

Audit and Advisory Services
401 Golden Shore
Long Beach, CA 90802-4210

July 7, 2022

Dr. Jeffrey D. Armstrong, President
California Polytechnic State University, San Luis Obispo
1 Grand Avenue
San Luis Obispo, CA 93407

Dear Dr. Armstrong:

**Subject: Audit Report 21-24, Endowment Management,
California Polytechnic State University, San Luis Obispo**

We have completed an audit of *Endowment Management* as part of our 2021-2022 Audit Plan, and the final report is attached for your reference. The audit was conducted in accordance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

I have reviewed the management response and have concluded that it appropriately addresses our recommendations. The management response has been incorporated into the final audit report, which will be posted to Audit and Advisory Services' website. We will follow-up on the implementation of corrective actions outlined in the response and determine whether additional action is required.

Any observations not included in this report were discussed with your staff at the informal exit conference and may be subject to follow-up.

I wish to express my appreciation for the cooperation extended by the campus personnel over the course of this review.

Sincerely,



Vlad Marinescu
Vice Chancellor and Chief Audit Officer

c: Jolene Koester, Interim Chancellor
Lateefah Simon, Chair, Committee on Audit
Yammilette Rodriguez, Vice Chair, Committee on Audit

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ENDOWMENT MANAGEMENT

**California Polytechnic State University,
San Luis Obispo**

Audit Report 21-24
July 7, 2022

EXECUTIVE SUMMARY

OBJECTIVE

The objectives of the audit were to ascertain the effectiveness of operational, administrative, and financial controls related to endowment management and to ensure compliance with relevant federal and state regulations; Trustee policy; Office of the Chancellor (CO) directives; and campus procedures.

CONCLUSION

Based upon the results of the work performed within the scope of the audit, the operational, administrative, and financial controls for endowment management as of June 2, 2022, taken as a whole, provided reasonable assurance that risks were being managed and objectives were met.

In general, we noted that the campus had an effective framework for the administration and management of endowments; however, we found that due to a journal entry error, the market value of the total endowments reported in the Investment Management System (IMS) did not match the general ledger/accounting system (PeopleSoft), and the variance had stood uncorrected for more than 18 months. Although we determined the impact to be minimal due to the relative size of the endowments, we noted that the process for timely reconciling differences needed improvement.

Specific observations, recommendations, and management responses are detailed in the remainder of this report.

OBSERVATIONS, RECOMMENDATIONS, AND RESPONSES

1. INVESTMENT MANAGEMENT

OBSERVATION

Oversight of the monthly investment value reconciliation process needed improvement.

The Foundation invests all endowment proceeds in a unitized fund and monitors its market value using the IMS. On a monthly basis, the Foundation completes a reconciliation of the IMS to PeopleSoft. Differences in value between these two systems are generally attributed to market gains and losses, fee accruals, and timing differences in revenues and expenditures. Once variances are identified, the two systems are rectified. PeopleSoft is reconciled through a manual journal entry, while the IMS is updated using a batch process from which staff enter the new total market value of the unitized fund. IMS then automatically allocates funds based on each endowments' share of the unitized fund.

We reviewed three monthly reconciliation calculations between September 2020 and December 2021 and noted that an unsupported \$21,008 difference between the IMS and PeopleSoft had been outstanding for more than 18 months. Per the Foundation, this difference was caused by a \$10,504 journal posting on the wrong side of the ledger. Because quarterly endowment fund distributions are calculated based on the average market value recorded for each fund in the IMS for the past 36 months, the longer this discrepancy exists, the greater the error to each endowments' share of the unitized fund and of future distributions. Although the impact is minimal in the context of a unitized fund valued at more than \$280 million as of December 2021, discrepancies between the two systems should be reconciled in a timely manner.

Documenting the cause of variances between IMS and Peoplesoft and timely correcting erroneous updates and journal entries will help reduce the risk of inaccurate endowment value and distributions, material misstatement in the financial statements, and fraud.

RECOMMENDATION

We recommend that the campus, in conjunction with the Foundation:

- a. Process the manual journal entry to PeopleSoft and corresponding update to IMS to correct the error noted above.
- b. Establish a process to ensure that the cause for monthly reconciliation variances between IMS and Peoplesoft are documented and timely corrected.
- c. Reiterate to Foundation staff the importance of documenting any variances between IMS and Peoplesoft.

MANAGEMENT RESPONSE

We concur and will process the manual journal entry to correct the error and update IMS as well. We will also strengthen our process to ensure that any reconciling items are addressed and corrected in a timely manner. We will meet with the Foundation Accountant and Foundation Executive Director of Finance to reiterate the importance of the IMS reconciliation.

