REPORT TO THE

UTAH LEGISLATURE

Number 2007-09

A Performance Audit 0f Compliance with UMIFA

May 2007

Audit Performed By:

Audit Manager	Rick Coleman
Audit Supervisor	Kade Minchey
Audit Staff	Aaron Eliason

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A Performance Audit of
Compliance with UMIFA

Prudent and effective management and oversight of endowment funds is necessary. In 2005 the governance and oversight structure for higher education endowment funds changed from the Money Management Act to the Uniform Management of Institutional Funds Act (changed in 2007 to UPMIFA).

We were asked to audit the system of higher education for compliance with the Uniform Management of Institutional Funds Act (UMIFA). Accordingly, we reviewed investment compliance with UMIFA and the approved investment policies. We also reviewed oversight and controls of the governance system.

Chapter I: Introduction

UMIFA Law Governs Higher Education Endowment Funds. UMIFA, as amended in 2005, is the governing law over higher education endowment funds. It requires the Board of Regents to establish an endowment fund investment policy for state higher education institutions. It also allows higher education institutions to establish their own endowment fund investment policies, which two institutions have done. Utah higher education institutions have significant investments in endowment funds.

UMIFA replaced the Money Management Act as the governing legislation over endowment funds. UMIFA came about because of improper management and inadequate governance over the investment of operating funds. One institution of higher education lost several million dollars in operating funds through investing in stocks and the Legislature had to appropriate new money to cover the loss of those operating funds. This history demonstrates the need to have adequate controls over institutional investments.

Chapter 2: Institutions Not in Compliance with Portions of Investment Policy

Institution Management Not Fully Tracking Investment Compliance. Investment policies are designed to ensure an appropriate return to risk tolerance. Once the investment policy is established, adherence to the policy means the approved return to risk tolerance is followed. The Regent investment policy contains certain permissible investments with limited asset allocation. The Regent policy is intended to be a safe harbor for investments. Institutions can opt out of the regent investment policy with approval from the institutions' trustees and Board of Regents.

Since adherence to the investment policy is important, tracking to ensure compliance with the policy is essential. However, we found that institution management has not been fully tracking compliance with the investment policy. Ability of the institutions to track compliance is important. Institutions should be careful not to have a portfolio that is too complicated to track. The Regents should require institution management to track all requirements of the investment policy. If institutions do not have the expertise or staff to fully track investment compliance they, should consider pooling their funds with a more sophisticated institution in the state system of higher education or, with another qualified, competent investment entity.

Insufficient Tracking Has Resulted in Some Compliance Problems. As previously discussed, institution management has not been adequately tracking the requirements of the investment policy. One consequence of insufficient tracking is that institutions may not be aware of investment policy noncompliance.

All five higher education institutions we audited had some degree of policy noncompliance with the Regent investment policy. Four of the five institutions we audited were under the Regent policy for all of fiscal year 2006. The U of U was transitioning to their own policy, and adopted it a few months into the fiscal year, thereby only being under the Regent policy for a short while.

Chapter 2 Recommendations

1. We recommend that Regent policy be amended to require institution management to fully track compliance with all requirements of the applicable investment policy.

2. We recommend that institutions consider pooling their endowment funds with a more sophisticated institution within the state system of higher education, or with another investment entity if they are unable to fully track compliance with the applicable investment policy.

Chapter 3: Governance and Oversight of Investments Can Be Improved

Regents Can Influence Better Oversight Through Investment Policy. The governance and oversight structure in place has not detected the institutions' policy noncompliance. The Regent investment policy needs to be clarified to be more effective in governing institutions' investments. The investment policy should be revised to include provisions such as rebalancing, requiring target allocations, and clarifying investment vehicles. The commissioner's staff should review the investment policy and seek ways to clarify and, where appropriate, strengthen requirements in the policy. The commissioner's staff should also, where appropriate, seek ways to help educate and guide the institutions toward policy compliance.

Trustees Do Not Have Sufficient Information to Accomplish Oversight Role. The institutions' board of trustees have an important oversight role that can function better with improved information from institution management. The Board of Regents have delegated responsibility to the trustees to manage institutions investments in compliance with the investment policy. However, the trustees are not receiving adequate information to fully understand and know if the institutions are in compliance with the policy.

Internal Auditors Work Inadequate To Detect Policy Non-Compliance. We found that the internal audit work performed at each institution was inadequate and did not detect institutions' policy non-compliance. The Regents have implemented agreed-upon procedures that require the internal auditors to attest to the institutions compliance with investment policy. However, auditors incorrectly attested to institutions' compliance with state law and investment policy.

The internal audit function has been established as the primary oversight entity. Internal auditors are the only entity that review detail of the investment policy for compliance. The Board of Regents relies on the auditors' opinion that the institutions are in compliance.

Chapter 3 Recommendations

1. We recommend that the Board of Regents analyze and review their investment policy to determine appropriate revisions and clarifications. Items that should be considered in the review are:
   - Clarifying the asset allocation ranges in the investment policy
   - Directing institutions to develop target allocations and manage their endowment pool accordingly
   - Adding language to the policy that would require further portfolio diversification
   - Including guidance and direction for re-balancing
   - Reviewing required reporting deadlines and adjusting to ensure for reasonableness and appropriateness
2. We recommend that commissioner staff seek ways to better communicate policy requirements and, where appropriate, help educate institutions of their responsibility to fully track investment compliance.
3. We recommend that the Board of Regents develop a uniform report format for the institutions, which addresses each of the requirements of the investment policy.
4. We recommend that institutional board of trustees direct institution management to provide them with a standard monthly report demonstrating compliance with all investment policy requirements.
5. We recommend that the Board of Regents and institutions' board of trustees approve investment policies, including investment guidelines, and other investment policy direction, and subsequent amendments.
6. We recommend that institutions' internal auditors perform sufficient work in accordance with statutory requirements and the appropriate investment policy to correctly attest to institution investment compliance.
7. We recommend that commissioner staff help train internal auditors on applicable statutory requirements and appropriate investment policy.

Chapter I
Introduction

Governing law over higher education endowment funds changed in 2005. Audit found some noncompliance with new law and new investment policy.

For over 30 years, the Money Management Act governed endowment fund investing. Specifically, endowments were governed through Rule 2 of the Money Management Council. Then, in 2005, the law changed, making the Uniform Management of Institutional Funds Act (UMIFA) the governing law over endowment funds. The law changed again in 2007, to the Uniform Prudent Management of Institutional Funds act (UPMIFA). Changes in 2007 with UPMIFA did not alter the system of governance and oversight in place with UMIFA. With UMIFA and UPMIFA, oversight shifted from the Money Management Council to the Board of Regents and Institutions' board of trustees.

This audit reviews the management and oversight controls over institutional endowment funds since the Legislature changed the governance structure from the Money Management Council to the Board of Regents. We believe the control weaknesses shown in this audit need to be corrected to ensure proper protection of endowment funds in the future.

UMIFA Law Governs Higher Education Endowment Funds

The law change in 2005 allowed institutions to create their own investment policies or follow a Board of Regent default policy.

