

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

May 16, 2024

Dr. Stephen Perez, President
California State University, Chico
400 W. First Street
Chico, CA 95929

Dear Dr. Perez:

Subject: Audit Report 23-04, Endowment Management, California State University, Chico

We have completed an audit of *Endowment Management* as part of our 2023-2024 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: Mildred García, Chancellor
Yammilette Rodriguez, Chair, Committee on Audit
Jean Picker Firstenberg, Vice Chair, Committee on Audit

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ENDOWMENT MANAGEMENT

**CALIFORNIA STATE UNIVERSITY,
CHICO**

**AUDIT REPORT 23-04
MAY 16, 2024**



EXECUTIVE SUMMARY

AUDIT OBJECTIVES AND BACKGROUND

In accordance with the fiscal year (FY) 2023/24 Audit Plan, as approved by the Board of Trustees, Audit and Advisory Services performed an audit of endowment management at California State University, Chico (Chico State).

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 and auxiliary procedures.

University endowments are made up of financial assets donated to the institution to support the teaching, research, and public service missions of colleges and universities. Endowment funds, the principal of which generally cannot be expended by the university and is intended to be held in perpetuity, are typically established with a donor-directed designation for the spending of the proceeds. The market value of endowments for Chico State at the end of FY 2022/23 was \$88.7 million. The University Foundation, California State University, Chico (University Foundation) is the steward of endowments and gifts for the campus; however, Chico State Enterprises (CSE) performs accounting services for the University Foundation per an operating agreement between the two campus auxiliaries. Administrative and investment oversight is provided by the University Foundation board of directors.

OVERALL CONCLUSION

Based upon the results of the work performed within the scope of the audit, except for the weaknesses described below, the operational, administrative, and financial controls for endowment management as of March 8, 2024, taken as a whole, provided reasonable assurance that risks were being managed and objectives were met.

AUDIT SCOPE AND RESULTS

In general, we found that endowment management operations were effective and services were provided in compliance with California State University (CSU) policies and procedures. In our review, we did not note any issues related to the core function of endowment management at Chico State. We observed a robust governance framework that included strategic management, comprehensive policies and procedures, and effective stakeholder communications, all of which have contributed to the ongoing growth of the campus’s endowment portfolio.

However, our review did note areas for improvement related to the review of dormant accounts and financial statement disclosure of underwater accounts. A summary of the observations noted in the report is presented in the table below. Further details are specified in the remainder of the report.

Area	Processes Reviewed	Audit Assessment
General Environment	Oversight of endowment program, outside reporting, policies and procedures, relationships and agreements with other entities (internal and external), and financial statement recording	<i>Observation noted in financial statement disclosures of underwater accounts</i>

Area	Processes Reviewed	Audit Assessment
Endowment Gift Processing	Endowment gift acceptance, creation, and recording; gift system access; and gift agreements	<i>Effective – No reportable observations noted</i>
Distributions	Distribution calculation and approvals, endowment account setup and recording of distributions, endowment spending rate	<i>Effective – No reportable observations noted</i>
Expenditures	Administration, review, and approval of expenditures; dormant accounts; spending/expenditure policies and procedures; and compliance with donor intent	<i>Observation noted related to dormant accounts</i>
Investments	Investment manager and administrative fees, investment performance reporting, investment policies and procedures (return objectives, investment asset allocation, rebalancing, etc.), allocation of investment gains and losses, and investment reconciliations	<i>Effective – No reportable observations noted</i>

The audit focused on procedures in effect from January 1, 2022, through March 8, 2024. Our audit and evaluation included the audit tests we considered necessary in determining whether operational, administrative, and financial controls are in place and operative. 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.

OBSERVATIONS, RECOMMENDATIONS, AND RESPONSES

1. DORMANT ACCOUNTS

OBSERVATION

The University Foundation did not have established policies and procedures for assessing dormant endowment accounts.

