Minutes
Business and Finance Committee
Board of Regents of the University of Wisconsin System
September 9, 1999

I.2.a. Audit Subcommittee

The Audit Subcommittee of the Business and Finance Committee met in Room 1511 Van Hise Hall, Madison, at 11:05 a.m.. Present were Regents Marcovich, De Simone and Gottschalk.

(1) A-133 Audit and LAB Management Letter

Vice President Bromberg reported that the A-133 audit is a federally-mandated audit of organizations receiving federal funds. The University is included as part of the Legislative Audit Bureau (LAB) audit of the State of Wisconsin. This audit is for the 1997-98 fiscal year which ended June 30, 1998. LAB notes that the University internal control structures appear adequate to ensure compliance with federal regulations. Review of activities noted only $10,058 of questionable costs, out of $671.8 million of federal funds disbursed, or .001%.

The LAB Management Letter, which reflects issues related to the UW System's 1997-98 financial audit, repeats concerns expressed previously which have either already been resolved or will not be resolved without cooperation from the State Department of Administration. LAB reiterated their earlier qualified opinion of the University's financial statements due to a mandated Y2K footnote (which only occurred because the report was issued during a period when the Government Accounting Standards Board [GASB] was mandating a certain type of footnote), repeated concerns about unreconciled balances between the State's accounting system in 1993-94 (which the University contends is an error on the State's records along with timing differences between the State and University) and expressed concern about accounting for library holdings (which seemed to generalize two minor concerns expressed earlier by the auditors). Staff contend that none of these concerns are material to the University or to the State of Wisconsin.

Vice President Bromberg informed the Subcommittee that staff continue to seek a resolution with the Department of Administration on the unreconciled balances. System has begun to reconcile cash on a month-to month basis with the State, which should prevent a similar situation in the future. Associate Vice President Durcan indicated that, several years ago, an LAB auditor spent a significant amount of time working on the problem, but was unable to determine an amount to write off and DOA has been reluctant to open their books. A new Financial Administration staff member will be assigned to try to reconstruct entries, and an outside firm may need to be hired to resolve it.

The library holding concern was due to inconsistent guidelines in how free publications were being recorded by the institutions. Associate Vice President Durcan noted that the policy paper has been updated to clarify the process for the institutions.

(2) Delegation Audit

Associate Vice President Durcan reported that the entrance conference has been held for the Delegation Audit. This is a routine audit which LAB has been conducting with all State agencies. Auditors are looking at internal audit reports done at the institutions and reviewing existing audit policies. This will be a desk audit unless they find an area of concern.

(3) Audit Status Report

Internal Audit Director Yates presented his report on the status of 12 major reviews being conducted by the Office of Internal Audit. All of the projects are on schedule with no major problems being encountered. Several of the reviews such as the Americans with Disabilities Act and the Study Abroad reviews have been favorably received by staff members in the areas being reviewed and the expectation is the reports will provide assistance and guidance.

In the area of outside audit activities, two Legislative Audit Bureau audits will be released in the near future. A limited review of the mass transit contracts that some UW institutions have with local transit, especially UW-Madison and UW-Milwaukee, will be released by the end of September. The legislatively-requested management audit of the UW-Madison Athletic Department will be issued in October 1999.

(a) Competition with the Private Sector

Internal Audit Director Yates presented a summary of "The Competition with the Private Sector" report. The review focused on compliance with Board of Regents Policy 89-1 and the adequacy of this policy in today's environment. The review found the policy is sufficiently comprehensive and has worked as intended. However, in order to strengthen the process, several recommendations for improvement were made to the institutions, which included identifying major new and ongoing activities that compete with the private sector and referring these activities to the competition committees for review,

The Audit Subcommittee meeting adjourned at 11:38 a.m. and the Business and Finance Committee meeting convened in Room 1920 Van Hise Hall, at 2:28 p.m., following an all-Regent meeting which is reported on in the Education Committee Minutes. Present were Regents Marcovich, Axtell, De Simone, Gottschalk, and Olivieri.

I.2.b. Approval of Minutes of the June 10, 1999, Meeting of the Business and Finance Committee

Upon the motion of Regent De Simone and the second of Regent Gottschalk, the Minutes of the June 10, 1999, meeting of the Business and Finance Committee were approved as presented.

