

# Audit Highlights



Highlights of Legislative Auditor report on the University and Community College System of Nevada's (UCCSN) Analysis of Investment Policies and Procedures issued September 22, 2004. Report #LA04-18.

## Background

The Board of Regents is responsible for executive and administrative control of the University and Community College System of Nevada (UCCSN). To facilitate its management of the system, the Board has delegated various responsibilities to its standing and special committees, including one established to oversee UCCSN's investment program.

The Board of Regents' Investment Committee is charged with the responsibility to formulate and recommend to the Board appropriate investment policies, review and evaluate reports from external investment managers, and make appropriate recommendations regarding investment transactions. The Banking and Investments section of UCCSN's System Administration is responsible for cash and investment management, and the distribution of endowment and operating pool assets among UCCSN's institutions and System Administration. All investments are handled by external investment managers.

## Purpose of Audit

The purpose of this audit was to assess the adequacy of policies and procedures over the generation and distribution of investment income. The audit included policies and procedures and corresponding investment activities for the fiscal year ended June 30, 2003, and activities for the fiscal year ended June 30, 2002, for certain audit issues.

## Audit Recommendations

This report contains six recommendations to UCCSN to improve its policies and procedures over the generation and distribution of investment income, and its compliance with existing policies and procedures. Specifically, UCCSN should conduct periodic comprehensive reviews of investment and income distribution policies. In addition, UCCSN should comply with existing procedures for contracting and allocating assets. Finally, policies and procedures should be strengthened to include adequate segregation of duties, and portfolio rebalancing.

UCCSN accepted all six recommendations.

## Status of Recommendations

UCCSN's 60-day plan for corrective action is due on December 21, 2004. In addition, the six-month report on the status of audit recommendations is due on June 21, 2005.

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# University and Community College System of Nevada

## Analysis of Investment Policies and Procedures

### Results in Brief

The Board of Regents has developed policies and procedures to provide guidance to staff and other parties involved in the generation and distribution of investment income. However, several areas of the Board's policies could be improved to provide better guidance on investment processes from pre-investment analysis to distribution of income. Specifically, policies should be complete, clear, and up to date. In addition, stronger policies and procedures are needed to correct internal control weaknesses in areas such as segregation of duties.

These issues are important, given the size of investment portfolios for the endowment and operating pools, and their importance as a source of income for UCCSN. According to UCCSN's investment advisor, as of June 30, 2003, the endowment pool was valued at almost \$200 million, with the operating pool valued at over \$210 million. During fiscal year 2003, the institutions and System Administration received distributions totaling \$10 million from the endowment pool and \$7 million from the operating pool.

### Principal Findings

The pre-investment analysis that underlies decisions on portfolio diversification, asset allocation, and portfolio rebalancing is not adequately addressed in UCCSN policy. Investment policies should include additional guidance in several areas, including cash forecasting, the investment time horizon, and risk tolerance.

The Board's policies, as written in its *Handbook*, do not provide any guidance on portfolio rebalancing for either the endowment or the operating pool. In addition, the policies do not address portfolio diversification for the operating pool. Not periodically rebalancing the portfolio may create an imbalance between levels of risk and return. The investment portfolio may assume greater risks than necessary or experience lower investment returns than needed to meet spending requirements.

Two specific investment issues were not addressed in the Board's policies. Those issues involved the control of investment costs and the legal jurisdiction of UCCSN's investments. Guidance is needed on these issues to help ensure UCCSN receives investment services at reasonable costs and its investments are adequately safeguarded.

The Board's policies do not clearly describe the practice for distributing assets from the operating pool. UCCSN distributes a percentage of the operating pool's assets to the institutions monthly. The percentage is established by the Investment Committee, in compliance with the Board's policy. However, the Board's policy also states that investment income is to be distributed, rather than a percentage of the operating pool's assets. Confusion could result if investment income does not equal the percentage of assets to be distributed.

Oversight of the contracting process for the investments function needs to be improved. First, the Chancellor's signature was found on only one of five contracts requiring the Chancellor's signature. The Banking and Investments staff signed the contracts without having the authority to do so. In addition, the contract with UCCSN's investment advisor had not been revised or put out for bid since 1984. In April 2004, the Investment Committee discussed issuing a request for proposals for an investment consultant.

Allocation of the endowment's assets as of June 30, 2003, was not in compliance with the Board of Regents' policies. First, actual allocations to two asset classes differed significantly from their strategic targets. If there is a significant difference between the strategic target and the actual allocation, the asset allocation strategy may not work as intended. Second, one asset class exceeded the Board's permitted range. Permitted ranges represent upper and lower limits for asset classes and subclasses. By exceeding the permitted range, UCCSN may be increasing the risk in its portfolios beyond what was agreed to by the Board of Regents.

Segregation of duties over some investment transactions needs to be improved. The signature of just one staff person is needed to execute investment transactions such as establishing a contractual relationship with an investment manager or transferring the control of assets to a new investment manager. Individual investment transactions executed by the Banking and Investments staff can exceed \$10 million. Allowing transactions of this size to be executed and approved by one person increases risk.