UMIFA, as amended in 2005, is the governing law over higher education endowment funds. It requires the Board of Regents to establish an endowment fund investment policy for state higher education institutions. It also allows higher education institutions to establish their own endowment fund investment policies, which two institutions have done. Utah higher education institutions have significant investments in endowment funds.

History of Money Management Act Shows Importance of Proper Controls and Governance

The Money Management Act was adopted about 30 years ago because of improper management and inadequate governance over the investment of operating funds at an institution of higher education. One institution lost several million dollars in shorter term operating funds through investing in stocks, and the Legislature had to appropriate new money to cover the loss of those operating funds. This history demonstrates the need to have adequate controls over institutional investments. While the school's loss dealt with operating funds, this audit deals with endowment funds.

Those charged with overseeing endowment funds at the institutions, or institution management, need the freedom to invest to maximize long-range return, but management controls and proper oversight to limit risk and ensure prudence are also necessary. Investment officers have the job of balancing the risk of an investment with the return it is expected to receive within the specifications of applicable laws and investment policies.

We believe the control weaknesses shown in this audit needs to be addressed. With over $600 million in the institutions' endowment funds, strong oversight and controls seem particularly prudent.

UMIFA Law Changed in 2005 to Include Higher Education Endowment Funds

Before the law change in 2005, endowment funds were governed under the Money Management Act.

UMIFA is the governing law over endowment funds for incorporated, unincorporated, or governmental organizations that are organized and operated exclusively for educational, religious, charitable, or other beneficent purposes. In 2005, UMIFA was changed specifically to include endowment funds of state higher education institutions. Previously, endowment funds of higher education institutions were governed under the Money Management Act.

Under the Money Management Act, Rule 2 of the Money Management Council governed higher education institutions endowment funds for 30 years. The Money Management Council was the oversight body responsible for making rules and ensuring endowment funds were invested according to those rules. This responsibility now rests with the Board of Regents and institutions' board of trustees.

UMIFA as amended in 2005 gave the Board of Regents the responsibility to establish asset allocations and guidelines for investing the endowment funds of higher education institutions. It also allowed institutions to adopt their own endowment fund investment policies.

Law changed again in 2007, but it did not change the governance or oversight of endowment funds.

In the 2007 General Legislative Session, the UMIFA law was replaced by the Uniform Prudent Management of Institutional Funds Act (UPMIFA). However, the governance structure over endowment funds with the Board of Regents as the oversight body remains the same. ***Utah Code*** citations in this report refer to UPMIFA, as the UMIFA section has been removed from the code.

UMIFA Law Gives Regents Authority Over Investment Policy

2005 law change gave the Board of Regents authority to approve or disapprove institutions' investment policies.

The Board of Regents has authority over institutions' investments to establish asset allocations and guidelines for investment funds. The Uniform Prudent Management of Institutional Funds Act (UPMIFA) requires that an institution follow the Regent policy unless it has developed a policy of its own that has been approved by the Regents. UPMIFA allows the institutions to draft their own investment policies, but each policy must be approved by the Regents before becoming effective. ***Utah Code*** 51-8-303(2)(a) states:

> A higher education institution may not invest its endowment funds in violation of the State Board of Regents' guidelines unless the State Board of Regents approves an investment policy that has been adopted by the higher education institution board of trustees.

Since the institutions must follow the Regents' policy or get approval from the Regents to have their own policies, the Regents have accepted responsibility to know if the institutions are in compliance with the Regent investment policy.

Regents have delegated some authority over endowment funds to institutions' trustees.

To know if the institutions are in compliance with the investment policy, the Regents have delegated responsibilities to each institution's board of trustees. The Regents require the trustees to monitor investments to ensure compliance with the investment policy, and report back to the Regents. The Regent investment policy states:

> The Board delegates to each institutional Board of Trustees full responsibility to manage and report institutional investments in compliance with this general policy. Each institutional Board of Trustees shall adopt institutional policy and procedures regarding investments (including any changes in such policy and procedures),

designate a public treasurer and approve the format of reports submitted for its review.

In accordance with UMIFA, the Board of Regents adopted new endowment fund allocation ranges and investment guidelines into Rule 541; or the investment and reporting policy. The rule was adopted in June 2005 and it became effective July 1, 2005. The rule specifies permissible investments, provides asset allocation requirements, and lays out various reporting requirements. The report goes into detail on these requirements in chapters II and III.

Institutions may develop their own investment policies, but are required to follow Regent reporting requirements.

Institutions can opt out of the permissible investment, asset allocation, and conflict of interest portion of the investment policy. However, all institutions must follow the portion of the investment policy dealing with trustees' responsibilities and required reporting. The Regents require the institution to incorporate those sections into their own policies. Further, the Regents have statutory authority to approve or disapprove any institutions' investment policy.

Some Institutions Have Adopted Their Own Endowment Investment Policies

Utah Code [51-8-303(3)] allows institutions to opt out of the Regent investment policy and adopt their own policies. Two institutions, the University of Utah (U of U) and Utah State University (USU) have adopted a separate policy. The U of U received approval for their policy in December 2005, and USU received approval in October 2006.

Utah Higher Education Institutions Have Significant Investment in Endowment Funds

The institutions of higher education in the state have collected and built their endowment dollars over the years. The larger institutions naturally have collected a greater amount of endowment funds. However, each school has sizable funds that need to be properly managed and controlled.

The principal of endowment funds is to remain inviolate for the life of the institution.

Endowment funds are different than most government funds. Whereas most government funds are appropriated operating funds that are intended to be used in the short-term future, endowment funds are privately donated permanent funds that are meant to remain for the life of the institution. Only a portion of an endowment fund's annual increase is available to be spent. Endowment funds are commonly used to provide scholarships, help specific academic programs, or fund other university needs. Because of the difference in investment time frames, endowment funds can properly be invested in higher-return and less liquid investments than operating funds. The following figure illustrates the size of each institution's endowment fund at the end of fiscal year 2006.

Over $600 million exists in endowment funds. The U of U and USU account for 86 percent of the institutions' aggregated endowment.

Figure 1.1 Higher Education Endowment Funds as of June 30, 2006. These numbers have been reported to the Regent's, by the institutions. Together, the University of Utah and Utah State account for 86% of higher education endowment funds.

Higher Education Institution	Endowment Funds (In Millions)	Percent of Total
U of U	$416 Million	68%
USU[1]	110	18
WSU	44	7
Dixie	10	2
SUU	12	2
UVSC	9	1
SLCC	6	1
Snow	4	1
UCAT	1	0
CEU[2]	Not Available	N/A
Total	**$612 Million**	**100%**

[1] USU number differs from that reported to the Regents' due to some USU accounting errors discovered during the audit.
2 CEU unable to provide information, FY 2005 number was $14 million.

These figures should include endowment dollars held by foundations, if the foundation's assets are included in the institution's audited statement of net assets. Quasi endowment dollars, or those not externally restricted, are also included in this report.

Private foundations also hold endowment funds.

