



December 21, 2016

Mr. Mark Warner  
Interim Chief Executive Officer  
The University of Texas Investment Management Company  
401 Congress Avenue, Suite 2800  
Austin, Texas 78701

Dear Mark:

We have completed our audit of The University of Texas Investment Management Company's (UTIMCO) travel and business entertainment expenses. The detailed report is attached for your review.

We conducted our audit in accordance with The Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

We appreciate the assistance provided by UTIMCO management and other personnel.

Sincerely,

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

cc: David J. Beck, Chairman of the of the UTIMCO Audit and Ethics Committee  
Joan Moeller, Senior Managing Director of Accounting, Finance, and Administration, UTIMCO  
Cissie Gonzalez, General Counsel and Chief Compliance Officer, UTIMCO  
Scott C. Kelley, Ed.D., Executive Vice Chancellor for Business Affairs, UT System

**The University of Texas Investment Management Company  
Travel and Entertainment Expense Audit Report  
Fiscal Year 2016**



**December 2016**

THE UNIVERSITY OF TEXAS SYSTEM AUDIT OFFICE  
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AUSTIN, TEXAS 78701-2981  
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The University of Texas System Audit Office  
UTIMCO Travel & Business Entertainment Expenses Audit  
Fiscal Year 2016

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**AUDIT REPORT**  
December 2016

**EXECUTIVE SUMMARY**

Employees from The University of Texas Investment Management Company (UTIMCO) often travel to domestic and international locations in order to meet with existing and prospective investment partners and to attend annual investor meetings, conferences, and training. They also incur business-related entertainment expenses when meeting with clients, existing and prospective investment partners, business associates, and colleagues. Guidance for related travel and entertainment expenses they incur is provided by various policies and procedures, including the UTIMCO Travel Guidelines, Travel Related Lodging Procedures, and UTIMCO's Code of Ethics.

The objectives of this audit were to determine whether travel and entertainment expenses incurred by the UTIMCO Chief Executive Officer and Chief Investment Officer (CEO) and selected members of UTIMCO Staff were appropriate, accurate, and in compliance with applicable policies and procedures. The audit scope included expense reimbursements and direct payments made for the UTIMCO CEO's travel and entertainment during the period March 1, 2015 through December 31, 2015. The scope also included expense reimbursements and direct payments made for travel and entertainment for selected members of UTIMCO Staff during the period January 1, 2015 through December 31, 2015.

***RESULTS***

The majority of the CEO's and Staff's travel and business entertainment expenses were appropriate, accurate, and in compliance with existing policies, procedures, and UTIMCO's Code of Ethics. However, we identified two entertainment expenses and one travel expense that did not appear to be ordinary and necessary, none of which were incurred by the CEO. Additionally, we found that supporting documentation and business justification for travel and entertainment expenses was not consistently retained. To address these observations, we have recommended that UTIMCO clearly document the business purpose for entertainment or recreation events sponsored by current and prospective investment partners or business associates and, in addition to the CEO's review and approval, require review and approval by the Chief Compliance Officer (CCO) for certain third-party paid travel and entertainment expenses to ensure such expenses are ordinary and necessary. We have also recommended that management ensure that adequate supporting documentation for travel and entertainment expenses be maintained. Finally, we followed up on the recommendations from our Report on the Chief Executive Officer & Chief Investment Officer's Expenses Audit for Fiscal Year (FY) 2015 and determined that management has implemented all three recommendations.

***CONCLUSION***

Overall, the majority of the CEO's and Staff's travel and business entertainment expenses were appropriate, accurate, and in compliance with existing policies, procedures, and UTIMCO's Code of Ethics. In addition, UTIMCO implemented all three recommendations from the Chief Executive Officer & Chief Investment Officer's Expenses Audit for FY 2015. However, we identified an opportunity to improve controls related to third-party paid travel and entertainment, instances in which expenses may not have been reasonable and necessary, and instances in which adequate documentation was not retained.

We appreciate the support and assistance provided by UTIMCO during this audit.

