Endowment Compliance

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Michael J. Barone  
Managing Director  
Health and Education Consulting Practice  
617.226.5540
Agenda

Today’s workshop will delve into the following topics:

- **Background on Endowments**
  - Rapid Growth (investment returns and new giving)
  - Congressional Pressure
- **Endowment Compliance**
  - Fiduciary Responsibility
  - Key Obstacles and Risks
  - *Cy Près*
- **Key Questions to Consider**
  - Receipt of Funds
  - Expenditure of Funds
  - Safeguarding and Accounting
- **Examples for Discussion**
- **Potential Avenues for Review**
  - Review of Endowment Fund Terms
  - Enhancement of Policies and Procedures
Background
In 2007, 76 universities had endowments valued over $1 billion.

The top 15 endowments, depicted below, account for approximately $175 billion (or 60% of the $293 billion in college endowments nationwide).

Source: 2007 NACUBO Endowment Study
University Fundraising

Private donations to colleges and universities reached $29.75 billion during the 2006 – 2007 academic year, representing a 6% increase in giving from the previous year.

- Pre-dates the current economic downturn, so these figures are expected to drop for 2007 – 2008.
- The top 20 schools accounted for more than 25% of total giving ($7.66 billion), though they account for only 2% – 3% of institutions.
- Stanford University’s Development office raised the most money for the second year in a row, though overall giving dropped from $911 million in 2005 – 2006 to $832.4 million last year.
  - Only two others had giving above $450 million – Harvard ($614 million) and University of Southern California ($469.7).
- Approximately 12% of alumni donate to their alma maters, which accounts for more than 25% of total fundraising.
- Foundations provide the largest source of college and university donations (28.6% of all dollars donated in 2006 – 2007).

Investment Returns

Endowments are generally well-diversified and generate consistent returns; not surprisingly, the larger the base of resources, the better the performance.

Source: 2007 NACUBO Endowment Study
Spending (Endowment Payout)

The majority of colleges and universities spend less than 5% of their endowment corpus annually.

As investment returns significantly outpace payout rates and new funds are added, year-over-year endowment growth of 20% or more is not uncommon.

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<td>Greater Than $1 Billion</td>
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<td>&gt; $500 Million to ≤ $1 Billion</td>
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<td>&gt; $25 Million to ≤ $50 Million</td>
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<td>Less Than or Equal to $25 Million</td>
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| Public                                 | 4.5    | 4.5    | 4.5    | 4.5    | 4.9    | 4.8    | 4.8    | 4.6    | 4.6    | 4.9    |
| Independent                            | 4.7    | 4.7    | 4.8    | 5.1    | 5.2    | 5.2    | 4.9    | 4.7    | 4.5    | 4.6    |
| Full Sample                            | 4.6    | 4.7    | 4.7    | 4.9    | 5.1    | 5.1    | 4.8    | 4.7    | 4.5    | 4.7    |

Source: 2007 NACUBO Endowment Study
Congressional Pressure

As tuition rates grow, schools have been facing mounting pressure to increase endowment payout as a means to make college more affordable for average families. Congress is currently considering legislation that would require universities to spend at least 5% of their endowment corpus every year.

- Similar restrictions are already imposed on other non-profits
- The bill, currently being considered by the Senate Finance Committee, would rescind a university’s tax exempt status for non-compliance
- Universities have responded that:
  - Most funds resident in endowments are restricted to narrow purposes
  - The purpose of an endowment is to protect against market fluctuation
- Harvard, Yale, Princeton, Dartmouth, and others have already committed to increasing aid by replacing loans with grants for low- and middle-income families
- Many other top institutions can’t afford to follow suit
Endowment Compliance
Endowment Stewardship

The business of managing, spending, and accounting for endowment funds and gifts has become an increasingly important and complex undertaking.

