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**Auditor's Review of the  
University of the District of Columbia's  
Land-Grant Endowment Fund**

**June 9, 2003**

## **PURPOSE**

Pursuant to D.C. Code, Section 38-1231.01, the District of Columbia Auditor conducted a review of the University of the District of Columbia's Endowment Fund (hereinafter referred to as the "Fund"). The review focused on the original land-grant endowment of \$7,241,706 initially presented to Federal City College in May 1970, and subsequently transferred to the University of the District of Columbia (UDC). In conducting the review, the Auditor found that UDC had at least one other endowment funded by a grant of approximately \$250,000 from the United States Department of Energy (DOE) in fiscal year 1998. The Auditor included a review of this fund as well. Finally, the Auditor has included information regarding the University's Endowment Reinvestment Fund, an account funded by a portion of the income generated by the permanent endowment fund.

## **OBJECTIVES, SCOPE, AND METHODOLOGY**

The objectives of the audit were to determine:

1. whether the principal portion of the original land-grant endowment fund (\$7,241,706) transferred to UDC in May 1976 remains intact as required by the endowment;
2. whether the Fund is being prudently invested and managed in accordance with applicable law and sound investment policy; and
3. the current status of the UDC-DOE endowment grant and what activity has taken place since the grant was received.

The audit covered the period October 2000 through September 30, 2002, however, other transactions occurring prior to this period have been referenced so as to provide an adequate overview of activities related to the Fund.

In conducting the review, the Auditor examined reports issued by the Office of the Chief Financial Officer for UDC, endowment fund performance reports issued by Riggs Investment Management Corporation (RIMCO) for calendar years ended December 31, 2001, and 2002; audited financial statements of UDC for fiscal years ended September 30, 2000, 2001 and 2002, monthly bank statements and bank reconciliation reports, minutes of UDC Board of Trustees' meetings, Board of Trustees' resolutions, internal UDC memoranda, and external memoranda concerning

UDC's endowment fund. The audit team also spoke with the Chief Financial Officer for UDC, former UDC Chief Financial Officers, the Executive Assistant to the President of UDC, the Vice President for Academic Affairs, the general accounting manager for UDC, members of the Board of Trustees, other UDC officials, and an Associate Treasurer in the District of Columbia Chief Financial Officer's Office of Finance and Treasury.

## **BACKGROUND**

The University of the District of Columbia (UDC) is the only public institution of higher education in the District of Columbia. In the mid-1970s, three institutions, the D.C. Teachers College, Federal City College, and the Washington Technical Institute, were consolidated to create the University of the District of Columbia in 1976. UDC is a land-grant institution and an independent agency of the District of Columbia government. It is governed by a 15-member Board of Trustees, 11 of which are appointed by the Mayor with the consent of the Council of the District of Columbia, three members appointed by the alumni association, and one full-time student elected by the student body. UDC receives an annual appropriation from the District government, and its budget is subject to review and approval by the Mayor, the Council, and the United States Congress.

In May 1970, Federal City College was the recipient of a land grant award of \$7,241,706 made available through the District of Columbia Public Education Act, Public Law 89-791.<sup>1</sup> In lieu of the donation of public lands for the endowment and maintenance of the college, the law authorized an appropriation of \$7.2 million.<sup>2</sup>

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<sup>1</sup>Public Law 90-354 amended P.L. 89-791 to provide that the Federal City College be considered a land-grant college in accordance with the "First Morrill Act", 7 USC 301-305, 307, 308. In lieu of the donation of public lands or land scrip, the act authorized the appropriation of \$7,241,706, and provided that the appropriation was to be considered as having been granted subject to the provisions of the First Morrill Act.

<sup>2</sup>An endowment is a fund or gift that is held forever by the recipient in accordance with the wishes of the entity providing the endowment. An endowment is designed to be an income producing asset, with the principal being invested and the income from such investment being used to support the program(s) specified by the entity providing the endowment. Any remaining income is added back to the principal for reinvestment to promote growth. The principal, or corpus, must remain intact forever and is not available to fund day-to-day activities. A general objective of endowment fund investing is to earn, over time, a rate of return at least equal to the total of inflation plus spending and the costs of investing and administering the funds.