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

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Eric Polonski, CIA, CPA  
Director of Audits



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**BACKGROUND**

The University of Texas Investment Management Company (UTIMCO) is 501(c)(3) corporation that was formed to manage investments for The University of Texas and The Texas A&M University Systems. In 1996, The University of Texas (UT) System Board of Regents (BOR) first contracted with UTIMCO to invest several major endowment funds (Funds) under its fiduciary control. The BOR has fiduciary responsibility for the Funds and has delegated day-to-day management of the Funds to UTIMCO, pursuant to the Investment Management Services Agreement (IMSA) between the BOR and UTIMCO. UTIMCO is a separate entity that is not part of UT System and is not a state agency.

UTIMCO employees often travel to domestic and international locations in order to meet with existing and prospective investment partners and to attend annual investor meetings, conferences, and training. Employees also incur business-related entertainment expenses when meeting with clients, existing and prospective investment partners, business associates, and colleagues. Expenses associated with travel and entertainment related to the conduct of official UTIMCO business may be reimbursed to or paid directly on behalf of UTIMCO employees. Guidance for these expenses is provided by various policies and procedures, including the UTIMCO Travel Guidelines, Travel Related Lodging Procedures, and UTIMCO's Code of Ethics.

**AUDIT OBJECTIVE, SCOPE, & METHODOLOGY**

The objectives of this audit were to determine whether:

- The UTIMCO Chief Executive Officer and Chief Investment Officer's (CEO) travel and entertainment expenses were appropriate, accurate, and in compliance with applicable policies and procedures; and
- UTIMCO Staff's travel and entertainment expenses were appropriate, accurate, and in compliance with applicable policies and procedures.

The audit scope included expense reimbursements and direct payments made for the UTIMCO CEO's travel and entertainment during the period March 1, 2015 through December 31, 2015. In addition, the scope included expense reimbursements and direct payments made for UTIMCO Staff travel and entertainment during the period January 1, 2015 through December 31, 2015.

To achieve our objective, we reviewed UTIMCO's internal policies and procedures; conducted interviews with UTIMCO staff to gain an understanding of related processes; and tested a sample of transactions to determine whether expenses were appropriate, accurate, and in compliance with applicable policies and procedures.

At the end of calendar year 2015, UTIMCO established new business-related entertainment expenses guidelines that became effective December 31, 2015. Because this policy was not in place during the audit scope we used auditor judgement in determining reasonableness of entertainment expenses.

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

**RESULTS**

We tested a sample of 22 entertainment expenses totaling \$6,419 and 25 trips taken by the CEO and six directors. The travel expenses associated with the directors' trips totaled \$195,843. Overall, the majority of the CEO's and Staff's travel and business entertainment expenses were appropriate, accurate, and in compliance with policies and procedures. However, we identified instances in which expenses may not have been ordinary and necessary and instances in which adequate documentation was not retained.



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**Third-party Paid Events**

One of the 25 trips tested, which was not on behalf of the UTIMCO CEO, included a recreation event paid for by an external investment manager. UTIMCO's Code of Ethics states that a director or employee may not accept a gift that the director or employee knows or should know is being offered or given because of their position with UTIMCO. The Code additionally states that attendance at seminars, conferences, or other sponsored events that involve entertainment or recreation may in some cases be in the best interest of UTIMCO. To attend such events sponsored by third parties, the policy requires that an employee must obtain specific written approval to attend such events from the CEO or Chief Compliance Officer (CCO) and approval may be withheld for elaborate entertainment events such as ski trips, hunting trips, or stays at expensive resorts. The trip, including the recreation event, was approved by the CEO. When the CEO approves a sponsored event that includes travel, the CCO's review is limited to an after-the-fact check as to whether or not the CEO provided written approval for the sponsored event. If the sponsored event does not include travel, the CCO is included on employee requests for approval from the CEO. However, in the absence of the CEO, the CCO will review and determine whether to approve the sponsored event.

UTIMCO's sole client is the UT System BOR. As such, practices that may be acceptable within the investment industry may not be perceived as acceptable when the client is the governing board of a Texas state agency. Attendance at entertainment or recreation events sponsored by current or prospective investment partners or business associates could result in or be perceived as creating a conflict of interest.

The observation described above is considered a **medium-level** finding in accordance with UT System's Internal Audit finding classification system.

**Recommendation:** To reduce the risk of an actual or perceived conflict of interest, UTIMCO management should:

- Clearly document the business purpose for entertainment or recreation events sponsored by current and prospective investment partners or business associates, why participation in the event is in the best interest of the funds managed by UTIMCO; and
- Require review and approval by the CCO for third-party paid travel and entertainment expenses, in addition to the CEO's review and approval, to ensure such expenses are ordinary and necessary.

