

**UNIVERSITY OF CALIFORNIA, DAVIS
INTERNAL AUDIT SERVICES**

**Accounting and Financial Services
Gift Accounting and Financial Reporting
Internal Audit Services Project #12-15**

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MANAGEMENT SUMMARY

UC Davis Health System (UCDHS) receives a significant amount of current gifts and endowments from private sources for a wide range of purposes such as support for student, faculty, program, research, and capital expenditures. In fiscal year 2010-2011, UCDHS net assets for current gifts and distributed endowments earnings were approximately \$17.5 million and \$16.7 million respectively.

Concerns for “hoarding” endowment income by some universities have been raised in the past. Federal tax laws require private foundations to distribute at least 5% of foundation’s net investment asset value annually to prevent excess accumulation of charity assets. While UCD Foundation is not a private foundation, congressional interest was raised in 2009 regarding university fiscal management of endowments in light of rising tuition costs for higher education. A senator attempted to introduce legislation to mandate a minimum 5% payout from endowments for all schools and help curb rising tuition. In 2008, Princeton paid \$90 million to settle a lawsuit for failing to fulfill the original intent of an endowment fund donor.

The basis of good stewardship is responsible management of current gift and endowment funds entrusted to UCDHS by balancing short-term needs of sufficient spending for intended program support as well as long-term needs to preserve the value of endowment gifts to ensure perpetuity.

Internal Audit Services reviewed the system and process for financial monitoring of UCDHS gifts and endowments. We assessed the accuracy and transparency of information related to development activities at the UCDHS designed to ensure that funds are properly accounted for and available for their intended purpose.

Our audit procedures included obtaining an understanding of the current gift and endowment accounting process, financial reporting and monitoring capabilities, interviewing management from responsible departments, reviewing applicable University policies and procedures, and performing analytical reviews of various types of financial data involving current gifts and endowments.

Overall, we found that key gift and endowment financial information is maintained in different formats by separate departments in disparate information systems, which limits management’s ability to generate a comprehensive financial report of UCDHS gifts and endowments.

We identified opportunities for improvement in financial reporting of pledges, current gifts and endowments that would facilitate monitoring and help ensure better stewardship. Process improvements in monitoring, budgeting, and financial reporting can also strengthen fiscal discipline in future UCDHS spending.

Our observations and recommendations are presented within the body of this report along with corresponding corrective actions management has agreed to take.

I. OBSERVATIONS, RECOMMENDATIONS, AND MANAGEMENT CORRECTIVE ACTIONS

A. Budgeting and Monitoring Gifts and Endowments

Budgeting and oversight for UCDHS gifts and endowments could be improved.

UCDHS Financial Services does not have an efficient process to conveniently obtain information on actual financial activities for gifts and endowments to allow for independent monitoring and comprehensive departmental budgeting.

UCDHS is currently monitoring only School of Medicine (SOM) gifts with budgeted balances over \$10,000 and gifts with no year-to-date expenditures for the SOM. Management follow-up action is limited to notifying respective departments regarding the availability of the funds and critical financial information, such as beginning net asset, revenues, and expenses, which are not separately reflected in the current gift management report. As of June 30, 2011, financial activities of 94 UC Davis Medical Center (UCDMC) gifts with accumulated funds of about \$981,000 were not being monitored by the UCDHS.

UCDHS endowments are monitored by Health Sciences Development in coordination with the Endowment and Gift Oversight Committee for appropriate spending and monitoring of excess income accumulation. However, critical financial information, such as beginning net asset balances and expenses are not separately reflected in the present endowment management report.

Critical information for gifts and endowments are recorded separately in disparate information systems that are managed by separate entities, such as the UCOP Endowment and Investment Accounting System (UCOP Financial Management), Advancement Information System (UCD Development and Alumni Relations), and the Fundriver System (UCD Foundation), in addition to the Kualii Financial System (UCD Accounting & Financial Services Administration). These systems have not been configured to provide necessary financial information to UCDHS to effectively manage these funds and associated activities.

Department budgets may be understated if gift and endowment incomes are not factored in as part of the overall department budget process. Independent oversight of the use of gift and endowment incomes is required to ensure that the funds are expended appropriately. For fiscal year 2011, expenditures of current gifts and endowment payouts totaling \$11 million were charged to only 533 of the 1,129 gift and endowment accounts that received proceeds totaling \$16 million. In addition, financial planning including the impact of fundraising to finance longer term goals is inhibited without complete information.

Finally, critical endowment restriction codes are not included for all endowments in the Kualii Financial System (KFS) to distinguish between true endowments and funds functioning as endowments. We were unable to determine if 51 of the 312 UCDHS

endowments totaling \$410,000 were true endowments or funds functioning as endowments in an efficient manner.

UCOP Business Bulletin A-47, *University Direct Costing Procedures*, states that each accounting entity shall charge its budget with all readily identifiable direct costs associated with the conduct of the operations of that entity. UCDHS requires comprehensive financial information for gifts and endowments to facilitate budgeting and monitoring and to ensure effective stewardship of the funds. Moreover, management needs information that is timely, accurate and in sufficient detail to facilitate effective decisions including assessing fundraising activities.