Endowment Funds Are Also Held by Institution Foundations

Most higher education institutions have created private, non-profit foundations. Some of these foundations also hold endowment funds. These endowment funds held by the foundations are contractually obligated to the institution by the donor. The following figure illustrates endowment holdings by foundations at the schools audited.

Figure 1.2. Higher Education Endowment Funds Held by Foundations as of June 30, 2006. Foundations' endowment dollars are currently smaller than institutions', but at least one school is putting an increased amount of future donations into foundations.

Institution	Institution Endowment (In Millions)	Foundations Endowment (In Millions)	Total (In Millions)
U of U[1]	$416 Million	$0	$416 Million
USU	101	9	110
WSU	38	6	44
SUU	12	0	12
Dixie[2]	10	9	19

[1] U of U does not have a primary institution foundation. The institution does have a hospital foundation with a small endowment of about $500,000.
[2] Dixie's number is different than figure 1.1 because the foundation assets are not reported with the institutions.

Questions About Foundations Exist. During the course of the audit, several questions were raised about foundations. Two of the primary questions about foundations are:

- Do state law and regent investment policy apply to endowment funds held by foundations?
- Should the state auditor audit endowment funds contractually obligated to the institutions, but held by foundations?

Regents should clarify questions about foundations holding endowment funds.

Foundation Questions Are Important and Regents Should Seek Answers. The questions about the role of foundations and what controls should be placed on the endowment funds they hold are important.

These questions were beyond the scope of this audit but should be reviewed and answered by the Board of Regents, commissioner's staff, institutions' board of trustees and institution management. Protection of funds obligated to the institutions is important, history has shown that controls need to be in place to protect funds.

Audit Scope and Objectives

We were asked to audit the Utah System of Higher Education in order to determine if the higher education institutions are in compliance with the Uniform Management of Institutional Funds Act (UMIFA), changed in the 2007 Legislative session to the Uniform Prudent Management of Institutional Funds Act (UPMIFA). The scope of our audit was to review the following areas:

- Compliance with UMIFA and endowment fund investment policies by institutions of higher education
- Oversight and controls of the governance system

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Chapter II
Institutions Not in Compliance With Portions of Investment Policy

Each of the five institutions audited had some degree of noncompliance with the Regent investment policy.

Higher education institutions at each of the five audited institutions had some degree of investment policy noncompliance during fiscal year 2006. Compliance with investment policy is important because it helps with diversification and protection of the endowment portfolio.

Policy noncompliance occurred because management at the five institutions did not properly track their endowment funds in strict accordance with investment rules. Consequently, some endowment funds are invested in instruments not approved by the Board of Regents. We recommend that the Regents require institution management to fully track compliance with all investment requirements.

Institution Management Not Fully Tracking Investment Compliance

Institutions are not fully tracking compliance with the investment policy.

Investment policies are designed to ensure an appropriate return to risk tolerance. Once the investment policy is established, adherence to the policy means the approved return to risk tolerance is followed. The Regent investment policy contains certain permissible investments with limited asset allocation requirements. The Regent policy is intended to be a safe harbor for investments. Institutions can opt out of the regent investment policy with approval from the institutions' trustees and Board of Regents.

Since adherence to the investment policy is important, tracking to ensure compliance with the policy is essential. However, we found that institution management has not been fully tracking compliance with the investment policy. Ability of the institutions to track compliance is important. Institutions should be careful not to have a portfolio that is too complicated to track. The Regents should require institution management to track all requirements of the investment policy. If institutions do not have the expertise or staff to fully track investment compliance they, should consider pooling their funds with a more sophisticated institution or, with another qualified, competent investment entity.

Investment Policy Has Safeguards To Protect Endowment Funds

The Uniform Prudent Management of Institutional Funds Act (UPMIFA) embodied in ***Utah Code*** title 51 and section 08, requires the Board of Regents to establish asset allocations and guidelines for investing endowment funds. Accordingly, the Board of Regents established an investment and reporting policy, in Regent Rule 541. If an institution's board of trustees decide they have a different investment approach ***Utah Code*** 51-8-303(3) allows them to opt out of the Regent investment policy and seek approval for their own.

Regent investment policy is designed to safeguard endowment funds.

Rule 541, or the investment policy, is designed to safeguard endowment funds. The investment policy weighs risk and return motives and is designed to maximize return with an acceptable risk structure. To accomplish this risk/return level, the regents have a two-tiered investment policy. First, investments must fall into one of three categories of permissible investments. Second, the overall endowment portfolio must follow certain asset allocation requirements.

Regent Investment Policy Allows Only Certain Permissible Investments. The Regent's investment policy allows institutions to invest in three investment vehicles and any investment vehicle required by the donor. Through contractual agreements donors can require institutions to hold certain investments such as stocks, bonds, and treasury notes. The three investment vehicles are intended to provide a safe harbor for institutions. The following list illustrates the three approved investment vehicles.

- Mutual funds or common trust funds from banks, must be SEC registered.
- Any investment vehicle sponsored by the "Common Fund" (Common Fund is used by many institutions of higher education)
- Investments allowed in ***Utah Code*** 51-7-11, such as the State of Utah Public Treasurers' Investment Fund (PTIF)

The Regents believe that pooled investment funds have less risk. Accordingly, individual stocks are not a permissible investment under the Regent investment policy. Additionally, corporate bonds with a maturity of more than 365 days are not allowed. Other individual investments, such as real estate, would also not be allowed.

Investment Policy Has Broad Asset Allocation Requirements. Asset allocation is considered to be an important aspect of managing investment risk and return. The Regents' investment policy mandates how much or how little of certain asset classes an institution may hold in their portfolio. It also includes other provisions that attempt to minimize risk. For example, the policy requires investment in larger companies if an institution decides to invest in equities, the policy limits exposure to sector funds, and limits exposure to developing markets. The five asset allocation rules are shown below.

- If equities are held, a minimum of 25 percent of the equity portfolio must be invested in companies of at least $10 billion in market capitalization
- A minimum of 25 percent in investment grade fixed income
- A maximum of 3 percent in any one sector fund
- A maximum of 5 percent in equity or fixed income funds of developing markets
- A maximum percentage of between 0 and 30 percent in alternative investments and between 0 and 20 percent in absolute return and long/short hedge funds, depending on the size of the institutions endowment.

Regent investment policy allows for broad asset allocations.

Even with these requirements, the Regents' policy gives considerable latitude to institutions in investing their endowment funds. Based on the foregoing rules in the Regents' policy, institutions could invest within the following broad asset allocation ranges:

- Fixed Income: 25 to 100 percent
- Equities: 0 to 75 percent
- Alternatives: 0 to 30 percent (depending on the size of the endowment)

These provisions help safeguard assets by requiring some investment in assets which are relatively lower in risk, and by limiting an institution's exposure to higher-risk investments. When institutions do not track compliance with these requirements, they lose the built-in safeguard benefits of the policy.

Institution Management Should Better Track Compliance

Management at each institution should institute a tracking mechanism to help them monitor and ensure compliance. Currently, institutional management is not tracking all policy requirements. The expertise and staffing ability to track compliance is essential. Tracking compliance is important; institutions should not have such complicated portfolios that make it too difficult to track.