The law required that the endowment fund principal (\$7,241,706) remain forever unimpaired. Since the creation of the Fund, the management of and investment decisions relating to the Fund have been made by officers of the District of Columbia government such as the District's former Deputy Mayor for Financial Management and the Chief Financial Officer of the District of Columbia, with input from UDC. Commissioner's Order Nos. 70-181 and 72-147 established the initial Investment Advisory Committee to oversee management of the funds. Mayor's Order 77-151, dated August 31, 1977, rescinded the previous Commissioner's Orders and reconstituted the Investment Advisory Committee (Committee) to oversee the management of the Fund, which by that time had been transferred to the newly established UDC. The Committee was authorized to retain the services of a trust or investment institution to manage the Fund. Mayor's Order 77-151 also provided that any investments must be made in accordance with the procedures set forth in an opinion of the Comptroller General<sup>3</sup>, annual performance reviews of the selected investment institution were to be conducted, and the UDC Board of Trustees was to pay any and all charges connected with management and investment of the funds.<sup>4</sup>

There have been several iterations of the executive order establishing an investment advisory committee for the Fund. Presently, Mayor's Order 99-195, dated November 30, 1999, authorizes the Chief Financial Officer of the District to invest any and all land grant endowment funds.<sup>5</sup> In addition to the Chief Financial Officer, the Committee also includes a member of the Executive Committee and a member of the Finance Committee of UDC's Board of Trustees, as well as alternates to serve in their absence. Almost since the receipt of the land grant endowment, UDC officials have consistently contended that the authority to manage the Fund should be vested in UDC's Board of Trustees. As late as February 2001, UDC officials were still seeking to gain full authority to manage the land grant endowment funds, and maintained that poor past financial management of the Fund by the Investment Advisory Committee as reflected in the resulting low rate of return on the investment of the Fund continued to harm the University. Despite these requests,

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<sup>3</sup>The Comptroller General, in response to inquiries from the Mayor-Commissioner, issued an opinion found at 50 Comp. Gen. 712, wherein the Comptroller General stated that investment of land grant funds in certificates of deposit, industrial bonds, and other U.S. Government Securities was permissible as "safe" investments as required by the First Morrill Act.

<sup>4</sup>This provision appears to conflict with Section 303 of the First Morrill Act which provides that the expenses of management were to be the responsibility of the State. Public Law 90-354 specified that the term "State" as used in the First Morrill Act included the District of Columbia.

<sup>5</sup>According to an official in the Office of Finance and Treasury, this responsibility has been delegated to the District of Columbia Treasurer.

the Fund principal and its investment is managed by the Investment Advisory Committee chaired by the Chief Financial Officer of the District of Columbia.

After a competitive procurement, the District of Columbia and UDC recently selected two firms to manage and invest the Fund. Bernstein Investment Research and Management and J.P. Morgan were selected to provide these services, with each managing half of the Fund. At the time of our field work, a contract had been executed only with Bernstein.

### **Endowment Reinvestment Fund**

A portion of the income generated by the investment of the permanent endowment is deposited into an endowment reinvestment fund. As early as 1975, District officials comprising the Investment Advisory Committee agreed that the interest income realized from investment of the Endowment Fund should be separated and reinvested for the benefit of Federal City College and the Washington Technical Institute (WTI), the predecessors to UDC.

On June 28, 1984, the UDC Board of Trustees, by Resolution No. 84-12, established the UDC Institutional Investment Fund, now known as the UDC Reinvested Income Fund, to receive endowment investment income beginning in 1986. Expenditures from the Reinvested Income Fund are authorized by the Board only for purposes of institutional advancement. Further, expenditures are to be made only for projects of extraordinary merit when no other funding sources are available. The use of money in the Reinvested Income Fund for operations is specifically prohibited.

In 1985, the Deputy Mayor for Finance established two accounts, the Land Grant Principal Trust Account and the Land Grant Revenue Trust Account, and directed that the endowment principal be invested in “time deposits and fixed income negotiable securities such as United States government and agency issues and corporate bonds.” The Deputy Mayor further directed the financial institution to invest the Land Grant Revenue Trust Account funds in “common stocks and mutual equity funds as approved” by the Investment Advisory Committee.

### **UDC/Department of Energy Endowment Grant**

On January 31, 1996, UDC established an endowment to fund a “virtual energy chair” with a \$250,000 grant from the U.S. Department of Energy. The chair is designed to be occupied by

various persons at different times. The faculty member occupying the chair would select an energy related activity each academic year, and would include:

- small investigations or literature studies by student interns;
- papers and presentations by faculty, students, and invited energy professionals; and
- instruction through seminars and workshops.