The UCD Administrative Responsibilities Handbook establishes that transactions should reflect accurately the actual value or information involved, and contain sufficient detail to support post authorization review and audit. The financial reporting and monitoring process should be integrated with the KFS. Each unit must ensure that all financial transactions are recorded correctly. Correct transactions must contain sufficient detail for proper identification and classification and be readily retrievable for inquiry or reporting. In addition, all financial systems should meet the users' needs.

Recommendations

We collaborated with Extramural Funds Accounting, Development and Alumni Relations, and UCD Foundation regarding current reporting systems and reporting capability related to gift and endowment financial data. As a result, we developed ad-hoc financial reports for gifts and endowments from current KFS queries to provide more meaningful analysis. Our efforts in developing the ad-hoc reports for more comprehensive financial information of UCDHS gifts and endowments revealed the current reporting limitations. We discussed our observations with UCD Accounting & Financial Services and reached a consensus that a more robust KFS report of gift and endowment financial activities could be designed. The following recommendations were formulated from our joint efforts.

UCD Accounting & Financial Services in coordination with UCDHS Financial Services should take the following actions:

- Program KFS to enable the report that conveniently presents detail comprehensive financial information for gifts and endowments relevant to end users from UCDHS Financial Services.
- Establish a new OP Fund purpose text field in the database to allow for donor restriction information.

Extramural Funds Accounting should take the following actions:

- Notify respective departments to update the KFS Account purpose text field as well as the OP Fund purpose text field to reflect administrative imposed uses and donor imposed restrictions, respectively.

- Collaborate with UCD Foundation in updating endowment restriction code designations in KFS for Foundation Endowments.

Management Corrective Action

1. UCD Accounting & Financial Services will design a KFS report that will provide detailed comprehensive financial information of gifts and endowments to improve monitoring as well as meet UCDHS Financial Services' needs by 06/30/2013.
2. UCD Accounting & Financial Services will establish a new OP Fund purpose text field in the database to capture donor restriction information by 12/31/2012. Extramural Funds Accounting will populate the new fund purpose text field by 07/31/2013. Extramural Funds Accounting will also notify respective departments to update the KFS Account with Account Purpose text field by 07/01/2013.
3. UCD Foundation and Extramural Funds Accounting will establish a process to update endowment restriction code designations in the KFS for Foundation endowments by 03/31/2013.

B. Pledge Reporting and Monitoring

Pledge reporting and monitoring could be improved.

UCDHS Health Sciences Development has developed processes for pursuing and tracking collection, and for reconciling UCDHS pledge balances on a monthly basis. However, sufficient pledge reporting information is not available to facilitate UCDHS Financial Services independent monitoring, independent review in the adequacy of allowance for uncollectible pledges, and comprehensive departmental budgeting. A detailed pledge aging report is required to facilitate reviewing the adequacy of the allowance for uncollectible UCDHS pledges and for monitoring and budgeting purposes.

The UCD Administrative Responsibilities Handbook establishes that transactions should reflect accurately the actual value or information involved and contain sufficient detail to support post authorization review and audit. The financial reporting and monitoring process should be integrated with KFS. Each unit must ensure that all financial transactions are recorded correctly. Correct transactions must contain sufficient detail for proper identification and classification and be readily retrievable for inquiry or reporting. In addition, all financial systems should meet the users' needs.

Pledges are accounted for in aggregate at the campus-wide level and related estimate of allowance for uncollectible pledges are made annually by UCD Accounting & Financial Services. Pledge records are stored in the Advancement Information System (AIS) which is independent of the KFS accounting system. Pledge records are tracked by allocation number in AIS while pledges are tracked by OP Fund number in KFS during collection. UCD Foundation does not track Foundation pledges by OP Fund number, and Foundation pledges recorded in the AIS are not updated with the OP Fund number.

In addition, the current AIS Pledge Aging Report does not have sufficient information to distinguish pledges by departments, to segregate capital pledges from current use pledges, and to distinguish pledges for the UCDMC, School of Medicine or School of Nursing. Grant information is also comingled with pledge data. Nevertheless, a revised report from AIS or Development and Alumni Relations was never requested.

Failure to properly account for UCDMC pledges will result in the understatement of restricted expendable net assets and overstatement of unrestricted net assets, if not exclusion from the financial statements altogether. In addition, budgets will be understated if pledge revenues are not factored into the budget development process.

Recommendations

Our evaluation and follow-up discussion with Health Sciences Development suggest additional fields that already exist within the AIS database can be customized into a current detail aging report to allow for effective UCDHS monitoring and budgeting of pledges. Based on procedures performed, Development and Alumni Relations should design an AIS Pledge Aging Report that provides comprehensive financial information for UCDHS pledges to facilitate monitoring, budgeting and GAAP basis financial reporting. Development and Alumni Relations should also collaborate with UCD Foundation in establishing a process to update OP Fund information in AIS for Foundation pledges.

Management Corrective Actions

1. Development and Alumni Relations will design an AIS Pledge Aging Report that will provide detailed comprehensive financial information on pledges to improve monitoring and budgeting for UCDHS pledges and meet UCDHS Financial Services needs by 10/31/2013.
2. Development and Alumni Relations and UCD Foundation will coordinate to establish a process to update the Fund number information in AIS for current use Foundation pledges by 04/30/2013.

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