



John Keel, CPA  
State Auditor

An Audit Report on

# The University of Houston System's Management Practices for Endowment Funds

August 10, 2006

Members of the Legislative Audit Committee:

The University of Houston System (System) manages its endowments adequately using appropriate controls. Specifically:

- The System's 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 System 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 System's delegation of asset management responsibilities to outside parties allows it to have access to the investment expertise of external money managers.

- The System 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 1997, on an annual basis, the System has spent between 4.5 percent and 5 percent of its endowment assets. Its asset allocations were within the target ranges established by the System's Board of Regents at the two points in time we tested (June 30, 2005, and December 31, 2005). Adhering to target asset allocations is important because asset allocation is considered one of the most significant determinants of an entity's investment return. In addition, with assistance from an outside consultant, the System regularly monitors investment activities and the performance of its money managers.

- The System had adequate procedures to measure and report endowment fund investment performance. The System's investment consultant reports long-term investment performance of endowment funds to the System's Board of Regents on a quarterly basis. The System also measures monthly investment performance for System management's use.

## Background Information

As of August 31, 2005, the University of Houston System (System) had 1,008 endowments with a total market value of \$417 million. Most of these endowments were established for the purposes of awarding scholarships and professorships. The System distributed \$18.2 million of its endowment income to spend for these purposes in fiscal year 2005.

SAO Report No. 06-054

- The System spent its endowment income in accordance with donor restrictions. Results of our testing of sample endowment expenditures determined that (1) donor restrictions were adequately documented and (2) endowment expenditures were made for the specific purposes requested by donors. In addition, the System conducts audits of all endowments on an annual basis. The scope of these audits includes both a financial review and testing of compliance with donor restrictions.

We identified and communicated certain less significant issues to System management. These issues include (1) instances in which donor agreements were not signed and (2) a lack of monitoring of service providers' compliance with annual ethics disclosure requirements for 2004 and 2005.

We appreciate the System'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

cc: Members of the University of Houston System Board of Regents  
Dr. G. Jay Gogue, Chancellor of the University of Houston System and President of the University of Houston

#### Objectives, Scope, and Methodology

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

- 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 System and expenditure data for a sample of endowments for fiscal year 2005 and part of fiscal year 2006. We conducted audit fieldwork in April 2006. We received assistance from the System's internal audit department in collecting data for testing endowment expenditures.

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

This audit was conducted in accordance with generally accepted government auditing standards. 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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