I.2.c. Report on Base Salary Adjustment to Recognize Competitive Factors

Vice President Bromberg explained that s.36.09(1)(h), *Wis. Stats*., allows the University System to grant salary increases to recognize competitive factors. Section 36.09(1)(j), *Wis. Stats*., provides that, no later than October 1 of each year, the Board of Regents must report to the Joint Committee on Finance and the Department of Administration and Employment Relations concerning the amount of such pay increase granted, and the institutions at which they are granted for the 12-month period ending on the preceding June 30. In 1998-99, increases totaling $1,085,689 were granted to 153 individuals at seven institutions.

Upon the motion of Regent Gottschalk and the second of Regent Olivieri, the Committee approved Resolution 1.2.c.

<u>Resolution I.2.c.</u>

That, upon the recommendation of the President of the University of Wisconsin System, the Report on Base Salary Adjustments to Recognize Competitive Factors Required by Section 36.09(1)(j), *Wisconsin Statutes*, be accepted for transmittal to State Officials.

I.2.d. Report of the Vice President

Vice President Bromberg began by reporting no computer problems with the 9-9-99 date. She sent an e-mail message to the Institution Business Representatives and Chief Information Officers asking them to report any problems, and there were none reported at any of the institutions.

Regent Olivieri inquired about potential Y2K problems with financial aid systems. Staff assured him that all critical systems are being tested for compliance. Because the institutions are involved with testing for compliance and many use the same software, they are sharing information on compliance to eliminate duplication of effort.

There will be a Y2K report from two institutions at the October meeting and a contingency plan report at the December meeting.

(1) Quarterly Gifts, Grants and Contracts Report

Vice President Bromberg reported that total gifts, grants and contracts for the twelve-month period ended June 30, 1999, were $691.4 million, an increase of $43.5 million from the comparable period of the previous fiscal year. Federal awards increased $62.4 million, while non-Federal awards decreased $18.9 million.

(2) Agreements with Private, For-Profit-Making Organizations

Vice President Bromberg presented two contractual agreements for the Committee's consideration. Board of Regents policy requires Regent approval when a contractual agreement with a private, for-profit organization exceeds $500,000.

(a) Contractual Agreement with Quintiles Pacific, Inc., on Behalf of Sanofi Pharmaceuticals, Inc.

Upon the motion of Regent De Simone and the second of Regent Olivieri, the Committee approved Resolution I.2.d.(2)(a).

Resolution I.2.d.(2)(a)

That, upon recommendation of the President of the University of Wisconsin System and the Chancellor of the University of Wisconsin-Madison, the Board of Regents accepts the agreement with Quintiles Pacific, Inc., entitled "Efficacy, Safety and Tolerability Study of SR57746A in Patients with Amyotrophiclateral Sclerosis (ALS) Protocol Number EFC 2941."

In response to a question on whether the Board is ever provided with follow-up information on any of the studies, Vice President Bromberg indicated she would try to obtain statistics on the efficacy studies.

(b) Contract for Soft Drink Sales and Marketing Rights between UW-Madison and the Coca-Cola Company and the Midwest Coca-Cola Bottling Company

Vice Chancellor Torphy noted that this is a supplement to the existing ten-year contract, adding the Kohl Center, McClimon Track/Soccer Complex and Goodman Diamond, which were not included in the existing contract. It is the result of a competitive proposal and negotiation process.

In response to questions from Regent Olivieri, Vice Chancellor Torphy explained that revenue goes to the Athletic Department. The contract does not cover private events held at the facilities, such as concerts, high school or NCAA events.

Matt Nelson, a student and research assistant at UW-Madison, spoke against the contract, noting his surprise that, given Madison Metropolitan School District's rejection of a similar contract, the University would consider approving it. He expressed concerns such as whether bottles could be recycled and that the Bucky logo would become associated with Coke. He asked that Regents not pass the motion before them.