The management of the energy endowment is such that the corpus remains intact. The interest earned from the investment of the energy endowment is restricted to expenditures for energy related activities in such amounts as to assure continued growth. The maximum amount to be spent in any given year is limited to the interest realized from investment of the corpus, less an amount necessary to provide for growth of the endowment at a rate at least equal to the rate of inflation. The scope of energy-related activities eligible for funding was expected to grow as interest in energy issues developed and as the endowment principal increased. As discussed further below, the original DOE grant of \$250,000 has increased in value to over \$323,000 as of September 30, 2002. Riggs Investment Management Company has managed the Department of Energy Endowment Grant Fund since its establishment.

## FINDINGS

### **ENDOWMENT FUND REMAINED INTACT AS OF SEPTEMBER 30, 2002**

As of September 30, 2002, the principal of the UDC permanent endowment fund, including accrued interest, cash, and cash equivalents, had a total value of \$9,431,503. During the period from 1970 until 1987, the permanent endowment earned a total of approximately \$725,000 in interest income. However, the Fund experienced significant losses during the early years, and did not actually begin increasing in value until 1986 as shown in Table I below. In fact, during a three year period from 1981 through 1984, the Fund fell below its original value to a low of \$5,519,064 in 1981. In 1991, UDC officials reported that from 1976-1990, the market value of the endowment grew only 14.8%, and attributed this poor performance to the fact that the endowment was only invested in United States bonds and other “safe” bonds, and that a “single manager” approach was used to manage and invest the endowment. During this period, control over the investment of the endowment was the responsibility of the Investment Advisory Committee, chaired by the District’s then Deputy Mayor for Financial Management.

**Table I**  
**Equity Growth of Endowment Trust Fund**  
**1970-1987**

| <b>Date (as of 9/30)</b> | <b>Book Value</b> | <b>Fair Market Value</b> | <b>Equity Change</b> |
|--------------------------|-------------------|--------------------------|----------------------|
| 1970                     | \$7,241,706       | \$7,241,706              | -0-                  |
| 1981                     | \$7,216,959       | \$5,519,064              | (\$1,697,895)        |
| 1982                     | \$7,346,574       | \$6,788,844              | (\$557,730)          |
| 1983                     | \$7,711,013       | \$7,078,431              | (\$632,582)          |
| 1984                     | \$7,443,062       | \$6,869,069              | (\$573,993)          |
| 1985                     | \$7,735,425       | \$7,630,725              | (\$104,700)          |
| 1986                     | \$7,837,604       | \$8,412,783              | \$575,179            |
| 1987                     | \$7,912,692       | \$7,967,094              | \$54,402             |

Source: UDC Office of the Chief Financial Officer

UDC officials have consistently contended that oversight and management of the Endowment Fund would be greatly enhanced by restructuring the Investment Advisory Committee and allowing the University to become more involved in investment decisions relating to the Fund. One of the primary concerns expressed by UDC officials was that the Endowment Fund was not actively managed in order to obtain the greatest rate of return. In 1990, the Report of the Commission on Budget and Financial Priorities of the District of Columbia (Financing the Nation's Capital) strongly suggested that responsibility for management of the University's land-grant endowment fund should be vested with the Board of Trustees. The report further recommended that the Board formulate a policy which permits investment of non-appropriated funds in stocks as well as bonds.

Historically, investment instruments for the Endowment Fund were limited to United States Treasury securities. Funds are currently invested in corporate bonds, Treasury notes and bonds, and other government backed securities. As noted above, the authority to manage UDC's Endowment Fund continues to reside with the Investment Advisory Committee, now chaired by the District's Chief Financial Officer.

After years of restrictive controls on the types of investments available for Fund investing, Congress in 1998 expanded the permissible investment options to include equity securities. Section 139 of Public Law 105-277 amended Public Law 90-354 to permit such investments, provided the Chief Financial Officer approved. Notwithstanding the expansion of investment options, as of September 30, 2002, the Fund continued to be invested only in corporate bonds, US Treasury notes and bonds, and other government-backed securities.

The Fund's value, overall, has continued to increase modestly. As of September 30, 2002, the fair market value of the Endowment Fund, including accrued income, cash, and cash equivalents, was \$9,431,503. Table II below illustrates the Fund's total market value during the last three fiscal years.



