Gap Analysis for Higher Education Institutions

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Whether your institution's portfolio is $10 million, $100 million, $250 million or more, safeguarding and strategically growing it is vital to the current success and future growth of your operations. These investments come with complex issues, such as allocation, valuation, spending rate, donor and Board restrictions, unrelated business income tax, reputational risk, compliance and environmental, social and governance (ESG) considerations, to name a few. The purpose of this article is to provide our point of view around the leading practices we see for higher education institutions that do not have dedicated investment professionals within their management structure.

The Issue at Hand

While there is no bright line quantitively as to when an institution should hire a chief investment officer (CIO), we believe there are several best practices a management team and Board should have as part of their duties. In our experience, many higher educational institutions with portfolios less than $500 million do not have internally dedicated investment professionals or at least one investment professional. In this case, we typically see investments managed by a combination of the finance office, investment committee of the Board of trustees (Board) and an outside advisor performing several administrative and oversight services. The management function is partially allocated to the Board and an outside group.

Responsibilities of an Investment Office Function

The responsibilities of an investment office can be divided into four main categories:

1. Understanding the investment mandate from applicable external donors and Board in satisfying donor allocation requirements and allocation recommendations as prescribed by institutional polices, predicated on risk appetite.

2. Exercising proper initial and ongoing due diligence over the investments themselves. Typical portfolios included easier to value positions, indirect ownership of NAV investments and more illiquid positions in items such as physical assets.

3. Monitoring and reporting to senior management and the Board.

4. Financial reporting and tax monitoring review, annual reporting to public and monitoring adherence to important institution areas like ESG as it relates to investing.

Finding the Right Model

This may sound like a cliché, but the right model is what is right for your institution. What is meant by that is "one-size" does not fit all. As an example, your Board may include a talented allocator who has access to an investment manager the institution would not normally know. Your CFO might have deep knowledge in investment performance measurement which is better than an analyst on Wall Street. Alternatively, as you go through the role of an investment professional as summarized above, there may be gaps between what the institution collectively has and what is needed. This leads us into the next step.

Perform a Detailed Gap Analysis

A gap analysis is exactly what you expect it to be. It falls into a key aspect of overall enterprise-wide risk analysis. It will involve developing a checklist of duties as laid out in the four general categories of responsibilities noted above.

- Develop a specific listing of responsibilities to be performed monthly, quarterly and annually. Detail is critical in this phase.

- Review your current written policies and procedures for completeness, accuracy and relevance. Do not underestimate the importance of updating policies and procedures at least annually. In this fast-paced world of technological advancements, data security, public sentiment and the burden of myriad regulatory requirements, the policies of yesterday can quickly become obsolete or, at a minimum, in need of tweaking.

- The last step is of critical importance in a gap analysis and that is to see what is really happening in your institution. Talk to the key stakeholders performing these functions. Do not be shy, this includes really understanding the role of the investment committee of the Board. You just might discover what is happening in practice is different than what is intended to happen.

A Word About Conflicts of Interest

Conflicts of interest are broken down into those conflicts of fact and those in appearance. Unintended conflicts can provide brand damage in addition to the related financial, compliance and operational headaches they trigger. It is important to look along the lines of relationships and fiduciary responsibilities throughout the investment process at your institution. Disclosure with robust documentation to explain why an item is or is not a conflict will pay dividends.

Summing It Up

- Understand your portfolio allocation mandate; realistically assess what capabilities you have and do not have.

- List out the role of the investment professional as a centralized function in detail under the four-category approach outlined above.

- Find the right model between allocating the investment function internally at the Board-level and externally.

- Perform a detailed, robust gap analysis.

- Do not forget to understand and manage your conflicts of interest.

Know Greater Service

Determining and analyzing your investment responsibilities and requirements can be overwhelming. Finding the right external partner to help you assess your current situation is a cost-effective way to help protect your endowment for many years to come. There is no reason to go it alone. PKF O’Connor Davies is the lead representative of the international association of PKF member firms across the globe with over four hundred locations in 150 countries.

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