Office of the Auditor General of Ontario

Preliminary Perspective on Laurentian University

April 2022

Office of the Auditor General of Ontario

To the Honourable Speaker of the Legislative Assembly

In my capacity as the Auditor General, I am pleased to submit to you our *Preliminary Perspective on Laurentian University* in accordance with section 12(1) of the *Auditor General Act*.

On April 28, 2021, the Standing Committee on Public Accounts requested, under section 17 of the *Auditor General Act*, that our Office conduct a value-for-money audit of Laurentian University's operations for the period of 2010 to 2020 and to answer questions of what led Laurentian University to seek creditor protection under the *Companies' Creditors Arrangement Act* (CCAA).

The Legislature will be dissolved within the next few weeks, as will the Standing Committee, in light of the upcoming election. As a result of Laurentian's consistent lack of co-operation and delays in allowing us our normal unfettered access to documents and people, it is unlikely we will be able to table our special audit report before the Legislature is dissolved.

Accordingly, we are providing this short perspective to assist the Standing Committee members who requested this work and the Legislature in obtaining a preliminary understanding of what led to the situation at Laurentian University. Our intent is to table the special audit report as soon as possible.

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Auditor General

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Toronto, Ontario

Ce document est également disponible en français.

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Preliminary Perspective on Laurentian University

On February 1, 2021, Laurentian University (Laurentian) made an unprecedented and momentous announcement: the Sudbury-based institution declared it was financially insolvent and had filed for creditor protection. By declining government assistance and opting to file under the federal *Companies' Creditors Arrangement Act* (CCAA), the university became the first public university in Canada to seek to restructure its operations using a legal process designed as a last resort for private sector entities.

The repercussions were profound and stirred up strong reactions, especially in Sudbury, where the university is an important contributor to the social and economic fabric of the community. Laurentian eliminated 36% of its programs, affecting the academic and career plans of an estimated 932 students. It also terminated 195 staff and faculty with little notice and severance. And by opting for creditor protection under the CCAA, Laurentian was able to bypass provisions in its collective labour agreements, allowing the administration to effectively terminate more senior employees and clear a number of long-standing union grievances.

The longer-term implications of the CCAA filing are still playing out but may be no less severe. The loss of jobs and students will undoubtedly affect the economy of Sudbury, where Laurentian is one of the largest employers. The use of CCAA proceedings might make it more difficult for other universities to acquire debt, or to hire and retain faculty. Quantifying the long-term reputational damage to Laurentian will be more difficult to predict, but one development was telling: as of mid-January 2022, high school student applications to Laurentian had dropped by nearly 44%.

Hopefully Laurentian will emerge from the CCAA proceedings as soon as possible with a Plan of Arrangement and with a strengthened foundation it can use to attract and educate future students, recruit top educators and conduct world-class research. Conversations and efforts need to wholeheartedly focus on these goals. But as part of the effort to move forward, Ontarians also want and deserve answers to some tough questions. Among them: how did an Ontario university that is significantly taxpayer-funded and accountable to the public end up in a dire financial position? And was its use of the CCAA an appropriate response?

In light of these and other questions, the Standing Committee on Public Accounts (Committee) of the Legislative Assembly unanimously passed a motion on April 28, 2021 requesting that our Office conduct a special audit on Laurentian's operations for the 2010-2020 period. During discussion on the motion, the Committee indicated that it wanted our Office to examine what led Laurentian into the CCAA process, bring transparency to the situation, and identify lessons learned to "ensure something like this does not happen in another academic institution."

We initiated our audit work on May 14, 2021. Because Laurentian is a broader public sector institution that receives significant provincial government funding—about $80 million a year, representing over 40% of its revenue—there is an expectation from the public that it provide transparency and accountability about its finances and activities. Despite that, Laurentian's President and Board of Governors (Board), guided by external legal counsel, implemented unprecedented restrictions on our access to Laurentian's information. The senior administrators put in place protocols that discouraged staff from speaking freely with us or providing our Office with unfettered access to documents and information without fear of reprimand. These restrictive protocols created a culture of fear surrounding interactions with our Office that put further pressure on the university and its staff.

What's more, our Office faced an unprecedented legal pushback from Laurentian, including a challenge to the *Auditor General Act*. The university also resisted voluntarily complying with Speaker's Warrants, issued by the Legislative Assembly of Ontario in December 2021, compelling the release of information requested by the Standing Committee on Public Accounts.

