



John Keel, CPA  
State Auditor

An Audit Report on  
**Texas Woman's University's  
Management Practices for Endowment Funds**

August 29, 2006

Members of the Legislative Audit Committee:

Although Texas Woman's University (University) uses its endowment funds as donors intended, the University does not otherwise manage its endowments in accordance with modern endowment management principles.

The University does not have a separate investment policy for endowment funds. Its current investment policy mirrors the requirements of the Public Funds Investment Act (PFIA), which is more applicable to short-term operating funds than long-term endowment funds. Although the University complied with significant provisions of its investment policy, the University's investment policy is not consistent with modern endowment management principles. Specifically:

- The University's investment policy does not focus on long-term growth of endowment funds. Instead, the University's policy focuses on managing its endowment funds like short-term operating funds. However, the purpose of short-term operating funds is to meet an entity's immediate liquidity needs by investing in liquid and safe assets.
- The University does not actively invest any of its endowment assets in investments that provide it with the potential to grow its endowments. According to a survey conducted by the National Association of Colleges and University Business Officers (NACUBO), examples of typical investments held by small endowments include stocks, bonds, and real estate. Although the University's practice tends to minimize volatility in investment returns, it limits the potential for principal growth.
- Each year, the University distributes to endowment spending accounts the entire amount of income allocated to endowments from the investment pool. This practice, combined with the types of investments held in the pool, does not allow for growth of the principal of the endowments over time.
- Because the University does not manage its endowment funds separately from its operating funds, it does not measure or report the investment performance of the endowment funds separately from the performance of its investment pool. In addition, the University does not measure total return or report

**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, Texas Woman's University (University) had 171 endowments with a total market value of \$8.1 million. Most of these endowments were established for the purpose of awarding scholarships. The System distributed \$296,961 of its endowment income to spend for these purposes in fiscal year 2005.

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its endowment funds' investment performance over a long-term period (for example, over a period of from five to ten years).

Auditors also noted that the University did not ensure that its service provider complied with statutory annual ethics disclosure requirements for 2004 and 2005. The attachment to this letter contains additional information on these two issues, our recommendations, and the University's responses.

The University spent its endowment income in accordance with donor restrictions. 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. Of the 36 expenditures auditors tested, only one was expended from an incorrect spending account.

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 Texas Woman's University Board of Regents  
Dr. Ann Stuart, Chancellor and President, Texas Woman's University

#### 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 July 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)



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# Attachment

Chapter 1

## ***The University's Endowment Management and Investment Policies Are Not Consistent with Modern Endowment Management Principles; Therefore, the University Does Not Manage Its Endowments to Achieve Long-term Growth***

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Texas Woman's University (University) does not have a separate investment policy for endowment funds. Its investment policy mirrors the requirements of the Public Fund Investment Act (PFIA, which is codified in Texas Government Code, Chapter 2256). However, the PFIA emphasizes safety and liquidity of the funds and, therefore, is more applicable to operating funds than endowment funds. Endowments should focus on long-term growth.

In compliance with the current policy, the University invests its endowment fund as part of its operating investment pool. However, Texas Education Code, Section 51.0031, distinguishes endowment management from the narrow restrictions embodied in PFIA and allows universities to manage endowment funds (which originate from donations, gifts, and trusts) differently from the way they manage operating funds.

Although the University complied with most of the current endowment management and investment policies, its policy includes many elements that are not consistent with modern endowment management principles embodied in the Uniform Management of Institutional Funds Act (UMIFA, which is codified in Texas Property Code, Chapter 163). Specifically:

- The University's investment policy was modeled after the PFIA and, therefore, does not focus on long-term growth of endowment funds. Instead, the University's policy focuses on managing its endowment funds like short-term operating funds. However, the purpose of short-term operating funds is to meet an entity's immediate liquidity needs by investing in liquid and safe assets. The modern endowment principles embodied in UMIFA focus more on long-term growth of endowment funds in order to maintain or increase purchasing power over time while maximizing distributions.
- The University does not actively invest any of its endowment assets in investments that provide it with the potential to grow its endowments. According to a survey conducted by the National Association of

### **The Importance of Growth for Endowment Funds**

If endowment funds do not grow with inflation, then the benefits they can provide decline in value (purchasing power) over time. This, in effect, diminishes the value of the donor's gift.

Colleges and University Business Officers (NACUBO), examples of typical investments held by small endowments include stocks, bonds, and real estate. Although the University's practice tends to minimize volatility in investment returns, it limits the potential for principal growth. Currently, the University's endowment assets are pooled with its operating funds, and the vast majority of this pool is invested in bonds and the Texas Local Government Investment Pool (TexPool, a state-sponsored short-term investment pool that operates like a money market mutual fund).

- Each year, the University distributes to endowment spending accounts the entire amount of income allocated to endowments from the investment pool. This practice, combined with the types of investments held in the pool, does not allow for growth of the principal of endowments over time. For example, the value of one scholarship endowment of \$59,592 established in 1984 was still \$59,592 as of August 31, 2005. However, this amount is worth significantly less than \$59,592 in 1984 dollars due to the effect of inflation over the previous 21-year time period. This means that future students will not receive the same dollar value of scholarship on an inflation-adjusted basis as students in the past might have received. The current distribution policy was based primarily upon the University's investment strategies to invest for current income (also known as "yield") instead of for total return (which includes both income and security price changes).
- Because the University does not manage its endowment funds separately from its operating funds, it does not measure or report the investment performance of the endowment funds separately from the performance of the investment pool. In addition, the University does not measure total return or report its endowment funds' investment performance over a long term period (for example, over a period of from five to ten years).

## Recommendations

The University should develop a separate investment policy for its endowment funds that is consistent with modern endowment management principles as embodied in UMIFA. This policy should include provisions for:

- Long-term growth of endowment funds.
- Asset allocations that will help accomplish long-term growth.
- Diversification of assets.

- An income distribution methodology that helps ensure intergenerational equity (the concept that future generations receive the same level of benefits from the endowment as the current generation).
- Performance measurement and reporting of both short- and long-term total investment return.

#### Management's Response

*TWU management will review its endowment investment and distribution policies and will present options to its Board of Regents at its November 2006 meeting for consideration. This review will include all areas cited in the audit report.*

## ***The University Did Not Ensure That Its Service Provider Complied with Annual Ethics Disclosure Requirements***

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The University did not ensure that its service provider complied with statutory ethics disclosure requirements for calendar years 2004 and 2005. The University's external investment manager did not submit ethics disclosure statements to the University and the State Auditor's Office by the due dates required by Texas Government Code, Chapter 2263. However, the University ensured that the manager complied with this requirement for calendar year 2003.

### **Recommendation**

The University should ensure that its service provider files ethics disclosure statements with the University and the State Auditor's Office as required by statute.

### **Management's Response**

*TWU management will ensure that its financial manager complies with statutory annual ethics disclosure requirements in the future.*