Investment tracking with policy requirements can be improved.

Investment Tracking Effort Can Be Improved. Institution management has simply not been tracking and ensuring compliance with the investment policy. When management does not track all the requirements of the investment policy, the risk of not being aware of all the policy requirements is greater.

Investment policy contains safeguards important for management to follow. Therefore, management should institute a tracking mechanism to ensure that they are in compliance with all the provisions of the investment policy. Management should then use the tracking mechanism to assure their institution's board of trustees and the Board of Regents that they are in full investment compliance.

Ability to track compliance is necessary and important.

Ability to Track Compliance Is Important. Some of those in institution management have commented that tracking compliance with all the policy's provisions would be too time consuming and not feasible. If true, then institutional management should consider a different investment approach. It is not prudent for the institutions to have such complicated investments if they lack the staff, knowledge, or expertise to track compliance. The investment policy exists to perform an important function of safe guarding the institutions' assets.

Several options exist for institutions that lack the staff and/or sophistication of investing and tracking compliance. One option is for the schools to pool their funds with a more sophisticated institution. ***Utah Code*** 51-8-102(8) and 51-8-401(1) states,

> Manager means either the state treasurer or a higher education institution that accepts responsibility for the management of the endowment funds of a different higher education institution. . .an institution may delegate to an external agent the management and investment of an institutional fund to the extent that an institution could prudently delegate under the circumstances.

The U of U investment guidelines also provide for them to manage other institutions' funds.

Institutions can pool their endowments funds with other institutions or qualified entities.

Accordingly, institutions may use another higher education institution in the state system or an independent firm to manage the money. Several well-qualified firms exist that will manage an institution's fund in accordance with their investment policy. USU is currently researching this option.

Tracking all the provisions of the investment policy is essential for institutions to know they are in compliance. We recommend that the Board of Regents require institution management to track fully all requirements of the investment policy.

Insufficient Tracking Has Resulted in Some Compliance Problems

As previously discussed, institution management has not been adequately tracking the requirements of the investment policy. One consequence of insufficient tracking is that institutions may not be aware of investment policy noncompliance.

Institutions are not in compliance with some investment policy requirements.

All five higher education institutions we audited had some degree of policy noncompliance with the Regents' investment policy. Four of the five institutions we audited were under the Regent policy for all of fiscal year 2006. The U of U was transitioning to their own policy, and adopted it a few months into the fiscal year; thereby, only being under the Regent policy for a short while.

Methodology of Compliance Review

Our criteria for the audit was the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and the Board of Regents investment

Rule 541. We also reviewed the U of U's and USU's investment policies. All higher education institutions were under Regent investment rule 541 for the entire fiscal year 2006, except the U of U, who operated under the rule for five months until their policy was approved in December 2005 (USU's policy was approved in October 2006).

We did not conduct a full compliance review. Institutions may have further noncompliance than what is listed in this audit.

We did not conduct a complete compliance review for the institutions. Instead we audited for general policy compliance and stopped when one or more concerns were uncovered. It is likely that further concerns would have been revealed with further audit work. Again, a prime concern was to understand if the management and Regent oversight system is functioning sufficiently. One or two undetected policy problems at each institution were sufficient to test the oversight structure and determine concerns with the system. We note that some of the specific compliance problems mentioned in this audit may themselves have a minor effect. The larger concern is that management and the oversight system were not tracking compliance and therefore had not detected the compliance problems.

We further acknowledge that the new rules and oversight system have been in place a short time, fiscal year 2006 being the first full year. We believe that some confusion exists with the new UMIFA law (now UPMIFA) and the Regents investment policy, Rule 541. Recommendations in this audit should be followed to help management and the oversight system correctly function.

Compliance Problems Varied At Four Institutions Under Regent Investment Rule

The four institutions under the Regent investment policy during fiscal year 2006 each had some degree of investment policy noncompliance. The institutions' policy problems and the causes for the policy non-compliance differ with each of the schools. However, if management at the schools would have strictly tracked the investment policy rules and managed according to them, all schools would have been compliant.

The Figure 2.1 illustrates the policy noncompliance with investment Rule 541 by the other institutions audited. Greater discussion and detail concerning the institutions' compliance problems are discussed after the figure.

Figure 2.1 **Noncompliance with Rule 541 Requirements.** Four of the five schools we reviewed were not in compliance with either permissible investments or the required asset allocations.

Institutions had various non-compliance concerns.

Institutions	Percent Non-Compliance	Areas of Noncompliance
Dixie State College	27%	Held common stocks and unallowed corporate bonds.
Weber State University	1[1]	Held common stocks. And did not meet asset allocation requirement for fixed income.
Southern Utah University	20	Held common stocks.
Utah State University	1	Held unallowed corporate bonds.

[1] 1% refers to common stock held. Asset allocation noncompliance discussed below.

Dixie College held and still holds common stock and long-term corporate bonds, neither of which is allowed by the Regent Investment Policy.

Dixie State College Held Individual Stocks And Long-Term Corporate Bonds. Dixie was not in compliance with the Regents' approved investment policy because they held individual stocks and corporate bonds not allowed under the policy. The Regent policy requires that stocks and corporate bonds be held in a commingled fund. The stocks and bonds held by Dixie were worth about $2.8 million of their $10 million endowment portfolio (as of June 30, 2006). The college continues to hold stocks and unallowed corporate bonds. Consequently, Dixie is currently out of compliance with the investment policy.

Another concern is that Dixie does not track the asset allocation for their entire portfolio, but rather tracks how much of their portfolio is with each investment manager. Tracking the asset allocation for their entire portfolio will help them better manage their risk and return.

Weber State University Held Individual Stock and Did Not Follow Some Allocation Requirements. Weber State University (WSU) was not in compliance with either the permissible investments portion of the policy or the asset allocation requirements. During fiscal year 2006 Weber held shares of common stock for two companies. WSU continues to hold shares of common stock for the two companies.

This practice is not allowed by the Regents' investment policy. These stocks were worth approximately $400,000, about 1 percent of their total endowment fund. The rest of their endowment fund was invested in permissible investments.

WSU holds some individual stock not allowed by the investment policy.

WSU believes that they have understandable reasons for holding the stock, but never asked or received formal permission from the Regents to do so. According to WSU, their investment committee approved the holding of both stocks, but this occurred under the old rules of the Money Management Council, when individual stocks were allowed.

Weber states that they hold one of these stocks so that students can attend shareholder meetings; therefore, the ownership of this stock serves educational purposes. While this is understandable, the university needs to get approval through the proper channels. ***Utah Code*** 51-8-303(3) allows trustees of the institutions to adopt their own investment policies. Thus, one option for WSU to take, if they desire to hold individual stock, is to adopt and seek approval for a policy that allows this.

WSU was also not in compliance with the minimum fixed income requirement.

Along with holding some shares of common stock, WSU was also not in compliance with one of the asset allocation requirements. The following figure illustrates WSU's allocation compliance concerns.