- Universities have a fiduciary responsibility to properly handle donor-restricted gifts
  - Responsibilities are akin to obligations for handling federal research dollars
  - Whereas most institutions have rigorous business systems and controls to handle research funds, the same is generally not true for endowment funds
- Large donors expect good controls to be in place over their funds
- Uniform Prudent Management of Institutional Funds Act responsibilities:
  - Give primary consideration to donor intent as expressed in a gift instrument
  - Act in good faith, with the care an ordinarily prudent person would exercise
  - Incur only reasonable costs in investing and managing charitable funds
  - Make decisions about each asset in the context of the portfolio of investments as part of an overall investment strategy
  - Dispose of unsuitable assets; and
  - Develop an investment strategy appropriate for the fund and the institution.
Endowment Compliance in the News

- **Robertson v. Princeton University**
  - In 1961, the Robertsons donated $35 million to finance a program dedicated to preparing students for government service through the Woodrow Wilson School.
  - Princeton’s institutional priorities have changed and the school no longer wishes to support a professional program training individuals for government service.
  - Princeton has spent $350 million of the Robertsons’ money, $200 million of which the family contests as having little or no relation to the donative intent.
  - Trial is set to begin in October in New Jersey state court.

- In 1995, Yale was ordered to return a $20 million gift because it failed to follow the donor’s stipulation that it spend the money on a western civilization course.

- The Southern Assoc. of Colleges and Schools announced that it will undertake a review of Texas Southern’s business affairs, including endowment compliance, resulting from former president’s alleged misuse of upwards of $500K.

- An audit of Ohio State’s endowment found that assets were inflated by $500 million in a report, but no fraud or misappropriation was present.

Sources: Use of Charitable Funds is at Heart of Princeton Case, Philadelphia Inquirer, Opinion Section, 9 April 2008
Accreditor to Scrutinize Texas Southern as Ex-President Goes on Trial, Chronicle of Higher Ed, 24 August 2007
Audit Finds Mismanagement of Ohio State’s Endowment, but not Fraud, Chronicle of Higher Ed, 12 June 2007
Key Compliance Obstacles

Major obstacles to effective endowment stewardship include the following:

- Major capital campaigns
- Age of the institution
- Degree of decentralization
- Number of accounts
- Complexity of accounting practices
# Endowment Management Risks

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<tr>
<th>Subject</th>
<th>Potential Risks/Concerns</th>
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<tr>
<td>Expenditure of Endowment Income</td>
<td>Endowment funds are not expended in compliance with donor’s terms and restrictions</td>
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<td>Specific use of endowment funds are not easily identifiable</td>
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<td>Endowment balances are not monitored to preserve the fund’s corpus/appreciation</td>
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<td>Endowment income is not expended</td>
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<td>Endowment Stewardship</td>
<td>Endowment activity is not reported to the donor in the manner stipulated in the agreement</td>
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<td>The department does not have access to the stewardship requirements of the endowment fund</td>
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<td>Stewardship reports are not directed towards the appropriate representatives of the endowment fund</td>
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<td>Accurate financial and programmatic information are not reported to the donor in a timely manner</td>
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<tr>
<td>Endowment Accounts</td>
<td>Terms and restrictions are too ambiguous or restrictive</td>
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<td>The department does not have access to the terms and restrictions of the endowment fund</td>
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<td>The department administrators are not notified of endowment agreement or amendments</td>
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<td>Donor has not yet stipulated a purpose for the endowment</td>
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When Donor Intent is Impossible to Effectuate

Often times, especially with donations to institutions made decades ago, the intent of the donor becomes impossible, impracticable, or even wasteful

- Courts will apply the doctrine of *cy près* to modify the terms of such a gift or bequest

- *Cy près* (French for “as near as possible”) allows for the amendment of the terms of a charitable donation to prevent the gift from reverting or escheating
  - Genesis of *cy près* was in *Jackson v. Phillips*, 96 Mass. 539 (1867), where money donated to a charity to turn public sentiment against slavery was “redirected” (or applied *cy près*) to provide financial support to persons of African descent

- Courts will amend the terms of the donation to be possible, practicable, legal, and as close as possible to the original intention of the donor

- Universities can rely on Offices of General Counsel to review gift terms and documented donor intent to identify problematic gifts and opportunities to apply *cy près*

- *Cy près* is specifically authorized pursuant to the Uniform Prudent Management of Institutional Funds Act
Key Questions to Consider
**Questions to Consider**

**Receipt of Funds for Endowment**

- Does the university have a formal process to determine whether certain gifts are acceptable (e.g., tied to organized crime; inconsistent with university mission, impractical to use, etc.)?

