



THE REGULATORY FUNDAMENTALS GROUP LLC

Survey of Internal Audit Practices At Endowment Investment Offices Larger Than \$1 Billion

by

The Regulatory Fundamentals Group LLC

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Introduction

Over the past year, investment activities at endowments have faced increasing public scrutiny in what can only be described as a highly politicized environment. At the same time, federal enforcement personnel have repeatedly warned that criminal charges will be harsher, and more likely to be brought, in cases where an organization lacks a comprehensive, continuously improving [compliance program](#) that is audited to assure its effectiveness.

Specifically, The Department of Justice, the federal agency that handles enforcement proceedings on behalf of the U.S. government, issued April [guidance](#) instructing prosecutors to consider whether the company audited its compliance program “to assure its effectiveness,” before charging a company. The April guidance is a further elaboration on DOJ’s instructions that prosecutors consider whether a company has engaged in “meaningful efforts to review its compliance program and ensure that it is not stale.” ([DOJ Guidance](#) at page 14.) Likewise, the federal agency that enforces economic and trade sanctions, the U.S. Treasury Department’s Office of Foreign Assets Control ([OFAC](#)), expects a “comprehensive, independent, and objective testing or audit function” which identifies “deficiencies within a compliance program.” ([OFAC Guidance](#) at page 7.)

Charitable organizations are covered by the above guidance—as are their endowment investment offices. In the face of these requirements, The Regulatory Fundamentals Group LLC (RFG) surveyed internal audit teams at charitable organizations with endowments larger than \$1 billion to understand how they tackled endowment audits. The surveyed organizations spanned the arts/humanities, education, environment/nature, foundations, health care, and social causes. The survey did not inquire into the type or extent of the audits.

“We undertook this survey to illuminate how internal auditors are thinking about endowments in an environment where endowments can provide a significant percentage of an organization’s annual operating budget,” said Deborah Prutzman, RFG’s CEO. “The responses demonstrate that internal audit teams are highly focused on auditing endowments and, during the audit, will often examine whether the investment office understands and adheres to regulatory requirements, as well as how funds are handled, managed and controlled. However, offsetting their interest in endowments, many auditors reported impediments to the audit process, such as lack of support and resources.”

Size and Scope of the Survey

Survey responses were obtained from 67 heads of internal audit functions at U.S. charities with endowments larger than \$1 billion. Of those endowments, 34 ranged from \$1.1 billion to \$3 billion; 11 from \$3.1 billion to \$5 billion; 12 from \$5.1 billion to \$10 billion; six from \$10.1 to \$20 billion; one from \$20 billion to \$30 billion; and three from \$30.1 billion to \$50 billion.

More than 95 percent of the endowments provided between 6 percent and 20 percent of their organization's annual operating budget. Within that range, 28.4 percent provided between 6 and 10 percent; 40.3 percent provided between 11 and 15 percent; and 23.9 percent provided between 16 and 20 percent.

Frequency of Audits

All responding organizations reported that their investment offices were audited within the past two years. Within that time frame, 19.4 percent stated the audit was undertaken within the past six months; 64.2 percent said it was within the past six to 12 months; and 16.4 percent said it was within the past one to two years. All planned to conduct their next internal audit sometime within the next two years. Within that time frame, 11.9 percent planned to audit within the next six months; 23.9 percent within the next six to 12 months; and 64.2 percent within the next one to two years.

Areas of Audit Focus

Internal audit respondents were asked: "What three aspects of the endowment office are you most interested in auditing?" A litany of responses was given, which RFG sorted into categories. Internal audit teams were highly interested in ascertaining whether investment office staff understood and adhered to **legal and regulatory requirements**, cited by 33 respondents. The next-highest topic of audit interest was **asset management**, which encompassed the handling and administration of funds and assets, and was mentioned by 29 respondents. Third place was a tie between **recordkeeping and documents** and **governance and internal procedures**, with 22 responses apiece; and in fourth place, **sources of funds**, was cited 21 times as an area of audit interest.

The categories and the number of responses given for each category is shown below. Additional detail is provided in the appendix.

Categories of Responses Number of Responses per Category

Laws and Regulations: Awareness and Compliance	33
Asset Management	29
Governance / Internal Procedures	22
Recordkeeping and Documents	22
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Impediments to Conducting Audits

In addition, respondents were asked: “What are the key impediments to auditing the investment office?” Five choices were given, and the respondents were asked to “select all that apply.” The most frequent response given was “lack of support/resourcing,” which was cited about 30 percent of the time. This was followed by “lack of time” mentioned approximately 24 percent of the time. Those responses were made about twice as often as “lack of subject matter expertise” and “lack of personnel.”