Figure 2.2 WSU Asset Allocation, FY 2006. Weber State was out of compliance with the required minimum fixed income asset allocation at the end of multiple quarters. Highlighted sections indicate compliance problems.

Asset Class	Required Allocation	WSU's Allocation Fiscal Year 2006			
		1st qtr.	2nd qtr.	3rd qtr.	4th qtr.
Fixed Income	Minimum 25%	23%	24%	24%	27%

University officials brought up a concern to us about rebalancing. Though the university should have been compliant with the asset allocations regardless of a rebalancing provision, they bring up a good point. The university is concerned because the Regent investment rule provides no guidance on rebalancing. Without a rebalancing provision, the school may be in compliance with the allocation requirements at one point in time; if the market really favors one class of investments in particular, those allocations could change, leaving the school out of compliance in the interim. The school does bring up an important issue; however, we believe that the lack of policy tracking, not the rebalancing issue, accounts for the noncompliance.

We do agree that a rebalancing provision may be appropriate for the Regents to include in their policy. The Regents should study and discuss the pragmatics of a rebalancing provision discussed more in Chapter III.

SUU held individual stocks during FY 2006, a practice not allowed by Regent investment policy.

Southern Utah University Held Individual Stocks. SUU held several individual stocks during the entirety of fiscal year 2006, which is in violation of the investment policy. The university has now sold the stock, and appears to be in compliance. The university for many years prior to fiscal year 2006 bought and sold stocks as part of their investment strategy.

The practice of holding individual stocks was allowed under the Money Management Council rules. However, the Regent investment policy is structured as a safe harbor for investments. Thus, individual stock is not a permissible investment in the new policy. The university is able to adopt their own investment policy, if they feel the Regents' policy is too restrictive.

SUU indicated that they were aware of the need to sell the stocks, but were confused with the time table for becoming compliant. Regent staff did notify the institution, during the second half of the fiscal year, of the need to sell the stocks. The institution still continued to hold stocks until the end of the fiscal year.

USU had long-term corporate bonds, not allowed by the Regent investment policy.

Utah State University Held Long-Term Corporate Bonds. USU also was not in full compliance with the Regent investment policy (Rule 541). USU held individual corporate bonds with various maturity dates greater than 365 days. Regent investment policy allows institutions to hold corporate bonds, but they must be accepted under ***Utah Code*** 51-7-11. This section allows for fixed-rate corporate obligations that:

- are rated "A" or higher or the equivalent of "A" or higher by two nationally recognized statistical rating organizations, one of which must be by Moody's Investors Service or Standard and Poor's
- are publicly traded

- have a remaining term to final maturity of 365 days or less or are subject to a hard put at par value or better, within 365 days

The corporate bonds held by USU were worth $700,000, a relatively small portion of their endowment fund, less than 1 percent.

USU Officials were not aware that the Regent investment policy was more restrictive than Rule 2 of the Money Management council; hence, they did not divest the corporate bonds disallowed by the Regent investment policy. If management had been tracking all investment rules, this concern could have been identified and corrected.

After the time period audited, USU adopted their own investment policy, which allows for the holding of long-term corporate bonds. Accordingly, the bonds held by USU are now in compliance with their investment policy.

U of U Temporary Policy Violation Occurred

U of U not in compliant with Regent investment policy during transition period to their own investment policy.

The U of U was not compliant while under the Board of Regent investment policy because the U of U did not anticipate being under the Regent policy. The U of U policy permits investments not allowed under the Regent policy. The Regent investment policy became effective July 1, 2005. Commissioner staff have indicated that the Regents allowed the schools 90 days to become compliant with their investment policy. The U of U's policy was approved December 2005. Consequently, for about two months, the U of U was out of compliance with Regent rules.

During this period the U of U held some investments with long-term commitments, which made it difficult and unreasonable to liquidate during the period they were governed by the Regents' investment policy. The university also held some common stock. The U of U's noncompliance is understandable, but nevertheless, could have been avoided. The university should have asked the Regents for permission to continue with the investment during the transition.

The next chapter discusses the oversight system, which has not been aware of the institutions' policy noncompliance. A primary part of the oversight system is the internal audit function. Internal auditors can benefit from more comprehensive information from management to test for accuracy, which, in turn, will help the entire oversight structure.

Recommendations

1. We recommend that Regent policy be amended to require institution management to fully track compliance with all requirements of the applicable investment policy.

2. We recommend that institutions consider pooling their endowment funds with a more sophisticated institution within the state system of higher education, or with another investment entity if they are unable to fully track compliance with the applicable investment policy.

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Chapter III
Governance and Oversight Of Investments Can Be Improved

Oversight structure in place did not detect instances of policy non-compliance.

The governance and oversight structure in place has not detected the institutions' policy noncompliance. The Board of Regents, in their oversight role, receive only high-level information and therefore rely greatly on internal auditors at the institutions to perform in-depth compliance audits. The regents, in their governance role, should review and analyze their investment policy for needed clarifications and additions.

The board of trustees for each institution performs an oversight role in their meetings by reviewing investments reports. However, these reports have not been adequate in detailing all policy requirements and showing compliance to them. Trustees should request from their staff more thorough reports to help them in their oversight function.

The internal auditors have not adequately performed their oversight role. The auditors have failed to detect the institutions' investment policy noncompliance, thereby depriving the Regents of this information. Internal auditors should take measures to ensure that future audits are adequate in detecting any investment policy violations.

Oversight System Not Detecting Policy Violations

The current oversight system is composed of three entities: the Board of Regents, institutions board of trustees, and the internal auditors. Figure 3.1 illustrates the various layers of oversight currently in place and briefly describes the functionality of the oversight entity.

Oversight system composed of Regents, institution trustees, and internal auditors.

Figure 3.1 Endowment Oversight Structure. Compliance measurement with all investment policy requirements is not a substantial part of the current oversight system.

Oversight Role	Implementation
Board of Regents	
Annually, Regents receive a summary of endowment holdings and ab auditor's attestation of compliance. As stated by ***Utah Code***, Regents also receive monthly reports detailing deposits and investments (51-8-303(4)).	The Regents' annual review provides a comparative summary. Regents rely on internal auditors' attestation of compliance. The monthly reports vary by institution, but don't provide a complete compliance picture.
Institution Board of Trustees	
As stated by ***Utah Code***, Trustees also receive monthly reports detailing deposits and investments (51-8-303(4)). The Regent investment policy also requires they receive quarterly reports.	The monthly and quarterly reports vary greatly by institution. None of the reports address all the investment policy requirements. Consequently, trustees may not be aware of all policy requirements.
Internal Auditors	
The Board of Regents requires an annual audit. Internal auditors are to review all details and attest to institutions' policy compliance.	Auditors have not adequately reviewed investments. Auditors have incorrectly certified investments as compliant when they have not been.

As discussed in the previous chapter (Chapter II), institutions have not been in compliance with investment policy requirements. The above oversight system has not detected the institutions' noncompliance.

Regents Can Influence Better Oversight Through Investment Policy

Regents and commissioner's staff can clarify investment policy and better train institutions on the policy.