- Is there a backlog of gifts to be logged into the gifts system, deposited at the bank, and recorded in the accounts?

- Does the university have policies on threshold levels of giving that provide for named professorships and naming of buildings?

- Has a large donor reneged on a pledge, is there a threat of such action, or has the university felt obligated to return a gift?
Questions to Consider

**Expenditure of Endowment Funds**

- Are the schools and departments who make expenditure decisions provided with summary interpretations of donor restricted funds?
- Does the budgeting process consider the availability of restricted funds and gifts to support operations?
- Does the university have policies on the use of donor restricted funds such as for professorships?
- Are you confident that all expenditures are incurred strictly in accordance with donor restrictions?
- Do some funds contain restrictions that cannot by met because the donor’s intent is no longer practical due to circumstances that were not contemplated at the time of the gift?
Questions to Consider

Safeguarding and Accounting

- Is original donor documentation retained centrally in support of all of the university’s endowment funds and current use restricted gifts?
- Are there controls in place to ensure that the identity of donors who wish to remain anonymous is preserved?
- Is the gift system reconciled to the general ledger?
- Are accounting transactions including fund sweeps and expense transfers supported by donor documentation?
- Does the university account for donor pledges accurately and on a timely basis?
Discussion Examples
Examples for Discussion

Were the institutions in the examples below justified in using their endowment funds in the manner articulated?

1. University A received $5 million to fund a chaired professorship. The institution used the endowment funds to pay the professor’s salary and benefits, travel expenses, a stipend to the professor’s teaching assistant, and a portion of departmental administration costs.

2. University B received a bequest to provide reduced interest rate loans (2% to 5%) to students from low-income families. The University Bursar determined that it could provide loan funds to the designated individuals at 0% interest and did so.

3. University C received a $50 million gift to fund a Research Center in Neuroscience. The school used this money to buy neuroscience-related library books, fund a retirement party for a faculty member with an appointment to the Research Center, and purchase a plasma TV for the center’s office.
Potential Avenues for Review
Potential Avenues for Review

In light of the enhanced public scrutiny on endowments occasioned by the bill before the Senate Finance Committee and the *Robertson v. Princeton* case, several institutions have begun a full-scale review of their endowment practices.

- Massachusetts Institute of Technology (MIT) completed a full-scale review of endowment terms to understand the restrictions and ensure compliance therewith.

- Columbia University is in the midst of a process redesign effort, reviewing personnel, technology, and business rules for accepting, managing, spending, and reporting on endowment funds.

- University of Texas campuses have policies and procedures for endowment spending.
Some Recommended Practices

To effectively mitigate the risk of non-compliance consider the following:

- Ensure central repository of original donor documentation
- Make donor terms easily accessible to schools and departments where expenditure decisions are made
- Involve legal counsel in matters of interpretation of donor intent
- Review and enhance policies to ensure they are relevant (e.g., consider policy on professorship expenditures)
- Train department administrators on university endowment policies
- Ensure that university policy includes a provision for incoming gifts that provides and out if donor restrictions cannot be met at a future date
- Require special accounting transactions (i.e., transfers, sweeps) of endowment funds to be well documented
- Report to donors on the use of their contributed funds
- Consider business processes / monitoring to ensure compliance with donor intent
- Periodically audit endowment fund expenditures
Sample Endowment Management Model

Administration of Endowment Funds (Central)

- Utilization of a standard Gift Agreement
- Terms and Restrictions entered into system
- Controller / Development consistently monitor funds
- Completion of Endowment Create/Amend Process
- Endowments considered for amendment or repurposing
- Internal Audit reviews a sample of funds annually
- Department Administrators are trained on policies/procedures
- Department Administrators access terms and restrictions
- Department Administrators annually certify spending is compliant
- Department Administrators spend funds appropriately

Utilization of Endowment Funds (Local Level)