**Table II**  
**Endowment Fund Performance:\***  
**Fiscal Years 2000-2002**

| <b>Fiscal year ending</b> | <b>Fair Market Value</b> |
|---------------------------|--------------------------|
| 9/30/00                   | \$9,024,625              |
| 9/30/01                   | \$9,161,737              |
| 9/30/02                   | \$9,431,503              |

Source: UDC Audited Financial Statements for fiscal years ending 9/30/00, 9/30/01, and 9/30/02.

\*includes short term investments and accrued income

As previously noted, notwithstanding the 1998 authorization to expand the types of investments suitable for the Fund, the Fund continued to be invested only in treasury, government agency, and corporate bonds, with the vast majority being invested in treasury/agency bonds. For example, during fiscal year 2002, the Fund was still invested only in the assets shown in Table III.

**Table III**  
**Endowment Fund Asset Allocation Summary:**  
**Fiscal Year 2002**

| <b>Bond Type</b>      | <b>Fair Value*</b>    | <b>Percent of Total</b> |
|-----------------------|-----------------------|-------------------------|
| Treasury/Govt. Agency | \$5,923,739.91        | 66.5                    |
| AAA                   | \$ 392,924.48         | 4.4                     |
| AA                    | \$ 497,890.18         | 5.6                     |
| A                     | \$1,800,198.30        | 20.2                    |
| Non-rated             | \$ 295,599.29         | 3.3                     |
| <b>TOTAL</b>          | <b>\$8,910,352.16</b> | <b>100</b>              |

Source: Riggs & Co.

\* Does not include short term investments or accrued income.

The failure to invest in equity securities increases the risk that earnings will not keep pace with inflation and results in long-term investment returns that are likely to be below that of average endowments. Endowment fund managers generally hold that greater diversification, combined with more emphasis on equities, can produce higher long term gains with approximately the same level

of risk as traditional approaches. Indeed, other universities, including public universities have long had the flexibility to invest endowment funds in such varied investment opportunities as stocks, real estate, and venture capital endeavors. A 2001 National Endowment Study (NES) commissioned by the National Association of College and University Business Officers (NACUBO) surveyed approximately 600 institutions of higher learning regarding endowment investing and management, including public universities.<sup>6</sup> Of the public universities reporting, the NES found that most public universities had very diversified portfolios with investments including, but not limited to, domestic and international equity securities, bonds, real estate, and alternatives (hedge funds, oil and gas, and venture capital).

Recently, the UDC Board of Trustees, based on the authorization contained in Public Law 105-277, expanded the types of investments in which the Fund can be invested by adopting a new investment policy permitting investment in stocks, bonds, real estate, alternative assets, and cash. The policy notes that the Board of Trustees has the responsibility and authority for the management of UDC's endowment assets, and the Board has designated the Chief Financial Officer of the University to be responsible for day-to-day management and oversight. The stated investment philosophy is that the endowment will be invested and managed with the intention of obtaining the highest possible long-term total return consistent with a prudent level of risk. The policy specifies how endowment assets are to be allocated and prescribes the asset allocation formula presented in Table IV:

**Table IV**  
**UDC Target Asset Allocation**

| <b>Asset Class</b>     | <b>Minimum Allocation</b> | <b>Maximum Allocation</b> |
|------------------------|---------------------------|---------------------------|
| U.S. Equities          | 40%                       | 60%                       |
| International Equities | 10%                       | 25%                       |
| U.S. Fixed Income      | 15%                       | 35%                       |
| Real Estate            | 0%                        | 10%                       |
| Alternative Assets     | 0%                        | 10%                       |
| Cash                   | 0%                        | 5%                        |

**Source: UDC Endowment Fund Investment and Spending Policy**

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<sup>6</sup>The endowment study was performed by TIAA-CREF on behalf of NACUBO.

The targeted asset allocation adopted by the Board reflects the asset allocation employed by many public universities as reported in the NES. The study found that asset class composition for public universities was 59.9% equity, 27.9% bonds, 8.3% real estate, and the remaining funds were invested in alternatives. UDC's policy prohibits investment in direct margin transactions, direct foreign currency transactions, direct commodity transactions, and foreign fixed income transactions.

The Board's investment policy also includes a spending policy consistent with most public universities, restricting annual distributions to no more than 5% of the average market value of the endowment for the three previous years. Funds not spent in one fiscal year will be carried forward and remain available for spending.