Anticipated completion date: November 30, 2022

GENERAL INFORMATION

BACKGROUND

In fiscal year (FY) 2019/20, the value of California State University (CSU) endowments reached a record high of \$1.89 billion. During that FY, the CSU received \$94.6 million in additional endowment funds and distributed \$65 million from proceeds. Endowment funds, the principal of which cannot be expended by the university, are generally established with a donor-directed designation for the spending of the proceeds. More than half of the CSU's endowments are designated for student scholarships; others support academic programs, such as nursing and agriculture, and student enrichment programs, such as study abroad.

The state of California adopted the Uniform Prudent Management of Institution Funds Act (UPMIFA), the standards of care for both managing and investing endowments, in 2009. UPMIFA and its predecessor, the Uniform Management of Institutional Funds Act (UMIFA), clarified and revised historic interpretations of income from endowment funds and provided both a duty to ensure the growth of the principal to maintain spending power and a right to distribute from the corpus when the actions taken are prudent for the purposes for which the fund was established. UPMIFA also imposed a duty to diversify; allowed for the delegation of investment decisions to an outside professional entity; and suggested a percentage limit for annual spend beyond which any spending would be presumptively imprudent.

The market value of endowments held at California Polytechnic State University San Luis Obispo (Cal Poly San Luis Obispo) during academic year 2019/20 was \$226.1 million, a 0.7 percent reduction from the previous year's value of \$227.7 million. The campus distributed \$8.7 million from endowment proceeds for scholarships, awards, and various programs, such as supporting an exchange program for the department of mechanical engineering and funding a faculty research position within the department of horticulture and crop sciences. Funds are held at the California Polytechnic State University Foundation (Foundation), and administrative and investment oversight is provided by the Foundation board of directors. The board-established policies that govern the investment activities are carried out by an outside investment firm, and the fund distributions are calculated and processed at the Foundation. Once the annual distributions are made to the designated department for the funds, it is the responsibility of that department to ensure that expenditures align with the donor intent for the endowment.

SCOPE

Due to temporary operating procedures and limitations resulting from the COVID-19 public health emergency, we performed fieldwork remotely with limited on-site visits as needed from April 11, 2022, through June 2, 2022. Our audit and evaluation included the audit tests we considered necessary in determining whether operational, administrative, and financial controls are in place and operative. The audit focused on procedures in effect from July 1, 2020, through June 2, 2022.

Specifically, we reviewed and tested:

- Foundation and campus policies and procedures for the receipt and administration of endowments to determine whether they are current, comprehensive, and aligned with relevant state and federal regulations, Trustee policies, and CO directives.
- Clear lines of organizational authority and responsibility in the acceptance, administration, and expenditure of endowment funds.
- Processes to establish and implement investment policies, including oversight of third-party providers and communication between the board of directors, the vendor, and Foundation staff.
- Processes to establish and implement spend policies, including the determination of the spend rate and allocation of the distribution among the funds in the investment pool.
- Processes to allocate investment gains and losses among the funds in the investment pool.
- Review of contracts with third-party providers to ensure they are current, reflective of the established policies, properly delegated, and inclusive of the roles and responsibilities of all parties.
- Compliance with donor intent and/or agreement restrictions.

As a result of changing conditions and the degree of compliance with procedures, the effectiveness of controls changes over time. Specific limitations that may hinder the effectiveness of an otherwise adequate system of controls include, but are not limited to, resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. Establishing controls that would prevent all these limitations would not be cost-effective; moreover, an audit may not always detect these limitations.

Our testing and methodology, which was designed to provide a review of key operational, administrative, and financial controls, included interviews and detailed testing on certain aspects of endowment management. Our review was limited to gaining reasonable assurance that essential elements of endowment management were in place and did not examine all aspects of the program.

CRITERIA

Our audit was based upon standards as set forth in federal and state regulations and guidance; Trustee policy; Office of the Chancellor directives; and campus and auxiliary procedures; as well as sound administrative practices and consideration of the potential impact of significant risks. This audit was conducted in conformance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

This review emphasized, but was not limited to, compliance with:

- Executive Order (EO) 676, *Delegation of Gift Evaluation and Acceptance*
- EO 1059, *Utilization of Campus Auxiliary Organizations*
- ICSUAM §13680, *Placement and Control of Receipts from Campus Activities*
- ICSUAM §15501.00, *Naming of California State Facilities and Properties*

- ICSUAM §15502.00, *Naming of California State University Schools, Colleges, Programs and Other Academic and Non-Academic Units*
- ICSUAM §8060.00, *Access Controls*
- CSU Auxiliary Organizations Sound Business Practices, Section 3.0, *Donations, Program Service Fees, Other Income*
- *CSU Auxiliary Organizations Compliance Guide*
- *CSU Auxiliary Organizations Sound Business Practices Guidelines*
- Probate Code §18501-18510, *Uniform Prudent Management of Institutional Funds Act*
- Council for Advancement Support of Education (CASE) Guidelines
- *Cal Poly Endowment Investment Policy*
- *Cal Poly Gift Administration Policy*

AUDIT TEAM

Senior Audit Manager: Joanna McDonald
Internal Auditor: Matthew Shum