In spite of these impediments, our Office consulted with many dedicated faculty and staff who provided us with whatever information they could to allow us to conduct our work. As a result of the Legislature's efforts, we were ultimately given access to thousands of university documents and emails. However, our ability to talk freely with certain past and present staff continues to be difficult. The delays have meant our Office continued to receive and review information from Laurentian into April 2022.

With additional questions that may still need to be answered and our inability to finalize our full report before the upcoming dissolution of the Legislature, we have decided to provide this preliminary perspective on what we've learned so far, in advance of tabling our formal special report on Laurentian. This is important given that the Standing Committee that requested this work will be dissolved when the upcoming election period begins on May 4, 2022.

Based on the information we have gathered to date, we have made the following preliminary observations:

- Although external factors such as tuition freezes and the COVID-19 pandemic impacted Laurentian, we determined that the primary cause of the university's financial deterioration from 2010 to 2020 was its pursuit of poorly considered capital investments. It proceeded with expansion projects without procedures in place requiring senior administrators to make a reasonable assessment of the value and viability of the plans, or to fully consider the risks associated with a rapid growth in debt. We also found there was poor management of the university's financial affairs and operations, exacerbating the situation.

- This poor management was allowed to continue in large part because of weak oversight by Laurentian's Board. It lacked key operational and governance practices and expertise, and allowed transparency to decline. For its part, the Ministry of Colleges and Universities (Ministry), which is the primary government ministry responsible for monitoring the financial health of post-secondary institutions, did not proactively intervene in a timely manner to provide guidance to help Laurentian slow—or ultimately respond to—its worsening financial deterioration.

- We believe Laurentian did not have to file for CCAA protection; it strategically planned and chose to take steps to file for creditor protection in the Ontario Superior Court of Justice on February 1, 2021. As Laurentian's financial situation grew increasingly dire, the university did not follow the normal broader public sector precedent by making comprehensive and clear efforts to seek financial assistance from the Ministry. It instead focused on advocating to elected officials and their staff, on the advice of external consultants. In August 2020, Laurentian raised the potential of CCAA to the Minister of Colleges and Universities but did not clearly define how much financial assistance was required from the province to avoid a CCAA filing. An explicit request for funding to the Ministry was not made until December 2020, at which point the ask was significant and the timeline for intervention was short. Had it sought to work earlier and more transparently with Ministry staff, had it not prematurely paid off and relinquished its line of credit in 2020, and had it accepted the temporary funding assistance that the province ultimately offered, Laurentian would have had sufficient time for its financial situation to be reviewed jointly with the province and a go-forward plan put in place.
- Nearly a year before Laurentian filed for CCAA protection, it had engaged lawyers and other consultants to explore strategic options, but the primary focus was on filing for CCAA protection. We believe that Laurentian's actions in this regard were significantly influenced by these external parties. As of March 3, 2022, the university had incurred legal and other financial consultant fees associated with its insolvency of more than $24 million.
- The university's contract with the Laurentian University Faculty Association (LUFA) contains a financial exigency clause, designed to deal with dire financial circumstances. Triggering this clause—which is in most university faculty labour contracts in Canada–would have required senior administration to work in partnership with LUFA to address Laurentian's financial situation. In 2020, LUFA requested that Laurentian's senior administration trigger this clause and provide it with additional information on the university's finances. Laurentian's senior management intentionally delayed providing information and did not trigger the clause. Instead, senior administration, with Board approval, chose to use CCAA protection, starting a process that diverted more money to external advisors through professional fees, was less transparent, and likely has had, and will continue to have, a greater impact on students, faculty, the community of Sudbury and the university's reputation.