The policy also includes reporting requirements for investment managers. Each investment manager retained by the Board must:

- utilize the care, skill, prudence, and diligence that similar professionals would employ under the conditions and circumstances;
- agree to fully comply with the Board's policy and any subsequent modifications;
- recommend appropriate portfolio investment strategy, asset allocation, and investment vehicles;
- manage the endowment assets under its care, custody, and control in accordance with the objectives and guidelines set forth in the policy and any written agreement;
- promptly inform the Chair of the Board's Investment Committee in writing of any significant or material matters and changes pertaining to the investment of endowment assets; and
- provide the Board's Investment Committee, President of UDC, the Chief Financial Officer of UDC, and the Treasurer of the District of Columbia with quarterly statements of activity and portfolio holdings and performance reports showing investment returns on a total return basis.

Based upon a review of the Board's investment policy and the findings regarding investment policies and practices set forth in the NES, the Board's Policy contains the essential elements of an endowment investment and spending policy as recommended by professional endowment fund managers.

### **ENDOWMENT FUND INVESTED IN NON-RATED BONDS**

The April 8, 1971 and July 19, 1974, opinions of the Comptroller General of the United States found that Section 4 of the First Morrill Act required that land grant endowment monies be invested in bonds of the United States or of the States rated "A" or better. However, the Auditor found that UDC's Endowment Fund continues to hold non-rated bonds, which totaled approximately \$300,000 in fiscal years 2001 and 2002, representing approximately 3.5% of all investments. While the percentage of funds invested in these unrated bonds is modest, the Auditor found no justification or authority permitting the University to invest the Endowment Fund in non-rated bonds, and therefore such investments appear to violate both the applicable law and opinions of the Comptroller General.

### **RECOMMENDATIONS**

1. The UDC Board of Trustees continue to pursue strategies to increase the rate of return on Endowment Fund investments.
2. The University ensure that the type of investments made are in full compliance with all applicable laws, agreements, and policies governing Fund investments.

### **ENDOWMENT FUND EXPENSES OF MANAGEMENT AND INVESTMENT REMAIN THE RESPONSIBILITY OF UDC IN VIOLATION OF THE FIRST MORRILL ACT**

Section 3 of the First Morrill Act, 7 USC 303, provides that:

all the expenses of management, superintendence, and taxes from date of selection of said lands, previous to their sales, and all expenses incurred in the management and disbursement of the moneys which may be received therefrom, shall be paid by the States to which they may belong, out of the treasury of said States...[Auditor's Emphasis]

Further, the April 8, 1971, opinion of the Comptroller General noted that Section 1 of P.L. 90-354 granted to the District the status of “State” as that term is used in the First Morrill Act. Based on the law and the relevant opinion, it appears that the District of Columbia, not the University, is intended to be responsible for the expenses of managing and investing the Endowment Fund. Nevertheless, Mayor’s Order 99-195, Section 3(c)(4), provides that UDC shall pay any and all charges connected with the management and investment of such funds. During the period of fiscal years 2000 through 2002, UDC paid Riggs Bank a total of \$26,603 in fees relating to management of the Fund.

Obligating UDC to pay the expenses incurred by the District to manage and invest the land grant endowment appears to be in direct contradiction with the letter and spirit of the federal law authorizing the land grant endowment. The statute clearly charges the “State”, in this instance the District of Columbia, with the responsibility for paying the expenses of management and investment. The Auditor has found no change in federal law transferring responsibility of endowment management expenses to the University. The Chief Financial Officer of the District of Columbia, UDC officials and the Investment Advisory Committee should take the appropriate steps to come into compliance with this provision.

### **RECOMMENDATION**

The Investment Advisory Committee immediately take the necessary action to ensure that all expenses of management related to the Fund are paid in strict compliance with applicable law.

### **UDC OFFICIALS CONDUCTED ENDOWMENT FUND RECONCILIATIONS DURING FISCAL YEARS 2001 AND 2002**

One aspect of establishing proper internal controls over endowment funds is the periodic reconciliation of the Endowment Fund’s financial activity. Included in such a reconciliation would be a review of all interest and other earnings accrued to the Fund over a specified period. The Auditor found that UDC officials did in fact conduct reconciliations of the Endowment Fund’s earnings, as well as its expenses, during fiscal years 2001 and 2002.

