



John Keel, CPA
State Auditor

An Audit Report on

The University of North Texas's Management Practices for Endowment Funds

August 29, 2006

Members of the Legislative Audit Committee:

The University of North Texas (University) manages its endowments in accordance with appropriate endowment management principles. Specifically:

- The University's overall investment policies are consistent with modern endowment management principles as embodied in the Uniform Management of Institutional Funds Act (Texas Property Code, Chapter 163).

The modern endowment principles the University has incorporated into its investment policies include focusing on long-term growth of endowment principal (to maintain or increase purchasing power over time), spending a prudent portion of endowment income, and delegating responsibility for managing endowment assets. The University's delegation of asset management responsibilities to outside parties allows it to have access to the investment expertise of professional asset management firms.

- The University complied with its endowment management and investment policies, including its income spending policies, asset allocation policies, and policies for monitoring money managers.

Since fiscal year 2003, on an annual basis, the University has been distributing 4 percent of its endowment assets for spending purposes. In addition, the University's asset allocation as of August 31, 2005, was very close to the targets established by the University of North Texas System Board of Regents. Adhering to target asset allocations is important because asset allocation is considered one of the most significant determinants of an entity's investment return.

- The University spent the distributions from its endowment in accordance with donor restrictions. Results of our testing of a sample of endowment expenditures determined that (1) donor restrictions were adequately documented and (2) endowment expenditures were made for the specific purposes requested by donors.

Endowments

An endowment is a gift accepted with donor stipulations that (1) the principal be maintained intact in perpetuity for a specified period or until the occurrence of a specified event and (2) the income earned by investing the principal can be expended.

Background Information

As of August 31, 2005, the University of North Texas (University) had 305 endowments with a total market value of \$20.9 million. Most of these endowments were established for the purposes of awarding scholarships. The System distributed \$405,966 of its endowment income to spend for these purposes in fiscal year 2005.

SAO Report No. 06-059

Auditors identified three areas in which the University should improve the management of its endowment funds:

- Before May 2006, the University had not been reporting the investment performance of its endowment funds to the University of North Texas System Board of Regents, and the endowment policy did not require such periodic reporting.
- Overall, the University has accumulated large balances in its endowment spending accounts. As of August 31, 2005, these balances totaled \$2.3 million, which is more than five times the amount of income distributed to the spending accounts in fiscal year 2005. These funds can be spent only for the purposes specified by the donors. The purposes are primarily for providing scholarships.
- The University's pooling of three endowments into its fixed income investment pool has resulted in the pool's holding some types of investments that are not permitted by donor agreements.

The attachment to this letter contains additional information on these three issues, our recommendations, and the University's responses.

We appreciate the University's cooperation during this audit. If you have any questions, please contact Verma Elliott, Audit Manager, or me at (512) 936-9500.

Sincerely,

John Keel, CPA
State Auditor

Attachment

cc: Members of the University of North Texas System Board of Regents
Mr. Lee F. Jackson, Chancellor of the University of North Texas System
Dr. Gretchen M. Bataille, President of the University of North Texas

Objectives, Scope, and Methodology

The objectives of this audit were to determine whether the University:

- Has endowment fund investment and annual distribution policies that are consistent with modern endowment management principles as embodied in the Uniform Management of Institutional Funds Act (Texas Property Code, Chapter 163).
- Is in compliance with its endowment management policies.
- Has adequate procedures to monitor and report endowment performance against stated objectives.
- Has controls that provide reasonable assurance of substantial compliance with donor restrictions.

The scope of this audit covered all endowments established at the University and expenditure data for a sample of endowments for fiscal year 2005 and part of fiscal year 2006. We conducted audit fieldwork in June 2006. This audit was conducted in accordance with generally accepted government auditing standards.

The audit methodology included reviewing endowment management practices, reviewing investment policies, and testing of compliance with investment policies and donor restrictions.

The following members of the State Auditor's staff performed the audit:

- Hugh Ohn, CFA, CPA, CIA (Project Manager)
- Roger Ferris, CPA (Assistant Project Manager)
- Hillary Hornberger
- Alan Walton, CIA
- Charles P. Dunlap, Jr., CPA (Quality Control Reviewer)
- Verma Elliott, MBA, CGAP (Audit Manager)



This document is not copyrighted. Readers may make additional copies of this report as needed. In addition, most State Auditor's Office reports may be downloaded from our Web site: www.sao.state.tx.us.