As of November 30, 2023, there were 40 endowment accounts totaling \$2.4 million in fair market value (FMV) that did not have any distributions (i.e., allocated spending funds) in the past two years despite the potential for distributions and/or other actions. Assessment of dormant accounts like these may include evaluating distribution parameters, meeting with the board or notifying the attorney general to modify a donor’s intended purpose, or reactivating accounts that have met distribution criteria. The FMV values of these accounts ranged from \$29 to \$382,000.

Regular assessments of dormant accounts facilitate appropriate distribution and use of funds, ultimately ensuring the fulfillment of donor intent.

RECOMMENDATION

We recommend that the campus, in conjunction with the University Foundation, establish and implement policies and procedures for reviewing dormant accounts to facilitate appropriate distribution and use of funds according to donor intent.

MANAGEMENT RESPONSE
<p>We concur. The campus, in conjunction with the University Foundation, will establish and implement policies and procedures for reviewing dormant accounts to facilitate appropriate distribution and use of funds according to donor intent.</p> <p>Expected completion date: September 30, 2024</p>

2. FINANCIAL STATEMENT DISCLOSURE

OBSERVATION

Required disclosures relating to underwater endowments were not properly reported in the audited annual financial statements for the fiscal year ended June 30, 2022.

Reporting requirements for underwater endowments, which are endowments that have a current FMV that is less than the original gift amount (or amount required to be retained by donor or by law), are delineated in Financial Accounting Standards Board (FASB) *Accounting Standards Update (ASU) 2016-14*.

University Foundation management noted that the underwater endowments were disclosed to the external audit firm and discussed with them. However, it was concluded that the underwater balance of approximately \$40,000, relative to the \$70 million endowment portfolio, was immaterial and thus disclosure was deemed to be unnecessary.

Adhering to financial presentation and related disclosure requirements is central to fulfilling the

objective of the ASU 2016-14, which was to enhance transparency in the financial statements of not-for-profit entities, particularly in terms of liquidity, financial performance, and cash flows.

RECOMMENDATION

We recommend that the campus, in conjunction with the University Foundation, comply with accounting standards and, going forward, include all required financial statement information and disclosures.

MANAGEMENT RESPONSE
<p>We concur. The campus, in conjunction with the University Foundation, will comply with accounting standards and include all required financial statement information and disclosures.</p> <p>Expected completion date: September 30, 2024</p>

GENERAL INFORMATION

ADDITIONAL BACKGROUND

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 that, beyond that figure, any spending would be presumptively imprudent.

In FY 2021/22, the value of CSU endowments reached \$2.3 billion. During that time, the CSU received \$108 million in additional endowment funds and distributed \$76 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.

At Chico State, the campus distributed \$2.8 million from endowment proceeds in FY 2022/23 for scholarships and various programs, such as funding faculty research and supporting the campus food pantry, engineering student success center, Big Chico Creek Ecological Reserve, and Osher Lifelong Learning Institute. The University Foundation board of directors has established policies that govern the investment activities carried out by an outside investment firm, and the fund distributions are calculated and processed by Chico State Enterprises after final review and approval by the University Foundation. Once the annual distributions are made to designated campus departments, it is the responsibility of the departments to ensure that expenditures align with the donor intent for the endowment.

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 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:

- Probate Code §18501-18510, *Uniform Prudent Management of Institutional Funds Act*
- FASB Accounting Standards Update 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*
- Council for Advancement Support of Education (CASE) Guidelines
- CSU *Delegation of Gift Evaluation and Acceptance*
- CSU *Utilization of Campus Auxiliary Organizations*
- CSU *Placement and Control of Receipts from Campus Activities*
- CSU *Information Security Policies and Standards*
- CSU *Auxiliary Organizations Compliance Guide*
- CSU *Auxiliary Organizations Sound Business Practices Guidelines*
- Chico State *Donor and Gift Procedures*

- University Foundation *Gift Acceptance Policy*
- University Foundation *Endowment Policy*

AUDIT TEAM

Audit Manager: Kyle Ishii

Senior Auditor: Carolyn Phu