Lack of subject matter expertise was chosen as an impediment approximately 15 percent of the time for the group as a whole, with a range of 25 percent for health focused endowments, 18 percent for education, 15 percent for arts/humanities, 14 percent for foundations, and 6 percent for social causes. Lack of subject matter expertise was not selected as a concern on the part of the environment/nature-focused endowments that responded to the survey.

For those who feel less than fully comfortable with the identification of legal and regulatory requirements, RFG’s Prutzman says, “Uncertainty is understandable. Regulatory requirements for endowments can be complex. For example, charitable organizations may need to consider whether to file more than 30 distinct reports. In addition, endowment legal and regulatory requirements differ depending on (i) whether the endowment is part of the endowed organization or a separate legal entity, (ii) whether the endowment has multiple clients, (iii) the types of investment made, (iv) the structures and legal entities used to make investments, and (v) the location of activities, and

other factors. All of these considerations need to be included in an appropriate compliance program, which is the subject of an audit.”

The specific number of responses, and their percentages, are shown in the table below. The first column is a composite showing the results for all the endowments; the following columns show the results for each type of endowment. In each box the number or responses mentioning an issue appears, followed by the total number of responses.

	Lack of time	Lack of subject matter expertise	Lack of support/ resourcing	Lack of personnel	Access to records
All endowments larger than \$1 billion	27/112 24.1%	17/112 15.2%	33/112 29.5%	16/112 14.3%	19/112 16.9%
Health	6/24 25%	6/24 25%	5/24 20.8%	5/24 20.8%	2/24 8.3%
Education	5/17 29.4%	3/17 17.8%	5/17 29.4%	2/17 11.8%	2/17 11.8%
Arts-Humanities	3/13 23.1%	2/13 15.4%	3/13 23.1%	3/13 23.1%	2/13 15.4%
Foundation	8/36 22.2%	5/36 13.9%	10/36 27.8%	5/36 13.9%	8/36 22.2%
Social Causes	4/17 23.5%	1/17 5.9%	6/17 35.3%	1/17 5.9%	5/17 29.4%
Environment/ Nature	1/5 20%	0/5 0%	4/5 80%	0/5 0%	0/5 0%

About RFG

RFG is the only organization solely dedicated to providing strategic, regulatory and operational insights to leading U.S. endowment offices. RFG offers a proprietary online knowledge management platform, RFG Pathfinder®, which provides a comprehensive overview of the laws and regulations impacting endowments. RFG's weekly newsletter is widely distributed throughout client investment offices and their organizations to facilitate issue identification and knowledge sharing. RFG combs the legal and regulatory horizons each week for present and prospective risks to endowment clients, and communicates those risks swiftly and thoroughly. RFG also assists clients in their steps to address the risks in a timely fashion. Finally, RFG acts as a "clearing house" by facilitating communications, surveys and meetings to discuss practices with peers.

APPENDIX A

Raw Responses to the Following Questions, Sorted by Category:
“What three aspects of the endowment office are you most interested in auditing?”

Sources of Funds

Responses:

Donation sources (5)
Validating endowment sources (3)
Monitoring the source of funds
Evaluating sources of funding
Keen eye on potential endowment sources
Funding motive
Clarity about potential donors
Donation handling (2)
Donation purpose
Funds origination points
Sources of potential endowments
Vetting endowment sources
Purpose of donation
Endowment origin point

Summary: Twenty-one respondents identified monitoring, validating and understanding the purpose of funds as goals of an audit.

Use of Endowment

Responses:

Endowment use
Finding out whether funds are utilized for the right purpose
How money is being used
Endowment utilization
How funds are utilized (2)
Usage of funding amount

Summary: Eight respondents mentioned that the audit should illuminate how funds are being used and determine whether they are being used for appropriate purposes.

Recordkeeping and Documents

Responses:

Structured documentation
Documentation of accounts
Records maintenance and verification
Transaction logs
Accounting records
Transparency of records
Authenticity of receipts with respect to donations
How records are maintained

Evaluation of financial logs
Investment records
Validating financial documents
Verify financial records
Clarity on financial records (2)
Records of transactions
Validating integrity of financial records
Understanding the financial records
Validation of documents
Examining financial logs
Authenticity of records
Transaction documents
Assessing billing documents

Summary: Twenty-two respondents emphasized the importance of recordkeeping as it pertains to financial logs, receipts, bills, and investment records.