**DOCUMENTATION COULD NOT BE FOUND TO JUSTIFY AND SUPPORT THE  
WITHDRAWAL OF \$8,515,801.57 FROM UDC'S ENDOWMENT REINVESTMENT FUND  
ACCOUNT**

As noted earlier, a portion of the income earned from the investment of the land grant endowment fund is used to fund other university operations. This income is deposited into UDC's Endowment Reinvestment Fund Account, also maintained at Riggs Bank. The value of the total portfolio of the Reinvestment Income Fund as of September 30, 2002 was \$8,978,419.63.

UDC officials withdrew a total of \$8,515,801.57 from the Endowment Reinvestment Fund account between March 5, 1992 and October 19, 1998, for purposes that cannot be adequately justified or supported by appropriate documentation. Records and information provided by UDC's CFO's office show no other withdrawals from this account after October 1998. The Auditor reviewed letters from UDC officials indicating that funds withdrawn in March 1992, June 1993, and January 1995 were to be transferred to the D.C. Treasurer. A \$1million May 1997 withdrawal was to be received by the University, and the remaining withdrawals totaling \$4 million were to be transferred to UDC's Postsecondary Education Account. Other than the withdrawal letters from University officials to the investment institution managing the reinvestment fund, the Auditor found no documentation detailing the reasons for and intended uses of the withdrawals and transfers. At the time of our field work, UDC's Chief Financial Officer, who did not assume the position until 2001, speculated that the \$8,515,801.57 was deposited into the University's Postsecondary Education Fund account with subsequent transfers to the D.C. Treasurer, as needed, to cover University expenditures, including projected deficit spending. The Auditor contacted two previous UDC Chief Financial Officers, but they also could not provide any additional information regarding the purpose of the withdrawals.

The CFO's office for the University provided only one journal voucher, dated June 9, 1999, reflecting a \$2,000,000 debit with a description that it was to record an investment transaction that occurred in October 1998. There was no further documentation explaining how this \$2,000,000 was used, or where it was deposited between October 19, 1998, and the date of the journal voucher approximately eight months later on June 9, 1999. Outside of the journal voucher reflecting the \$2,000,000 transaction, UDC's Chief Financial Officer's office could not provide any additional supporting documents explaining the other withdrawals. The Auditor notes that had these withdrawals not taken place the value of the Reinvestment Income Fund could have totaled

approximately \$17.5 million. Table IV presents the amounts of each withdrawal, the date each withdrawal was made, and the University official who authorized each withdrawal.

**TABLE IV**  
**University of the District of Columbia**  
**Withdrawals From Endowment Reinvestment Fund**  
**For The Period March 5, 1992 Through October 19, 1998**

| <b>Amount of Withdrawal</b> | <b>Date of Withdrawal</b>        | <b>UDC Official Authorizing Withdrawal</b> |
|-----------------------------|----------------------------------|--------------------------------------------|
| \$ 1,135,513.74             | March 5, 1992                    | Arthur W. Danner                           |
| 113,180.30                  | June 16, 1993                    | Arthur W. Danner                           |
| 1,594,293.35                | January 25, 1995                 | Arthur W. Danner                           |
| 672,814.18                  | January 25, 1995                 | Arthur W. Danner                           |
| 1,000,000.00                | May 21, 1997                     | Donald L. Rickford                         |
| 2,000,000.00                | December 15, 1997                | Donald L. Rickford                         |
| 2,000,000.00                | October 19, 1998                 | Cyril Byron                                |
| <b>\$8,515,801.57</b>       | <b>TOTAL WITHDRAWALS TO DATE</b> |                                            |

Source: UDC Office of the Chief Financial Officer

### **RECOMMENDATION**

The UDC Office of the Chief Financial Officer must implement and maintain a sound record keeping system to enable UDC to justify and document all withdrawals from any endowment fund or other accounts and the uses and purposes for the withdrawals.

### **ENERGY ENDOWMENT GRANT RECEIVED FROM THE U.S. DEPARTMENT OF ENERGY REMAINS INTACT**

The market value of the energy endowment fund was \$322,983.60 as of September 30, 2002. There have been no withdrawals by University officials from this fund since its establishment in 1996. UDC officials could not produce copies of grant-required annual reports mandated to be filed with the U.S. Department of Energy regarding the uses and expenditures from the energy endowment fund during the first three years of the endowment, although they maintain such reports were filed. The Auditor also contacted the Vice President for Academic Affairs regarding the use and purposes

of this grant, but he was unable to provide any additional information. He did inform the Auditor that the UDC office responsible for implementing the grant's requirements was abolished approximately five years ago. Based upon the above, it does not appear that any entity within UDC is now responsible for complying with the grant's requirement regarding the establishment of a virtual energy chair or conducting energy-related activities. Further, the energy endowment funds appear to be used solely as a passive investment and no activities required by the grant appear to be taking place.