**Management's Response:** *Staff will consult with the Chairman of the UTIMCO Audit & Ethics Committee to provide additional clarity related to entertainment or recreation events and provide additional guidelines for approving third-party paid travel and business-related entertainment expenses paid by current or prospective investment partner or business associate. Staff will also require CCO approval for entertainment or recreation events that, in the opinion of the CEO, may be perceived as elaborate entertainment events such as ski trips, hunting trips, or stays at expensive resorts. The CCO will also continue to review a sample of all travel and entertainment events as part of her quarterly compliance review of conflicts of interest.*

**Anticipated Implementation Date: February 28, 2017**

**Documented Justification for Certain Travel Expenditures**

UTIMCO's Travel Related Lodging Procedures require that written justification be submitted for approval prior to travel in cases where UTIMCO lodging costs exceed the Runzheimer's Travel Management Network or U.S. Department of State price range by \$50. The approvals should be obtained by the employee's supervisor or other



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authorized key person. We identified one instance in which justification for a lodging overage for a UTIMCO staff member was not documented or retained.

We also found that two of 22 entertainment expenses tested were not adequately supported because the supporting documentation did not include the attendees for the associated events. These expenses were incurred prior to implementation of UTIMCO's Business-Related Entertainment Expenses Guidelines, which require that business-related entertainment expenses be substantiated by a receipt for the total cost of the meal or entertainment that includes the date, location, and business purpose of the expenditure and the names of the individuals present. In addition, the field used to record attendees was not a required field in UTIMCO's travel management system until 2016.

The observation described above is considered a **low-level** finding in accordance with UT System's Internal Audit finding classification system

**Recommendation:** UTIMCO management should:

- Standardize how employees document the justification for instances in which hotel expenses exceed allowed rates. Management should also ensure that these documentation requirements are clearly defined in its travel policies.
- Establish internal controls and procedures to ensure that all required documentation for entertainment expenses is retained.

**Management's Response:** *Management will continue to train Staff on documentation related to hotel expenses exceeding allowable rates.*

*Based on the Audit Office's recommendation in 2015, UTIMCO developed and implemented the Business-Related Entertainment Expenses Guidelines, effective December 31, 2015. Management will continue to train Staff related to all policies, procedures and guidelines. In addition to annual training, Management has implemented extensive new hire training in this area and will continue to explore ways to train and educate Staff on these policies, procedures and guidelines.*

**Anticipated Implementation Date: February 28, 2017**

**Ordinary & Necessary Expenses**

As recommended in the Chief Executive Officer & Chief Investment Officer's Expenses Audit for Fiscal Year 2015, UTIMCO developed the Business-Related Entertainment Expenses Guidelines, effective December 31, 2015. These guidelines state that, "Entertainment expenses are ordinary and necessary expenses paid by UTIMCO employees to entertain a client, investment partner or prospective partner, business associate, or colleague." The guidelines define an "ordinary" expense as one that is common and accepted in UTIMCO's trade or business and a "necessary" expense as one that is helpful and appropriate.

Two of 22 entertainment expenses tested (neither of which were incurred by the UTIMCO CEO) included charges that did not appear to have been ordinary and necessary. However, these expenses were incurred prior to implementation of the guidelines and UTIMCO management has since provided training to employees to ensure they understand applicable policies, procedures, and guidelines. In addition, UTIMCO provides training on the expense guidelines to new employees. Training reduces the risk of non-compliance with UTIMCO's guidelines.



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**Follow-up on Prior Year Recommendations**

We performed follow-up procedures on three open recommendations from the Report on the Chief Executive Officer & Chief Investment Officer's Expenses Audit for Fiscal Year 2015. We conducted our follow-up in accordance with the *International Standards for the Professional Practice of Internal Auditing* as promulgated by The Institute of Internal Auditors. These standards require that we ensure that management has effectively implemented the recommendations or has accepted the risk of not taking action.

We determined that management has adequately implemented all three recommendations which related to:

- Development of business entertainment guidelines;
- Ensuring that lodging overages for the CEO are complete, timely, and documented; and
- Improving the timeliness of travel reimbursement requests.