Financial Transactions

Responses:

Monitoring financial transaction
Checking the statements of transaction
Examining transaction records
Account statements
Vetting financial records

Summary: Five respondents commented on the need for financial transactions to be monitored or verified.

Financial Statements

Responses:

Comparison of financial position to last year
Financial management
Checking the statement of finance
Records of finance
Examining the financial documents and records
Financial reporting
Internal process of handling financial statements
Checking the sync of financial report
Accuracy of financial statements (3)

Summary: Eleven respondents identified the quality of financial statements produced as an important dimension of the audit.

Accounting

Responses:

Accounting irregularities

Accounting transparency
Knowledge of internal accounting
Evaluate accounting statement of organization
Validating accounting records (2)
Accounting logs
Internal accounting process
Accounting records

Summary: Nine respondents suggested that the audit should scrutinize accounting logs and records and ensure that internal processes are appropriate.

Transparency / Disclosure

Responses:

Transparency in fund allocation
Financial transparency (4)
Transparency in funds allocation
Transparency in money handling
Transparency in financial records
Financial reporting
Transparent and reliable financial statements (2)

Summary: Eleven respondents identified transparency in fund allocation, money handling and financial records as elements that should be tested for reliability.

Asset Management

Responses:

Handling of funds (5)
Funds administration(3)
How funds are being utilized
Inflow and outflow of funds
Tracking of fund movement across organization
Keeping check on fund flows
Internal process of handling funds
Money control(4)
Analysis of money flow (2)
Examine records of inflow and outflow of cash
Checking logs of financial flow
Funds management (2)
Clarity on money flow
Funds control policies
Funds administration
Tracking money flow (2)
Endowments handling
Cash flow

Summary: Twenty-nine respondents remarked on asset management, identifying a range of audit

considerations, including how funds are handled, managed and controlled, what policies are in place, and how logs of financial flow are maintained.

Portfolio Risk / Risk Management

Responses:

- Identification of risk
- Risk evaluation
- Evaluating risk areas
- Evaluating risk management strategies
- Risk management (2)
- Understanding financial risk
- Financial risks

Summary: Eight respondents addressed portfolio risk and risk management, citing the need for the audit to understand risk management strategies and identify financial risks and risk-taking.

Portfolio Return

Response:

- Gauging the financial growth

Summary: One respondent addressed portfolio growth.

Use of Resources

Responses:

- Usage of resources
- Validating spending practices
- Validating financial resources
- Evaluating efficacy of process
- Assessment of expenditures
- Overview various costs and expenses
- Endowment resources
- Tracking of expenditure processes

Summary: Eight respondents were interested in understanding more about how the audit gauges use of resources including how spending is tracked and validated.

Laws and Regulations: Awareness and Compliance

Responses:

- Laws awareness (2)
- Familiarity with laws (5)
- Compliance with laws (4)
- Knowledge of regulations (2)
- Check legal status of institution
- Check on regulation for any investments
- Awareness of regulations
- Finding out unethical practices

Ensure compliance with updated regulations
Regulation framework (2)
Checking guidelines and regulations
Familiarity with regulation framework
Laws and regulation adherence (2)
Regulatory framework (2)
Compliance with regulation (3)

How well staff is aware about laws and policies
To ensure that compliance are being followed
Laws adherence

Summary: Thirty-three respondents were keenly interested in whether investment offices understood and complied with legal and regulatory requirements.

Governance / Internal Procedures

Responses:

Internal governance (6)
Money governance
Internal process
Control of internal procedures
Internal authority body
Evaluating internal policies
Verification of internal check
Internal control (2)
Reviewing the process
Compliance with policies
Governance
Internal reporting system
Check on investments and related policies
Investigating process
Balance Process
Internal control

Summary: Twenty-two respondents cited governance and internal procedures as an area of audit interest, including understanding governance structures within organizations and examining the policies and practices used.

Misc.

Responses:

Clarity on upcoming endowment
Understanding financial structure of endowments Control (3)
Clarity of funds quota
Billing structure
Fraud detection

Summary: Nine respondents provided answers that did not fit precisely into other categories.

About RFG

RFG helps clients proactively understand regulatory and legal issues (and solutions) that arise from engaging in investment activities. RFG represents clients that have approximately \$150 billion in combined assets under management, including a consortium of the nation's leading endowment investment offices. RFG advises clients through its weekly newsletter, white papers, webinar presentations, semi-annual programs, and its online knowledge management portal, RFG Pathfinder®.

For more information, visit www.RegFG.com.