring his annual leave balance to KSU or to receive a payout of 200 hours at his professorial rate of pay. Dr. Papp chose the latter option and received an additional annual leave payout of $13,981.63. It would have been possible for Dr. Papp to have received the $13,981.63 payout of annual leave when he originally transferred to the USO in 2000 had he actually resigned his tenured position at Ga. Tech instead of waiting to resign until 2011. Dr. Papp has subsequently reimbursed Ga. Tech for the improperly paid-out annual leave.

Vehicle Allowance & Tax Reporting. Dr. Papp has received a car allowance greater than that authorized in his annual compensation letter. Additionally, KSU has underreported Dr. Papp's taxable income in the form of his car allowance. Specifically, Dr. Papp has purchased new vehicles approximately every three years under an arrangement by which Dr. Papp purchases the vehicle and the KSUF pays the monthly vehicle note. The most recent vehicle was paid off in November 2015 and Dr. Papp purchased a new vehicle in December 2015.

The monthly vehicle payment of $1549.23 is paid by the KSUF. Dr. Papp indicated that his vehicle allowance totals approximately $20,000 each year since 2012, i.e., Dr. Papp received approximately $40,000 in unauthorized compensation in the form of payments on his behalf for automobile purchases. The president's authorized compensation letter is unchanged from the original $6,000 per year; however, the letter to the KSUF from the Chancellor in 2006 authorized $6,000 - $9,000 per year.

A subsequent June 2011 email from the former Chancellor to a former KSUF Chairman specified a $10,000 vehicle allowance. Specifically, the June 6, 2011 email from Chancellor Davis listed current and proposed compensation for Dr. Papp. Chancellor Davis added a note under the current compensation stating: "The Foundation also contributes $10,000 for a car allowance." Chancellor Davis went on to list proposed compensation and added a note under that list as follows: "The Foundation will continue to contribute $10,000 in addition for a car allowance." Chancellor Davis confirmed that the note was clearly intended to convey that $10,000 was the authorized amount for a car allowance and that it would be "in addition" to the other (non-vehicle related allowances) compensation listed above. Dr. Papp indicated KSUF interpreted this email to mean that an additional $10,000 was authorized; however, neither the specific language used in the email nor the context of the email convey that a $20,000 annual vehicle allowance was authorized. Furthermore, the email communicated the Chancellor's planned proposal prior to the meeting and not what actually was approved at the meeting.

The $20,000 for a vehicle allowance is in excess of the amount authorized at any point in the compensation letters sent to Dr. Papp. In fact, the entire email exchange referenced above pertained to what Chancellor Davis would bring to the BOR meeting scheduled for the following day. At that meeting, the BOR authorized no changes to Dr. Papp's compensation as indicated in the Chancellor's June 9, 2011 letter to Dr. Papp. Dr. Papp indicated he believed that the KSUF and the Office of the Chancellor had negotiated this change. No record in writing exists of any agreement to change the compensation.

A more serious issue arises with respect to both tax reporting and Open Georgia. KSU officials charged with W-2 issuance and Open Georgia reporting were not aware of the actual payment arrangements with respect to Dr. Papp's vehicle. Specifically, they understood that the vehicle was an "employer-provided vehicle" and that any taxable income associated with the vehicle was being reported insofar as Dr. Papp had personal use of the vehicle. In reality, Dr. Papp was receiving a taxable vehicle allowance in the form of direct payments for the vehicle. As a result, the payments made on Dr. Papp's behalf over multiple years by KSUF to purchase vehicles were not reported as income on any KSU reporting. Additionally, various club membership dues paid by KSUF on behalf of Dr. Papp appear to not have been appropriately reported. KSU and KSUF are coordinating with the USG System Office to ensure that the required prior year income adjustments are made and reported as required by law.

Each issue noted above warrants corrective action. Please note that Dr. Papp has agreed to fully cooperate in remediating the issues noted above. He already has asked my office to make contact with Ga. Tech to arrange for a return of the overpayment of annual leave funds and has since refunded Ga. Tech the required funds. Additionally, KSU personnel are working with KSUF personnel to ensure the appropriate tax reporting is corrected and re-issued.

Sincerely,

John M. Fuchko, III

John M. Fuchko, III
Chief Audit Officer and Vice Chancellor

JMF/

cc: Regent Kessel D. Stelling, Jr., Chair, Board of Regents of the University System of Georgia
Regent C. Thomas Hopkins, Jr., Vice Chair, Board of Regents of the University System of Georgia
Regent Don L. Waters, Chair, Committee on Internal Audit, Risk & Compliance
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