In compliance with the Americans with Disabilities Act, this document may also be requested in alternative formats. To do so, contact our report request line at (512) 936-9880 (Voice), (512) 936-9400 (FAX), 1-800-RELAY-TX (TDD), or visit the Robert E. Johnson Building, 1501 North Congress Avenue, Suite 4.224, Austin, Texas 78701.

The State Auditor's Office is an equal opportunity employer and does not discriminate on the basis of race, color, religion, sex, national origin, age, or disability in employment or in the provision of services, programs, or activities.

To report waste, fraud, or abuse in state government call the SAO Hotline: 1-800-TX-AUDIT.

Attachment

Chapter 1

Before May 2006, the University Had Not Been Reporting the Investment Performance of its Endowment Funds to the Board of Regents

Before May 2006, the University of North Texas (University) had not been reporting the investment performance of its endowment funds to the University of North Texas System Board of Regents. Although investment performance information is available at least on a quarterly basis, the University does not have policies and procedures that require reporting of investment performance to the members of the Board of Regents.

Periodic reporting of investment performance would help ensure that management and the members of the Board of Regents have the information necessary to monitor investment manager performance effectively. This information will also help the Board of Regents monitor the University's progress toward achieving the long-term investment goals and objectives established by the Board. The Board's financial goal for the endowment funds is to preserve the inflation-adjusted purchasing power of principal and income after accounting for endowment spending, inflation, and costs of investment management.

Recommendation

The University should develop policies and procedures for reporting investment performance of its endowment funds to the University of North Texas System Board of Regents on a quarterly basis. The University also should measure and report on investment performance in compliance with these policies and procedures.

Management's Response

The university invests all but a few of its endowed funds with an organization called "Commonfund." At every regularly scheduled Board of Regents meeting the university has showed the performance of Commonfund in accordance with the requirements of the Public Funds Investment Act. However, we did not show in the report the benchmarks (S&P 500 Index for equities and Lehman Aggregate Index for bonds) against which we measure performance of endowment management and the report lacked the clarity and disclosure that is now incorporated (beginning May 2006) in its report to the Board of Regents.

The University Has Accumulated Large Balances in Endowment Spending Accounts

Overall, the University has accumulated large balances in its endowment spending accounts. As of August 31, 2005, these balances totaled \$2.3 million, which is more than five times the \$405,966 in income distributed to these accounts in fiscal year 2005.

This accumulation of funds occurred because the University made annual distributions to endowment spending accounts but did not always spend all of those funds. In addition, the University does not have a central monitoring function to ensure that these funds are spent in a timely manner and according to donor restrictions. Instead, the University relies on each department and college to monitor the use of funds in the spending accounts. These funds are available to be spent only for the purposes specified by the donors.

The balances in the spending accounts are invested as part of the University's investment pool and, therefore, earn interest. However, the interest income stays within the pool and, as a result, does not benefit the endowments.

Recommendation

At least semi-annually, the University should monitor the balances of the spending accounts for all endowments to determine whether available funds are being accumulated and not spent in a timely manner.

Management's Response

The university will periodically monitor these endowed funds and inform the account holders of their balances and their responsibility to appropriately use the funds.

The University's Pooling of Investments Has Resulted in Its Holding Some Investment Types That Are Not Permitted by Donor Agreements

The University has three endowments whose donor agreements restrict the endowments' investment to either government bonds or government guaranteed instruments. Because of this restriction, the University did not combine these endowments with the regular endowment investment pool that includes investments in stocks. Instead, the University included these endowments in the University's fixed income investment pool.

However, the fixed income investment pool includes some investments that are neither government bonds nor government guaranteed instruments. As a result, the University technically did not comply with donor restrictions. The market value of these three endowments was \$54,403 as of August 31, 2005.

Recommendation

The University should consider separately investing these three endowments in the donor-specified investment types. Alternatively, the University could attempt to obtain revisions to the donor agreements to permit it to invest these endowments as part of the regular endowment investment pool.

Management's Response

The university will purchase Treasury Bills or Notes for these endowments.