

# AUDIT OF

**INVESTMENTS**

## Andrew S. Groover, M.Ed., CPA, CIA, CICA, CISA, CFE

**Director of Internal Audits**

**Audited by:**

## Andrew S. Groover, M.Ed., CPA, CIA, CICA, CISA, CFE

**Director of Internal Audits**

**Maria D. Maldonado**

**Auditor I**

##### December 17, 2013

**Report No. 14-01**

DATE: December 17, 2013

TO: Dr. Ann Stuart, Chancellor and President

Members of the Board of Regents

FROM: Andrew S. Groover, M.Ed., CPA, CIA, CICA, CISA, CFE

Director of Internal Audits

RE: Audit Report of Investments

Our internal audit report of Investments follows. We appreciate the cooperation and assistance provided to us by Kelly McCullar and others during the audit.

A follow-up audit will be conducted in approximately six months.

C: Dr. Brenda Floyd, Vice President for Finance and Administration

Kelly McCullar, Associate Vice President – Finance, Controller, and Treasury

Governor’s Office of Budget and Planning

Legislative Budget Board

State Auditor’s Office

Sunset Advisory Commission

## Executive Summary

***An audit was conducted of Texas Woman’s University’s (TWU) Investments. Our audit determined that overall; TWU is in*** ***compliance with the Public Funds Investment Act (PFIA) (Government Code, Section 2256) and the TWU Investment Policies. Management controls on investments are effective and adhere to the TWU Investment Policies. However, we have made recommendations to improve compliance.***

### Overview

The PFIA provides guidance to state agencies related to investment policies, strategies, board and investment officer(s) responsibilities, standards of care, training of board members and investment officer(s), authorized investments, internal reporting requirements and other miscellaneous provisions.

Investments reported in the Fiscal Year 2012 and Fiscal Year 2013 Annual Financial Report totaled $201,330,377 and $206,874,953, respectively. The audit of Investments is required at least once every two years per section 2256.005 (n) of the PFIA.

### Audit Objective

The objective of our audit was to review compliance with the Public Funds Investment Act (Government Code, Section 2256), management controls on investments, and adherence to the TWU Investment Policies.

### Scope

The scope of our audit was fiscal year 2012 and fiscal year 2013. We performed our testing on a sample basis.

### Methodology

### We conducted our audit in accordance with the *International Standards for the Professional Practice of Internal Auditing* and *Government Auditing Standards*, where applicable.

Primarily, we reviewed to determine the following:

* The Annual Investment Report was submitted to the State Auditors’ Office (SAO), Comptroller of Public Accounts, Legislative Budget Board (LBB) and the Governor. The report was prepared in the prescribed SAO format and is accurate.
* Annual and quarterly investment reports are published on the TWU website and in compliance with the PFIA.
* An Investment Officer has been appointed and has received the required continuing professional education.
* Each member of the Board has received required training.
* There are written Investment Policies and the Board has reviewed and approved the policies annually.
* The policies are in compliance with the PFIA.
* There is a separate investment strategy adopted for each of the funds or group of funds under the University’s control and it is in compliance with the PFIA.
* Amounts reported in the FY 2012 and FY 2013 Annual Investment Reports agree to the amounts reported in the FY 2012 and FY 2013 Annual Financial Reports.
* Investment pools are rated no lower than AAA or AAA-m by at least one nationally recognized rating service.
* Investment firms are registered with the U.S. Securities and Exchange Commission and/or a State Securities Board.
* Contracts with investment firms do not exceed two years and contract renewals or extensions are approved by the Board.
* Compliance with the reporting requirements of the General Appropriations Act (82nd Leg) - Special Provisions Relating Only to State Agencies of Higher Education 5. Investment Reports.
* Investments are diversified in compliance with the investment policies.

### Summary of Results

We have made recommendations related to:

* Compliance with Section 2256.003 (b) of the PFIA.
* Compliance with Section 2256.005 (b) (3) of the PFIA.
* Ensuring that the Annual Tracking Report for Investment Reporting by Higher Education Institutions is submitted to the State Auditor's Office by December 31 each year in compliance the requirements of the State Auditor’s Office.
* Ensuring that question #2 (as required by the State Auditor’s Office) is updated to include whether or not the University uses directed brokerage or directed commission, commission recapture, or similar arrangements.

The detail audit results and management’s responses follow.



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Director of Internal Audits

Audit Results and Management’s Responses

1. We recommend that management comply with Section 2256.003 (b) of the Public Funds Investment Act.

Sec. 2256.003 (b) of the Public Funds Investment Act states:

*(b) …A renewal or extension of the contract must be made by the governing body of the investing entity by order, ordinance, or resolution.*

We obtained and reviewed the contracts from both investment management companies and the approved minutes from the Board of Regents to ensure compliance with Sec. 2256.003 of the PFIA. The initial contracts were approved by the Board of Regents on September 1, 2010 and run for two years with three one-year options to renew. We determined that the first year extension of both contracts was not approved by the Board of Regents. We conferred with TWU’s General Counsel for an interpretation of the statute above and determined that formal Board approval is required for any extension at the time of the extension.