## **RECOMMENDATION**

UDC officials immediately take all steps necessary to fulfill the purpose of the energy endowment grant as specified in the grant proposal and agreement with the U.S. Department of Energy or return the funds.

## **CONCLUSION**

The Auditor's examination of UDC's original endowment of \$7,241,706 revealed that it remained intact as of September 30, 2002 with a fair market value, including accrued interest, cash, and cash equivalents, of \$9,431,503. In 1991, UDC officials reported the market value of the endowment fund grew only 14.8%, and attributed this poor performance to the fact that the endowment was only invested in United States bonds and other "safe" bonds, and that a "single manager" approach was used to manage and invest the endowment. Despite significant losses during the fund's earlier years, the fund began to increase in value beginning in 1986. This trend continued for most of the 1990's and for 2001 through 2002.

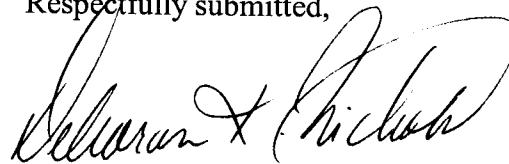
In 1998 after years of restrictive controls on the types of investments available for endowment fund investing, Congress expanded the permissible investment options to include equity securities. Notwithstanding the expansion of investment options, as of September 30, 2002, the Fund continued to be invested only in corporate bonds, US Treasury notes and bonds, and other government-backed securities. The Auditor notes that the failure to invest in equity securities increases the risk that the earnings will not keep pace with inflation and results in long-term investment returns that are likely to be below that of average endowments.



Based on Section 3 of the First Morrill Act, 7 USC 303, and an opinion of the Comptroller General regarding Section 1 of Public Law 90-354, it appears that the District of Columbia government, not the University, was intended to be responsible for the expenses of managing and investing the endowment fund. Despite this, Mayor's Order 99-195 stipulated that UDC shall pay any and all charges connected with the management and investment of such funds. During the period of fiscal years 2000 through 2002, UDC paid Riggs Bank a total of \$26,603 in fees relating to management of the Fund. This appears to be in direct contradiction with the letter and spirit of the federal law authorizing the land grant endowment.

Finally, the Auditor was not provided with documentation to justify and support the withdrawal of \$8,515,801.57 from UDC's endowment reinvestment fund account which is funded with a portion of the income earned from the investment of the land grant endowment fund. This fund is used to support other university operations. The withdrawals, which took place between March 5, 1992 and October 19, 1998 were not adequately justified or supported by appropriate documentation. Other than the withdrawal letters from the University to the investment institution managing the reinvestment fund, the Auditor found no documentation detailing the reasons for and intended uses of the withdrawals and transfers. At the time of our fieldwork, UDC's Chief Financial Officer, who did not assume the position until 2001, speculated that the \$8,515,801.57 was deposited into the University's Postsecondary Education Fund account with subsequent transfers to the D.C. Treasurer, as needed, to cover University expenditures, including projected deficit spending.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Deborah K. Nichols", written in a cursive style.

Deborah K. Nichols

District of Columbia Auditor

## **AGENCY COMMENTS**

## **AGENCY COMMENTS**

On April 2, 2003, the Office of the District of Columbia Auditor submitted this report in draft for review and comment to the Chief Financial Officer of the District of Columbia, the Deputy Chief Financial Officer and Treasurer, and the Chief Financial Officer, General Counsel, Chairman of the Board of Trustees, and President of the University of the District of Columbia.

Written comments were received from the Interim Chief Financial Officer for the University of the District of Columbia on May 6, 2003. Where appropriate, changes were made to the final report to reflect the comments received. All written comments received by the Auditor are appended, in their entirety, to the final report.

University of the District of Columbia

**Office of the Chief Financial Officer**

4200 Connecticut Avenue, NW

Washington, DC 20008

Telephone (202) 274-5358



Dr. Natwar M. Gandhi  
Chief Financial Officer  
Office of the Chief Financial Officer  
1350 Pennsylvania Avenue, NW, Ste. 203  
Washington, D. C. 20004

Dear Dr. Gandhi:

The Office of the District of Columbia Auditor, furnished us with a copy of a draft report entitled "Review of the University of the District of Columbia's Endowment Fund". The due date for a written response to the Office of the District of Columbia Auditor was April 15, 2003. As Interim Chief Financial Officer for the University of the District of Columbia, this matter did not come to my attention until April 17, 2003.

