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System Audit Office

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October 15, 2013

Mr. Bruce Zimmerman
Chief Executive Officer and Chief Investment Officer
The University of Texas Investment Management Company (UTIMCO)
401 Congress Avenue, Suite 2800
Austin, Texas 78701

Dear Mr. Zimmerman:

We have completed our review of UTIMCO's internal controls over financial reporting related to the Separately Invested Funds (SIFs). The audit objective was to gain an understanding of the classifications of SIF types, along with the related processes and associated controls.

Our engagement was conducted in accordance with the guidelines set forth in the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*. The results are detailed in the attached report. We appreciate the assistance provided by your staff.

Sincerely,

J. Michael Peppers, CPA, CIA, CRMA, FACHE
Chief Audit Executive

cc: Joan Moeller, Senior Managing Director - Accounting, Finance and Administration,
UTIMCO
Francisco G. Cigarroa, M.D., Chancellor, UT System
Dr. Scott C. Kelley, Executive Vice Chancellor for Business Affairs, UT System
Terry Hull, Associate Vice Chancellor for Finance, UT System

**The University of Texas System Administration
The University of Texas Investment Management Company
Separately Invested Funds (SIFs) Audit Report
FY 2013**



October 2013

THE UNIVERSITY OF TEXAS SYSTEM AUDIT OFFICE
702 COLORADO STREET, CLB 3.100
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AUDIT REPORT

October 2013

Background

The University of Texas Investment Management Company (UTIMCO) is an external investment corporation that was formed to manage the investment of assets under the fiduciary care of The University of Texas (UT) System Board of Regents. UTIMCO's mission is to provide competitive, innovative, and effective asset management and financial advisory services. UTIMCO manages several major endowment funds on behalf of the UT System Board of Regents, including the Permanent University Fund (PUF), Long Term Fund (LTF), Permanent Health Fund (PHF), and Separately Invested Funds (SIFs). The UT System Board of Regents has fiduciary responsibility for the PUF, LTF, PHF, and SIFs; however, the day-to-day management and operational responsibilities of these funds are delegated to UTIMCO pursuant to the Investment Management Services Agreement between the UT System Board of Regents and UTIMCO.¹

The SIFs include endowment, annuity and life income (trust), agency, and current purpose fund types. They are maintained separately and, for various reasons, cannot be invested in pooled investment vehicles (i.e., the LTF, a pooled fund for the collective investment of private endowments and other long-term funds). Guidelines for management of the SIFs are established in the SIF Investment Policy Statement; however, any specific restrictions in the endowment agreements or trust instruments supersede the policy.

The endowment funds are permanent funds that generate income distributions used to support UT System institutions but are prohibited from being invested in the LTF due to donor restrictions in the endowment agreement. While UTIMCO manages the investment of most of these endowments, there are seven endowments that are managed by two outside investment managers, which were selected by donors.

The annuity and life income funds are charitable trusts for which the UT System Board of Regents serves as trustee and are managed by UTIMCO. During the term of the trust, distributions are made to income beneficiaries according to terms set forth in the trust instrument. Upon termination of the trust at a predetermined date or event, the remainder is distributed to the remainder beneficiaries per the donor's request. UT System Policy UTS138 *Gift Acceptance Procedures* requires that a UT institution must be at least 50 percent remainder beneficiary, but it is possible for the other 50 percent to be non-UT entities. The distribution to the UT beneficiary institution may be made as current purpose funds or to create or supplement an endowment.

The current purpose funds are operating funds from donors and other external entities that are available for the institutions to spend. These monies flow through UTIMCO and are distributed to the institutions. Current purpose accounts may also hold assets until they can be invested or distributed.

¹ Source: <http://www.utimco.org>



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The agency funds are assets held under an agency relationship for an external but UT-affiliated entity (primarily foundations).

The majority of SIFs, in terms of dollar value, are endowment funds, followed by trust funds. As of the end of May 2013, the SIFs' market value was approximately \$146 million (less than 1 percent of total endowment funds managed by UTIMCO). These amounts are primarily invested in mutual funds, cash and cash equivalents, stocks, and

SIF Fund Type	Market Value*
Endowment SIF ²	\$92,243
Annuity and Life Income (Trust) SIF	26,139
Current Purpose SIF	21,013
Agency SIF	6,411
Total SIFs Managed by UTIMCO	\$145,806
*Market values in thousands as of 5/31/2013 ³	

bonds. The market value amount does not include real (physical) assets, such as real estate and oil and gas properties, which totaled approximately \$285 million as of May 2013. While the income (and sale proceeds) from real estate properties and the royalties from mineral interests are invested by UTIMCO and included in the SIFs' reported value, the real assets are not managed by UTIMCO and are not reported as part of its assets under management. Other UT System offices, such as the Real Estate Office and University Lands, or affiliated entities, such as the Geology Foundation of the Jackson School of Geosciences at UT Austin, manage these assets. While UTIMCO is not directly responsible for their management, it handles the back-office accounting functions for some real estate and oil and gas properties using information reported by the responsible parties. All parties involved work together in different aspects of SIF administration.