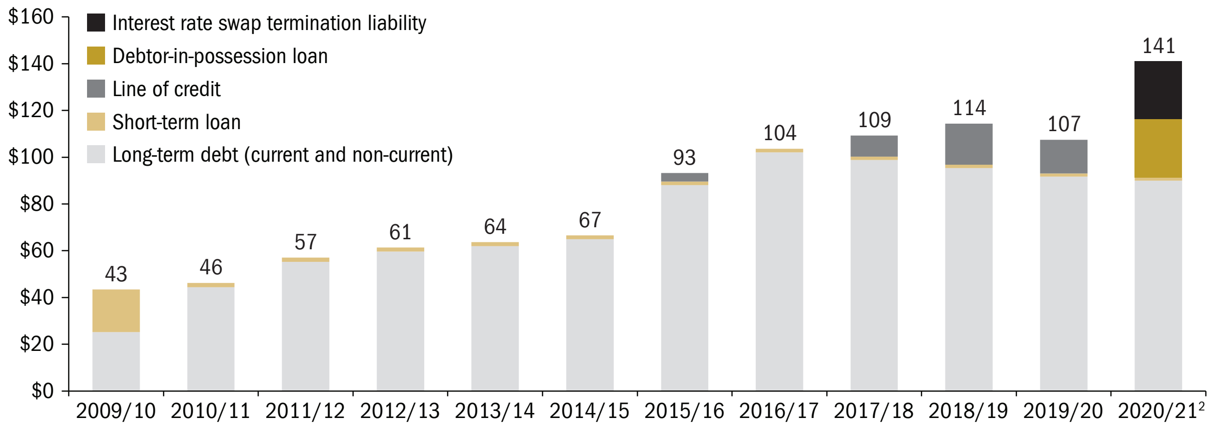
Laurentian's Financial Decline

Laurentian was showing clear signs of financial distress even before the 2010-2020 period. In response to accumulating deficits and projected difficulties in enrolment growth affecting all Northern Ontario universities, Laurentian's Board approved in February 2009 "A Plan for Regaining Sustainability at Laurentian University," which recommended that the university take reasonable steps to reduce costs.

However, under the leadership of its incoming President, Laurentian took a different tack later in 2009. It started what would become a modernization and expansion plan that led to the assumption of more than $87 million in additional long-term debt. Between 2009/10 and 2019/20, Laurentian's principal and interest payments on its long-term debt increased nearly fourfold to $7.9 million, accounting for $56 million in cash outflows over that 11-year period resulting in a net increase of $67 million in long-term debt by 2019/20.

Figure 1: Total Debt for the Years Ending April 30, 2009/10–2020/21 ($ million)[1]

Source of data: Laurentian University audited financial statements



1. This figure does not include liabilities other than debt.
2. Total debt in 2020/21 includes the following:
   - Items reclassified and recorded as a component of liabilities subject to compromise, which is a current liability:
     - $89.9 million (2019/20 – $91.7 million) of long-term debt;
     - $1.3 million (2019/20 – $1.4 million) of short-term loan with TD Canada Trust;
   - $25.0 million (2019/20 – $nil) in short-term loans owed to the debtor-in-possession lender as part of the *Companies' Creditors Arrangement Act* (CCAA) process, which increased to $35.0 million on May 2, 2021 after the end of the 2020/21 fiscal year; and
   - $24.7 million (2019/20 – $nil) of obligations for the termination of seven interest rate swaps triggered by the CCAA filing.

We found the university's senior management did not develop or work from a long-term plan that considered the risks associated with a rapid growth in debt. Nor did it gauge, before making large capital expenditures, to what extent the projects would increase revenues. Instead, it appears Laurentian took a risky "build it and they will come" approach.

In the face of growing debt, Laurentian amended its internal capital debt policy in 2010 to allow it to incur more debt for capital activities. In 2016, when its primary lender, Royal Bank of Canada, declined to provide more long-term debt, Laurentian sought short-term lines of credit to fund its capital expansion.

As access to funding decreased, the university ramped up the use of money designated for other purposes, such as employee health benefits and funds provided specifically for academic research projects. This strategy of using restricted funds was obscured by the fact the administration did not segregate the funds into separate bank accounts, and because it inappropriately labeled their use "internal financing." Amid the focus on new capital-project spending, and with little immediate return on its capital investments, Laurentian deferred needed repairs and upgrades on existing infrastructure. As of December 2020, Laurentian estimated that it had $135 million worth of required repairs that had not been addressed.

Rising Senior Administration Costs

Prior to its CCAA process, Laurentian suggested a significant cause of its financial decline was “excessive faculty costs.” But we found Laurentian’s overall faculty costs did not significantly surpass those of comparable universities.