*Management’s Response: Authority for extension of the contracts was conveyed to the Vice President-Finance & Administration in the initial Board Resolution approving the contracts.  The rationale for Board of Regent approval of the second year extension at the August 2013 meeting was to gain approval of the firm that had purchased the firm managing endowment investments.  Other than this change in the legal name of one of the firms providing services, there were no changes in either contract at the extension dates.*

1. We recommend that management comply with Section 2256.005 (b) (3) of the Public Funds Investment Act.

Sec. 2256.005 (b) (3) of the Public Funds Investment Act states:

*(b)  The investment policies must:*

*(3)  address…the quality and capability of investment management.*

We obtained and reviewed the investment policies to ensure compliance with Sec 2256.005 (b) (3) of the PFIA. We determined that the Investment Policy does address the quality and capability of investment management; however, the Endowment Investment and Distribution Policy does not address the quality and capability of investment management. This recommendation was also made during the last audit of Investments.

*Management’s Response: The same language that was added to the Investment Policy document will be added to the Endowment Investment and Distribution Policy.*

*“The University's designated Investment Officer will initiate and administrate a process for the selection by the Board of a qualified firm to serve as Investment Manager. The Process will solicit proposals from firms that are qualified by the Securities and Exchange Commission under the U.S. Investment Advisors Act of 1940. This qualification provides assurance that the firm chosen to serve as investment manager does compliance with Texas Government Code Section 2256.005 (b) (3) concerning the quality and capability of investment management. The term of the contract with an investment management firm shall be two years, and may provide for two additional one-year extensions to the original term. (*[*http://www.twu.edu/regents/investment-policy.asp*](http://www.twu.edu/regents/investment-policy.asp)*)”*

1. We recommend that management ensure that the Annual Tracking Report for Investment Reporting by Higher Education Institutions is submitted to the State Auditor's Office by December 31 each year in compliance the requirements of the State Auditor’s Office.

The State Auditor’s Office states:

­*The SAO adopted new procedures in 2012 for higher education institutions to address Rider 5’s requirements to report information to the SAO. These include: Implementing an Annual Tracking Report for Investment Reporting by Higher Education Institutions that every higher education institution should submit to the SAO by December 31 of each year to satisfy its Rider 5 reporting requirements to the SAO. The new procedures are effective August 2012.*

We reviewed to determine compliance with the new SAO requirements stated above. We determined that the fiscal year 2012 Annual Tracking Report for Investment Reporting by Higher Education Institutions was not submitted to the State Auditor’s Office by December 31, 2012.

*Management’s Response: As explained during the field work stage of the audit, there is no record of any request or notification of this new “tracking” requirement.  It was not mentioned in the training classes attended in August 2011 or September 2012, nor has any notification from SAO been received indicating that they were expecting this “new” report.  SAO did review TWU’s FY12 financial statements (including investment holdings) during January and February 2013, but there was no mention of the new requirement. This may be due to the fact that all or most of the information called for in the “Investment Tracking Report” is available on the TWU website at* [*http://www.twu.edu/controller/idt.asp*](http://www.twu.edu/controller/idt.asp)*. TWU has adapted the file on the website to conform to the new requirement and will use the revised format when filing the investment report for FY13.*

1. We recommend that management ensure that question #2 (as required by the State Auditor’s Office) is updated to include whether or not the University uses directed brokerage or directed commission, commission recapture, or similar arrangements.

Beginning in 2002, the SAO required all higher education institutions to include on their website the answer to questions about their (1) use of external investment advisors or managers, (2) use of “soft dollar” arrangements, and (3) association with an independent endowment or foundation. Effective August 2012, the SAO expanded question #2 to includeuse ofdirected brokerage or directed commission, commission recapture, or similar arrangements.

*Question #2: Does the institution use soft dollar, directed brokerage or directed commission, commission recapture, or similar arrangements (these arrangements typically involve using brokerage commissions as a means of paying for other related investment services through credits of a portion of brokerage commissions paid rather than through direct payments, or using selected brokers who will rebate a portion of commissions they receive on trades for the investor)? If the answer to this question is yes, the institution must summarize briefly the guidelines that govern the use of such arrangements.*

We reviewed the required questions and answers posted on TWU’s website via the Annual Investment Report for fiscal years 2012 and 2013. We determined that question #2 was not updated to include whether or not the University uses directed brokerage or directed commission, commission recapture, or similar arrangements.

*Management’s Response: As in the response to Recommendation #3, there has been no notification either in training classes or directly from SAO regarding this revised requirement. The probable cause for this omitted notification is the fact that the brokerage and commission arrangements mentioned are not commonly utilized by most of the entities subject to PFIA. TWU’s response to Question #2 will be revised to indicate a negative answer to the revised question.*