The Regent investment policy needs to be clarified to be more effective in governing institutions' investments. The investment policy should be revised to include provisions such as rebalancing, requiring target allocations, and clarifying investment vehicles. The commissioner's staff should review the investment policy and seek ways to clarify and, where appropriate, strengthen requirements in the policy. The commissioner's staff should also, where appropriate, seek ways to help educate and guide the institutions toward policy compliance.

Policy Clarifications Can Help Steer Compliance

Some clarifications to the investment policy are needed.

The Regent's investment policy is vague in certain areas and does not adequately address other investment needs. The Regents should review their policy with the institutions to clarify and revise where appropriate. These clarifications should make it easier for institutions to understand the requirements imposed on them, thereby aiding compliance. Some points to consider when revising the policy are:

Clarify Asset Allocation Ranges. The investment policy has asset allocations but could be more clearly presented. The Regents should make these allocation ranges more apparent.

Require Target Allocations. We found that at least one school has not established target allocations for their endowment funds. The regent policy does provide some guidance in asset allocation but only within broad ranges. Target allocations, on the other hand, give specific allocation goals for each asset class. Having target allocations is an industry-accepted way of managing investment fund portfolios. Without targets, institutions are lacking the strategic guidance that targets provide in managing endowment funds.

Greater attention to portfolio diversification is needed in the Regent investment policy.

Ensure Greater Portfolio Diversification. The policy needs further direction on portfolio diversification. We have been told that one of the aims of the policy is to ensure that the endowment funds are in diversified investments, a key to managing a portfolio's risk. The Regent policy may attempt to achieve diversification through the rules above but diversification itself is not mentioned as a principal or requirement in the policy. Without providing more guidance on diversification, the Regents may see endowment fund portfolios that are not as diverse and consequently not as safe as they would like. The policy currently allows an institution to overinvest in certain parts of the economy. For example, it appears that under the regent policy, an institution could invest 75 percent of its endowment funds in real estate investment trusts (REITs). However, the Regent investment policy is intended to encourage diversification.

Establish a Rebalance Provision. Rebalancing is a necessary and common item for an investment policy. A rebalancing provision allows institutions to stay within target ranges without incurring significant transaction fees. Weber State University has requested the Regents add a rebalancing provision to the policy.

Regents can clarify reports to require a more complete picture of policy compliance.

Reports Deadlines and Purpose. Regents should clarify the purpose of compliance reports and, at a minium, require that they show a more complete picture of required policy requirements.

Figure 3.2 Investment Policy Required Reports. Current compliance reports are inadequate to show full compliance with investment policy. These reports have also been untimely.

Monthly Reports to Trustees.	"Each institutional Board of Trustees shall approve monthly reports of portfolio activity" R541-4.3.
Report Deadline	Monthly or as often as trustees meet
Quarterly Reports to Trustees.	"Each institutional Board of Trustees shall approve quarterly reports of the institution's entire portfolio, showing costs and market amounts for each investment and maturity dates where applicable" R541-4.3.
Report Deadline	Quarterly
Annual Money Management Report.	"Annually, each institution shall submit, on forms provided by the Commissioner of Higher Education, a summary report of its money management activities for the year. This report shall include an auditor's opinion. . .regarding [fairness of presentation and compliance with applicable law and policy]" R541-4.10.
Report Deadline	November 30
Comparative Annual Summary	"The Office of the Commissioner shall compile a comparative annual summary of investment results from the audited reports and submit the summary for Board approval at its December meeting. After approval, the report shall be forwarded to the Legislature and Governor" R541-4.12.
Report Deadline	December Regent Meeting

The Regents' investment policy reports deadlines that have not been adhered to. Dixie College and the College of Eastern Utah have not been reporting monthly to the Regents and, in some cases, their trustees. The other institutions have been reporting monthly. While the reports provide some information on compliance, they do not address all areas of investment policy requirements. We recommend that the Board of

Regents develop a uniform report format for the institutions, which addresses each of the requirements of the investment policy.

Required deadlines for reports have not been met.

Timely information is pertinent to be able to correct policy noncompliance in a expeditious manner. The investment policy requires the Comparative Annual Summary be presented to the Regents by December of each year. However, this has not yet occurred. The fiscal year 2006 report (ending June 2006) is not scheduled to be reported until several months after the December deadline. This late reporting does not allow the Legislature and Governor to review timely reports. Regents should ensure their report deadlines are adhered to.

Clarifying these points will help establish a clearer direction for endowment investing. Thus, the commissioner's staff should analyze and review the investment policy for incorporation of these points and others deemed important.

Regent Staff Can Help Train Institutions

Staff at the Board of Regents can play a greater role in informing the institutions of investment policy requirements. Commissioner staff can help institutions become compliant by better informing them of the requirements.

Commissioner staff can help inform and train institutions with requirements in their investment policy.

Commissioner staff can also, where appropriate, help train some of the institutions on investment best practices. Training may also include details on how to best track investments according to the investment policy. We recommend that commissioner staff seek ways to better communicate policy requirements and where appropriate help educate institutions regarding investment compliance tracking.

Trustees Do Not Have Sufficient Information to Accomplish Oversight Role

The institutions' board of trustees have an important oversight role that can function better with improved information from institution management. The Board of Regents have delegated responsibility to the trustees to manage institutions' investments in compliance with the investment policy. However, the trustees are not receiving adequate information to fully understand and know if the institutions are in compliance with the policy.

Reports showing a more complete compliance picture can help trustees in their oversight role.

We recommend that institutional board of trustees direct institution management to provide them with a standard monthly report demonstrating compliance with all investment policy requirements. Trustees could also review the role of the investment committee to decide if any additional responsibilities are appropriate.

Trustee Oversight Role Can Function Better

The Regents' investment policy delegates investment responsibility to each institution board of trustees. However, the trustees are not receiving adequate information to monitor compliance. Further, investment committees organized by the institutions are serving well in an advisory capacity, but are not charged with specific compliance oversight responsibilities.

Trustees have a defined role in oversight over endowment funds.

Utah Code* and Regent Investment Policy Gives Trustees Responsibilities over Investments.** The trustees have a defined function over endowment funds. The ***Utah Code provides general suggestions and requirements for the trustees' involvement and has these requirements for trustees:

- May adopt a separate investment and conflict of interest policy
- If separate policy is adopted, then trustees have requirement for defining responsibilities of certain groups as well as to determine risk level, etc
- Receive monthly reports from the institution detailing the deposit and investment of funds

The Board of Regents' investment policy more specifically defines the trustees' responsibilities. The investment policy requires the trustees to:

- Manage and report institutional investments in compliance with general investment policy
- Adopt policies and procedures regarding investments
- Approve format of reports submitted for its review
- Approve monthly and quarterly reports

Investment advisory committees help with strategic investment decisions, but are not charged with specific compliance oversight.