As such, contact was made with the Office of the District of Columbia Auditor and an extension was granted until April 25, 2003. However this extension does not allow this office with ample time to research and coordinate the authorized responses within the University Community.

Therefore, in attempt to acknowledge the report and our intention to follow up to obtain the authorized responses and corrective actions where possible, I am forwarding you only with the responses available at this time.

Respectfully,

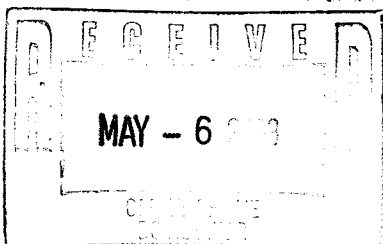
A handwritten signature in cursive script that reads "LaShahn Gaines".

LaShahn Gaines

Interim Chief Financial Officer

Enclosure

cc: Lucille Dickinson, Chief of Staff  
Ben Lorigo, Internal Audit and Security Director  
Deborah K. Nichols, D.C. Auditor ✓  
Joe Brooks, UDC Assistant Controller



**Draft Audit Report**  
**“Review of the University of the District of Columbia’s Endowment Fund”**

**Finding #1 - Endowment Fund Invested in Non-Rated Bonds:**

**Condition:**

Endowment Fund invested in non-rated bonds.

**Recommendations:**

1. The UDC Board of Trustees continue to pursue strategies to increase the rate of return on Endowment Fund investments
2. The University ensure that the type of investments made are in full compliance with all applicable laws, agreements and policies governing Fund investments.

**UDC’S Response:**

The University has begun to put measures in place to address and resolve this finding. Effective April 2003, all of the University’s endowment funds are now under professional management with either JP Morgan or Bernstein Investment Research and Management under the aegis of the University. With the University gaining authority to manage the land grant endowments funds, the following outcomes are expected:

- Eliminate all investments in non-rated bonds
- Realize a significant increase in the rate of return
- Full compliance with all applicable laws and regulations

The University will monitor closely the endowment funds now being managed by the two new investment firms to insure the objectives mentioned above are in indeed accomplished.

**Draft Audit Report**  
**“Review of the University of the District of Columbia’s Endowment Fund”**

**Finding #2 – Endowment Fund Expenses of Management and Investment Remain the Responsibility of UDC in violation of the First Morrill Act:**

**Condition:**

The “State”, in this instance the District of Columbia, is responsible for paying the expenses of managing and investing the Endowment Fund, not the University.

**Recommendation:**

The Investment Advisory Committee take the necessary action to ensure that all expenses of management related to the Fund are paid in strict compliance with applicable law.

**UDC’S Response:**

UDC’s Interim CFO is coordinating a response with the UDC Board and the District’s Treasury Office.

**Draft Audit Report**  
**“Review of the University of the District of Columbia’s Endowment Fund”**

**Finding #3 – Documentation could not be found to justify and support the withdrawal of \$8,515,801 from UDC’s Endowment Reinvestment Fund Account:**

**Condition:**

Documentation could not be found to justify and support the withdrawal of \$8,515,801.57 from UDC’S Endowment Reinvestment Fund Account made from 1992 through 1998.

**Recommendation:**

The UDC Office of the Chief Financial Officer must implement and maintain a sound recordkeeping system to enable UDC to justify and document all withdrawals of income from any endowment fund and the uses and purposes for the withdrawals.

**UDC’S Response:**

The University has put measures in place to address and resolve this finding. In 2001, the University’s Finance Office assigned one staff person with the responsibility of tracking and maintaining all debit and credit endowment fund activity in accordance with the established retention policy.

**Draft Audit Report**  
**“Review of the University of the District of Columbia’s Endowment Fund”**

**Finding #4 – Energy Endowment Grant Received From the U.S. Department of Energy Remains Intact:**

**Condition:**

Energy Endowment Grant received from the U. S. Department of Energy remains intact

**Recommendation:**

UDC officials immediately take all steps necessary to fulfill the purpose of the energy endowment grant as specified in the grant proposal and agreement with the U. S. Department of Energy or return the funds

**UDC’S Response:**

UDC’S Interim CFO is coordinating a response with the UDC Board and the University’s President.