The System Audit Office has not previously reviewed the SIFs, and this audit was performed as part of the Fiscal Year (FY) 2013 audit plan.

Audit Objective, Scope, and Methodology

The objective of this audit was to gain an understanding of the processes and associated controls surrounding the different types of SIFs. The audit focused on FY 2013 SIFs activity. While the exact numbers may slightly change on an intermittent basis (due to new SIFs or final SIF distributions), there were eight SIF endowments and 43 SIF charitable trusts in the scope of our audit. The Debt Proceeds Fund and Short Term Fund, though also separately invested, were not included in the scope of this audit.

We conducted interviews with UTIMCO and UT System staff, performed process walkthroughs with UTIMCO staff, and validated selected controls in order to gain a more complete understanding of the SIF processes and procedures.

Our audit was conducted in accordance with the guidelines set forth in the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

²The value includes approximately \$38 million of cash that was temporarily held for the purchase of LTF units at the next quarterly buy-in.

³Source: UT System Board of Regents' August 2013 Meeting Agenda Book (Finance & Planning Committee, p. 97)



Results

In order to facilitate our understanding of the processes surrounding the SIFs, UTIMCO provided various documents with varying levels of details related to the handling of the SIFs. Some of the documents outlined descriptions of procedures, while others listed step-by-step instructions to execute a specific task related to certain SIF processes.

Through reviewing these documents and using information from the interviews and walkthroughs, the audit team organized SIF procedures in general process areas, specifically:

- Receiving contributions;
- Making investments;
- Paying out distributions, reinvestments, and withdrawals;
- Receiving income and paying expenses;
- Valuing assets; and
- Reporting and monitoring.

By considering the major risks in these general process areas, the audit team designed and conducted select audit procedures to gain a fundamental understanding of the processes and to examine the related controls in place to appropriately manage and account for the SIFs. As emphasized by UTIMCO, we found that while the general processes may apply to all of the SIFs, there are exceptions or variations to the specific processes depending on the individual SIF.

In addition to having several of the processes documented, UTIMCO has worked to develop cross-training of staff members in some of the SIF processes; however, it appears that there may be substantial reliance on a limited number of employees who have historically been responsible for the management, accounting, and reporting of the SIFs. While these staff members are very knowledgeable about the processes, intricacies, and uniqueness of the SIFs, the current documentation appears to be disconnected such that it would be difficult to follow for an employee unfamiliar with the SIF processes.

Due to the uniqueness and differences of the various SIF accounts, coupled with the business process continuity risk in the potential circumstance of losing the key employees responsible for SIFs, it is important to have comprehensive and systematic documentation of the processes and procedures.

Recommendation:

To complement cross-training, UTIMCO should augment the current SIF-related documentation so that the overall general processes are cohesively organized and also integrate how specific interrelated procedures fit within them, which will provide a more complete description of the diverse aspects of the SIFs. Existing documentation may be supplemented with additional information or used in conjunction with documents already in use.

UTIMCO may also consider whether it would be beneficial to summarize key information, such as specific distribution terms, donor investment restrictions, or other



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relevant elements from the endowment agreement and trust instrument documents that are maintained. Such a summary document could be used as reference by any staff member who is not already familiar with the particular aspects of a specific account.

Management's Response:

Management will review the current procedures and augment the SIF related documentation so the overall general processes are cohesively organized and integrated.

Implementation Date:

February 28, 2014

We also performed limited validation of certain identified controls that would address the risks that we considered in the general process areas. Generally, we found that the selected controls tested were functioning as expected. We did identify a few minor observations related to timely reconciliations and instances in which practices slightly differed from the SIF Investment Policy Statement. These items were informally communicated to UTIMCO management.

Conclusion

Overall, we gained an understanding of the SIFs processes and associated controls. In doing so, we identified an opportunity for continued enhancement in the area of supporting documentation so that the unique aspects of the various SIFs are captured in a more cohesive manner. In our limited validation of selected controls, we found that they were in place and generally functioning to mitigate the risks that we considered.

We would like to thank UTIMCO management and staff for their support and assistance during this audit.

J. Michael Peppers, CPA, CIA, CRMA, FACHE
Chief Audit Executive

Moshmee Kalamkar, CPA, CIA
Manager of Audits