Investment Advisory Committees Provide Investment Guidance Rather Than Oversight. The advisory committees consist of qualified professionals who help the institutions on strategic investment decisions, but do not have an oversight role. The investment committees' role is not clearly defined in statute but is developed in more detail in each school's policies. Both the University of Utah and Utah State have made their investment committees advisory in nature. Some of the responsibilities of these committees include, among other things:

- Reviewing current economic conditions and future economic forecasts
- Reviewing the University's current investment portfolio and investment results
- Reviewing the pool's current investment strategy and advising the administration on the strategy to be employed
- Advising the administration on the engagement, termination, or continuation of investment advisors, consultants, independent investment managers, banks, and/or trust companies
- Advising the administration as to the adoption of appropriate operating guidelines or practices relating to the administration and investment of endowed funds, and the allocation of investment earnings

The two institutions with investment advisory committees do appear to be receiving valuable assistance and guidance from their committees. Overall, it appears that the role of the committee is to provide competent investment knowledge to the school and help steer the institution toward strategically sound investments. Trustees might review the role of the investment committee to decide if any additional responsibilities are appropriate.

Better Information Can Help Trustees in Their Oversight Role

In reviewing minutes from several trustees' meetings, we are certain that trustees are both receiving and approving investment reports. However, the information presented to the trustees is not adequate to determine if the institutions are in full compliance. Reports to trustees' vary greatly by school. Further, the institutions' public treasurers are certifying in the reports to trustees that they have been in compliance with the policy, when they have not been.

Trustees should require more complete reporting from institutional management.

The investment policy requires that trustees "approve the format of reports submitted for its review." The trustees should require from management at the institutions that reports presented to them contain information on all investment policy requirements. Further, public treasurers' assertions should be correct, and the trustees should be aware of all investment policy guidelines.

Public Treasurers' Assertions Require More Knowledge. Institution management, which includes the public treasurers, must have sufficient knowledge to attest to the compliance of the investments. The Regent investment policy requires public treasurers to assert compliance with the appropriate law. The policy states:

> All reports should include the public treasurer's assertion that, to the best of the treasurers knowledge, the institution is in compliance with the State Money Management Act, the Rules of the State Money Management Council, and the Uniform Management of Institutional Funds Act.

Institution public treasurers have attested compliance with state law and investment policy, when they have not been in compliance.

Public treasurers or institutional management have been attesting compliance with the law, when they were not in compliance. The treasurers must obtain sufficient knowledge of the investments to know if they are in compliance. Hence, the institution must more fully track investments, so the public treasurer is fully knowledgeable and aware of any policy noncompliance problems.

U of U Trustees Did Not Approve Investment Guidelines. The trustees as a body did not approve the school's investment guidelines. Instead, the guidelines, along with the policy, (investment policy had been previously approved by trustees) went straight to the Regents for approval. The investment guidelines contain the specific investment strategy for the institution. The trustees should approve the investment policy and guidelines, and any subsequent amendments. The ***Utah Code*** and the Regent investment policy also require the Regents to approve any subsequent changes to an institution's investment policy.

Regents and trustees should approve all investment policies and guidelines at the schools.

The U of U endowment fund investment guidelines contain responsibilities for the trustees. For the trustees at the U of U, or any other institution, to properly direct and govern investing activity at the institution it is important for them to direct and approve all investment direction and guidelines. We recommend that the Board of Regents and institutions board of trustees approve investment policies, including investment guidelines, and other investment policy direction, and subsequent amendments.

Internal Auditors Work Inadequate To Detect Policy Noncompliance

Internal auditors did not detect policy noncompliance and, thus, incorrectly attested to compliance.

We found that the internal audit work performed at each institution was inadequate and did not detect institutions' policy noncompliance. The Regents have implemented agreed-upon procedures that require the internal auditors to attest to the institution's compliance with investment policy. However, auditors incorrectly attested to institutions' compliance with state law and investment policy.

The internal audit function has been established as the primary oversight entity. Internal auditors are the only entity that review detail of the investment policy for compliance. The Board of Regents relies on the auditors' opinion that the institutions are in compliance. We recommend that the institutions' internal auditors perform sufficient work in accordance with UMIFA and the appropriate investment policy to correctly attest institution investment compliance.

Internal Auditors Work Insufficient To Certify Compliance

Auditor work was not adequate to detect policy non-compliance.

Audit work performed by internal auditors was not adequate to certify compliance with investment policy. Internal auditors have been certifying investment compliance for several years. However, changes occurred in 2005 that affected the relevant criteria used in a compliance audit. We found that the auditors either did not use the new investment policy or misunderstood the policy and consequently inaccurately certified investment compliance.

Internal Auditors at Each of the Five Institutions We Visited Had Lapses in Their Audit Work. The internal auditors' work was insufficient for primarily two reasons. First, some internal auditors did not use the correct investment policy when testing for compliance. Second, other internal auditors were aware of the appropriate investment policy but either did not test for compliance with all the provisions in the investment policies or did not understand the policy. The following chart shows the concerns of each institution.

Auditors did not perform adequate audits for different reasons.

Figure 3.3 Internal Audit Concerns. Various reasons exist for why internal auditors did not detect policy noncompliance.

Institution	Audit Problem
U of U	Used the wrong law and policy for endowment funds when testing for compliance. Auditors used the Money Management Act and rules of the Money Management Council.
USU	Used the correct law and policy (UMIFA and Regent Investment policy), but did not understand the policy. Consequently, impermissible investments were not identified.
WSU	Used the correct law and policy (UMIFA and Regent Investment policy), but did not evaluate all investment policy requirements.
SUU	Used the wrong law and policy for endowment funds when testing for compliance. Auditors used the Money Management Act and rules of the Money Management Council.
Dixie	Used the correct law and policy (UMIFA and Regent Investment policy), but did not understand there were asset allocation requirements. Also, did not detect impermissible investments.

Because of these problems the institutions' policy violations were neither detected nor corrected.

Oversight Function Impaired By Auditors' Insufficient Work

Regents rely entirely on work by internal auditors to know if institutions are in compliance with policy requirements.

The system of oversight set up by the Regents relies entirely on the internal auditors to examine compliance with the details of the investment policy. The commissioner's staff have developed agreed upon procedures with each of the institution's internal auditors. These agreed upon procedures require the auditors to attest compliance with investment policy. The agreed-upon procedures state:

> Internal auditors are required to attest to the accuracy and completeness of the numbers in the annual Report of Cash, Cash Equivalents and Investments. . . internal auditors are required to express an opinion regarding the institution's compliance with the laws and policies governing investment activity. These laws include. . .Uniform Management of Institutional Funds Act,

Regent Policy R541, and individual institutional investment policies.

While each institution internal audit office agreed to these procedures, some did not comply with it. As previously shown some audit offices did not audit in accordance with UMIFA and Regent rule 541. More complete reporting and tracking by institutional management should help the auditors test for compliance.

More complete reports by institution management will also help auditors test for compliance.

We recommend that commissioner's staff help train internal auditors on the UMIFA law and appropriate investment policy. It is imperative for the auditors to perform correct audits or the oversight bodies will not receive accurate information.