In contrast, we found that it was high senior administrator salaries and expenses that negatively impacted Laurentian’s financial situation. From 2010 to 2020, the university’s senior administration costs grew by about 75%, peaking in 2018 at more than $4 million annually, and the relative size of its senior administration had been consistently larger than most other Ontario universities. Further, hiring practices for some positions lacked transparency and fairness—for instance, selected candidates were hired without a clearly documented rationale—and senior administrators’ salaries surpassed limits set through legislation intended to put a ceiling on executive pay in the broader public sector.

We determined that the senior administration did not work cooperatively with its faculty association and staff union to manage the university’s growing financial issues. Nor did it transparently provide the association and union with information on the extent of Laurentian’s financial situation in the months leading up to the CCAA process. At the same time, it was slow to address costly association and union grievances, including those alleging discrimination and harassment.

Governance Deficiencies

We found significant deficiencies in the activities and governance of Laurentian’s Board of Governors and its committees. For instance, the Board did not ensure the administration was providing it with adequate information to fully understand and assess issues affecting the financial sustainability of the university. These weaknesses diminished the Board’s ability to understand the impact of major capital projects on the university’s finances and potentially challenge senior administration’s plans.

The committees of the Board responsible for overseeing aspects of the financial sustainability of the university also failed to fulfil their roles. The Audit Committee, for example, did not perform its duty to ensure key financial risks were identified and managed. In its role overseeing external auditors, the committee did not ensure that the audited financial statements contained adequate information on the financial struggles facing the university—even in 2020 when Laurentian was deliberately preparing for the impending CCAA filing.

Further, the Board’s extensive use of in-camera meetings limited public transparency and accountability. We also learned that in some instances, Board members were involved in discussions and decisions that held personal or professional implications for them, raising conflict of interest concerns.

Planning for CCAA Protection

In our view, Laurentian could have avoided the widespread disruptions of the CCAA process. An external law firm that was working with the university on other business first introduced the concept of the creditor-protection process in 2019 to senior administration. We believe that serious consideration of the concept lay dormant until the spring of 2020, when Laurentian made the decision to actively pursue creditor protection.

By pursuing creditor protection under the CCAA, the university did not follow the normal broader public sector practice of first making efforts to work collaboratively and transparently with the Ministry to secure government-backed financial assistance. One example Laurentian could have emulated was Nipissing University in North Bay. In 2014, Laurentian's closest neighboring university cooperated with the Ministry when it was facing financial struggles that were by some measures worse than Laurentian's before it filed for CCAA creditor protection. Through the Ministry's intervention, Nipissing was able to take steps to ameliorate its declining enrolment trend and financial performance at that time.

For its part, Laurentian did not provide complete financial information or a comprehensive business case to the Ministry. In December 2020, less than two months before its announcement that it would initiate a CCAA proceeding, it made a sizeable financial request to the Ministry, with insufficient information. Guided by external legal counsel and other parties, Laurentian had earlier taken what can be called a political advocacy approach: it sought support for financial assistance directly from elected officials and their staff, rather than working transparently and directly with the Ministry's Deputy Minister, the Assistant Deputy Minister and their staff.

As noted, Laurentian also purposely avoided triggering the financial exigency clause in the faculty association's collective agreement. That process is intended to help ensure that job terminations during dire financial circumstances are done collegially and transparently. Because Laurentian had identified some of its financial issues during labour negotiations in April 2020, the association ultimately filed a grievance on October 30, 2020 requesting the administration use the financial exigency clause. Laurentian chose not to do so.

Instead, guided by external lawyers, external financial consultants and government-relations specialists, the President of Laurentian and certain Board members, strategically pursued restructuring under the CCAA. This chosen path appears to have enabled Laurentian to limit the full disclosure of financial and operational information to the public and other stakeholders, such as the faculty association and the staff union. It appears that Laurentian's external auditors were not made aware of the CCAA plans, and as such, Laurentian's financial statements ultimately did not clearly disclose to stakeholders the university's imminent financial risk.

The planning for and use of CCAA has come with additional costs for the financially strapped university. As of early March 2022, Laurentian had paid out more than $24 million to external lawyers and other consultants, including those who recommended and guided the CCAA restructuring process. The CCAA decision also triggered a series of large additional costs including a $24.7 million charge related to loan agreements with banks.