Recommendations

1. We recommend that the Board of Regents analyze and review their investment policy to determine appropriate revisions and clarifications. Items that should be considered in the review are:
   - Clarifying the asset allocation ranges in the investment policy
   - Directing institutions to develop target allocations and manage their endowment pool accordingly
   - Adding language to the policy that would require further portfolio diversification
   - Including guidance and direction for re-balancing
   - Reviewing required reporting deadlines and adjusting to ensure for reasonableness and appropriateness

2. We recommend that commissioner staff seek ways to better communicate policy requirements and, where appropriate, help educate institutions of their responsibility to fully track investment compliance.

3. We recommend that the Board of Regents develop a uniform report format for the institutions, which addresses each of the requirements of the investment policy.

4. We recommend that institutional board of trustees direct institution management to provide them with a standard monthly

report demonstrating compliance with all investment policy requirements.

5. We recommend that the Board of Regents and institutions' board of trustees approve investment policies, including investment guidelines, and other investment policy direction, and subsequent amendments.

6. We recommend that institutions' internal auditors perform sufficient work in accordance with statutory requirements and the appropriate investment policy to correctly attest to institution investment compliance.

7. We recommend that commissioner staff help train internal auditors on applicable statutory requirements and appropriate investment policy.

Agency Response

May 17, 2007

Mr. John Schaff
Legislative Auditor General
W315 State Capitol Complex
Salt Lake City, UT 84114

Dear Mr. Schaff:

Thank you for allowing us to respond to your report titled "A Performance Audit of Compliance with UMIFA." In general, the Utah System of Higher Education (USHE) agrees with the findings and recommendations included in the audit report. Technically speaking, instances of non-compliance did exist at each of the five institutions. However, as indicated in the audit report, most of those instances were relatively minor and have since been resolved (WSU and DSC will be making appropriate corrections).

We note that the fiscal year selected for audit was the first year under the new UMIFA law and associated governance structure. This was truly an implementation year in every sense of the word, with an almost 30-year history of investing, reporting, and auditing being changed virtually overnight. The change involved 10 institutions, multiple oversight bodies (regents, trustees, internal auditors), and multiple offices at each institution (treasurers, controllers, auditors, financial officers, etc). The communication and coordination efforts required during this transition were significant, and the audit has clearly identified some items that were not adequately addressed. The new UMIFA standard and structure represent a watershed event for the USHE. All of the associated adjustments, while beneficial for both the State and the System, continue to require enhanced communication, coordination, and training efforts.

The USHE acknowledges, accepts, and appreciates the findings related to weaknesses in the oversight and governance structures. The fact that cases of non-compliance (small as they were) went undetected by the oversight mechanism is indeed troubling. Commissioner's staff will immediately begin a review designed to remedy the deficiencies noted in the audit report. The following responses to the individual audit recommendations detail specific steps to be taken.

<u>Recommendation 19-1:</u> Concur. The Board will amend current policy to clarify that institutions are required to track all aspects of investment compliance.

<u>Recommendation 19-2:</u> Concur. The Board will investigate those cases where institutions lack the resources to track full compliance with investment policies. Where practical, staff will consider the benefits of pooling funds with more sophisticated institutions within the USHE.

Recommendation 32-1: Concur. The Board will (1) clarify asset allocation ranges; (2) require institution-specific target allocations (several institutions already maintain target allocations); (3) further endorse the concept of diversification and require a prudent level of diversification even within the pooled and commingled investments already permitted by policy; (4) provide guidance on the issue of portfolio re-balancing; and (5) adjust reporting deadlines to reflect requirements currently outlined in the USHE agreed-upon-procedures document.

Recommendation 32-2: Concur. The Office of the Commissioner will take additional steps to meet regularly with institutional personnel involved in the investment oversight process, with the goal of better educating and communicating with respect to policy and reporting requirements.

Recommendation 32-3: Concur. In consultation with institutional representatives, the Board will develop a uniform monthly report designed to demonstrate compliance with all investment policy requirements.

Recommendation 32-4: Concur. Institutional boards of trustees will be asked to review and track investment compliance based on the uniform monthly report referenced in recommendation 32-3.

Recommendation 32-5: Concur. The Board will clarify its current position, that all investment policies, guidelines, and other related guidance, as well as subsequent changes to those documents, must be approved by both trustees and regents.

Recommendation 32-6: Concur. As noted in the response to recommendation 32-2, the Office of the Commissioner will meet regularly with internal auditors to better educate and communicate on matters related to investment compliance.

Recommendation 32-7: Concur. As noted in the response to recommendation 32-2, the Office of the Commissioner will meet regularly with internal auditors to better educate and communicate on matters related to investment compliance.

Again, we appreciate the chance to respond to this audit. We believe we can comply fully with each of the recommendations. If you have any questions, please feel free to contact us.

Sincerely,

Richard E. Kendell
Commissioner of Higher Education

REK/MHS/BRF

THE UNIVERSITY OF UTAH

May 16, 2007

Mr. John M. Schaff
Legislative Auditor General
W315 State Capitol Complex
Salt Lake City, Utah 84114

Re: Performance Audit of Compliance with UMIFA

Dear Mr. Schaff:

On behalf of the University of Utah, thank you for the opportunity to respond to the above-referenced report concerning the investment of endowment funds in the State System of Higher Education. We appreciate the professionalism and effort of your staff in performing the audit.

Prudent and effective oversight and management of endowment investments is of critical importance to the University of Utah. We were intimately involved as UMIFA was developed, evaluated, and enacted in 2005 as well as associated policies of the Utah State Board of Regents and the University of Utah. Prime objectives throughout the process were to improve safeguards, strengthen accountability, and achieve greater transparency with respect to our endowment investments. We believe the Legislature deserves great credit for the positive impact of this legislation on the State's educational institutions.

We welcome your recommendations to further strengthen our existing controls and oversight processes. We agree with each of the recommendations and are looking forward to implementing them.

Sincerely,

Arnold B. Combe

Arnold B. Combe
Vice President

c: Michael K. Young, President

University of Utah
201 South Presidents Circle, Room 209
Salt Lake City, Utah 84112-9012
Phone: (801) 581-6404 • Fax: (801) 581-4972

WEBER STATE UNIVERSITY

OFFICE OF THE VICE PRESIDENT
ADMINISTRATIVE SERVICES

May 16, 2007

Mr. John M. Schaff, CIA
Auditor General
Legislative Auditors Office
W 315 State Capitol Complex
Salt Lake City, UT 84114-5315

Dear John,

Weber State University appreciates the review of its endowment investment activities that has recently been completed by your office. The audit team of Rick Coleman, Kade Minchey and Aaron Eliason have been thorough and fair. We agree with the findings of the audit as they relate to Weber State University and we will implement the audit recommendations as soon as possible.

Sincerely,

Dr. Norm Tarbox
Vice President for Administrative Services

OFFICE OF THE VICE PRESIDENT ▯ ADMINISTRATIVE SERVICES
WEBER STATE UNIVERSITY ▯ 1006 UNIVERSITY CIRCLE ▯ OGDEN UT 84408-1006
(801) 626-6004 ▯ (801) 626-7922 FAX