Weak Ministry Oversight

As noted, weaknesses in the Ministry's approach to overseeing universities in Ontario prevented officials from fully recognizing and addressing the serious financial issues facing Laurentian.

The acts that created Ontario's universities collectively lack many of the controls and oversight mechanisms found in provinces like British Columbia and Alberta. Unlike most other provinces, Ontario does not have legislated limits on university deficits, borrowing or major capital expenditures. Absent these restrictions, Laurentian was able to run successive annual deficits and acquire a substantial debt burden, deteriorating its financial position. As with all Ontario universities, the Ministry does have individual funding agreements with Laurentian. But these agreements do not include stipulations that Laurentian operate sustainably.

The Ministry did not start monitoring the financial condition of universities until 2014/15. Had these financial indicators been in place earlier, the Ministry could have flagged financial sustainability issues at Laurentian as early as 2009/10, as the university would have failed to meet most of the Ministry's financial-sustainability benchmarks. Even when the Ministry did begin to identify financial concerns at Laurentian, Ministry officials did not attempt to proactively intervene. However, even if it had wanted to, the Ministry does not have the clear legislative power to step in and unilaterally require changes to a university's operations, but can only influence the institution's choices, as it did with Nipissing.

OVERALL OBSERVATIONS

While the focus now should be on rebuilding Laurentian, it is also important to draw lessons from the experience that could help avoid a similar situation occurring elsewhere.

Universities are crucial institutions in democratic societies. They promote social and economic progress by reappraising societal assumptions, contributing to new knowledge and technologies and, most importantly, providing Ontario's students with the skills and education needed in the 21st century. Universities thrive when governments ensure they can maintain a high degree of academic independence; this is an important, centuries-old tradition that should be strenuously upheld in Ontario.

While, for these reasons, universities differ from other broader public sector institutions, they are also recipients of substantial support from the province and have specific transparency and accountability requirements. Mechanisms need to be set up that both respect universities' academic independence and prevent them from falling so deep into financial distress that the situation negatively affects students, faculty and staff.

When a university fails to meet certain financial sustainability metrics, the Ministry should be able to proactively intervene to more thoroughly assess the institution's finances and identify opportunities where it can help. The province should consider introducing legislation that formalizes the Ministry's prerogative to appoint a supervisor to help a university when there are serious sustainability concerns, and to set limits on deficits, borrowings and major capital expenditures.

Equally important, if a government or community imposes specific academic requirements or a tuition freeze on a university, public officials have a continuing responsibility to assess whether funding continues to be sufficient for the university both to fulfil those mandates and remain true to its core values. This is particularly true in Northern Ontario given the unique challenges facing Northern universities and their importance to the large regions they serve.

Ontario should consider the types of legislated limits on university deficits, borrowing and major capital expenditures found in other provinces. In Nova Scotia, for instance, the government introduced the *Universities Accountability and Sustainability Act* in 2015 in response to instances of post-secondary institutions experiencing financial difficulties. This act serves to identify and correct financial difficulties before they become emergencies.

Whatever model Ontario chooses, annual funding should be dependent on each university demonstrating to the Ministry that it has fully functioning governance structures in place. For instance, each board should have and follow clear ground rules on how it oversees its university's activities.

The word "paradigm" is important to think about in the Laurentian story. No one would have expected a broader public sector organization like a university to choose to use the CCAA process, including Laurentian's own external auditors and the lenders that held the university's unsecured or low-interest debt. Typically, a broader public sector organization facing financial distress works directly and transparently with its funding government ministry. In our view, there were many people hired by Laurentian who were more focused on laying the track that guided the train toward the CCAA process, and less on working co-operatively and with full transparency with the Ministry of Colleges and Universities and faculty and staff labour unions.

There is a strong argument that the CCAA, an important tool used in the private sector, is an inappropriate remedy for public entities. There are certain principles held high in the public sector—including transparency, accountability and the primacy of the public interest—that make the CCAA—court-ordered protection—a detrimental choice for public entities.

Sometimes, when faced with a crisis, it is difficult to discern the right thing to do, and then to do the right thing. In a situation where paradigms may be broken, it is important to ensure that actions taken are not contrary to those very public-sector principles that Ontarians rely upon and hold dear. Perhaps one guiding principle for an organization's board, senior management, external advisors and consultants should be that if one is doing the right thing for the public good, transparency comes easy.

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