In response to Mr. Nelson's concern regarding the use of the Bucky logo, Regent Marcovich noted that the proposed contract provides, "UW-Madison will continue to have prior approval for any and all use of trademarks and promotional material. All promotional material must be consistent with the campus policy on advertising." He noted that Mr. Nelson's concerns were well taken, and also explained that the Madison School District situation is different in that they have tax allocations and the Athletic Department does not have tax support and needs the income a contract such as this can provide.
Vice Chancellor Torphy added that the contract specifies prior approval for the use of the Bucky logo. It was also confirmed that the bottles are recyclable.

Upon the motion of Regent De Simone and the second of Regent Grebe, the Committee approved Resolution I.2.d.(2)(b).

Resolution I.2.d.(2)(b)

That, upon recommendation of the President of the University of Wisconsin System and the Chancellor of the University of Wisconsin-Madison, the Board of Regents accepts the agreement with the Coca-Cola Company and the Midwest Coca-Cola Bottling Company.

I.2.e. Additional Items Which May Be Presented to the Business and Finance Committee with Its Approval

No items were presented at this time.

I.2.f. Trust Funds

(1) Update on Activities of Trust Fund Office

Treasury Manager Mills gave an overview of some of the changes which have taken place in the office in recent years. In 1997, the department was reorganized, with the accounting function moved to Financial Administration and the investment operations function remaining within Trust Funds. At that time, there was a complete turnover in staff and a new Treasury Manager was hired.

Having new staff allowed for critical evaluation of tasks and improvement in processing efficiency. Most notably, the cash management function of trade settlement and processing was changed, resulting in a savings of the $15 per wire cost while the cash fund the office now invests in at the custodian is earning over 30 basis points more than the State Investment Fund.

As the department continues to shift from an operational focus to an investment focus, more changes will be coming. An investment analyst has been hired to assist in the monitoring of investment managers, evaluation of asset classes and implementation of new risk management procedures. A significant change in the next year will be to comply with the systemwide PeopleSoft financial system implementation. The office currently maintains two systems—one for donor accounting and reporting and one for investment reporting—which will have to be upgraded or abandoned in the conversion to PeopleSoft. Due to the strategic importance of this decision, most of the new analyst's time will initially be spent on researching alternatives.

By the end of September 1999, all testing and remediation of the asset and accounting systems to ensure Year 2000 compliance will be completed. Additionally, staff are working with the State of Wisconsin Investment Board on business continuity plans in preparation for any potential problems at the end of the year.

Regent Gottschalk expressed interest in having the new analyst review socially-responsible investments. Regent De Simone agreed that this should be a priority. Ms. Mills indicated the analyst will also be looking at proxy issues.

Vice President Bromberg noted that prior to the time Ms. Mills was hired the focus of the Trust Funds Office was more on accounting and was much more passive. Since that time, the office has been reorganized to focus more on investment results. She indicated that, starting with the October meeting, the Committee will be meeting with two investment managers per meeting.

Regent Orr, who arrived during discussion of this item, inquired if it would be more cost-effective to hire a consultant than to hire an analyst. Ms. Mills responded that the analyst will be assigned more ongoing responsibility.

(2) Asset Allocation

Treasury Manager Mills reviewed that, in 1995, the Business and Finance Committee moved to 67% equity and 33% fixed income allocation. This remained unchanged until September 1998, when the Committee approved an increase in international equity commitments, moving the overall allocation to 70% equity and 30% fixed income.

The analysis this year centered around using an optimizer model to find the lowest risk portfolio that would meet target return needs. The target return is roughly 10% and is made up of the 5% spend rate, a 3% inflation estimate, a growth target of 1% and fund expenses. By inputting Regent-approved portfolio constraints (i.e., no more than 20% of the equity portion of the fund invested in international equities) and the target return, the model solves for the lowest variance portfolio. The model's recommended portfolio is nearly identical to the current allocation; for this reason, no changes are recommended at this time.

The analysis also includes a review of venture capital. Although venture capital would provide a strong diversification benefit, the risks and costs of implementing a commitment at this time would be much too high.

Regent Orr and Regent De Simone agreed that investing in venture capital might bring bad publicity or have negative political implications.

(3) Spending Rate

The 5% spending rate was adopted by the Business and Finance Committee in 1990 to be phased in over a period of two years. However, in 1993, 1994 and 1995, the plan was amended to pay out only the actual earnings amount less 0.25% In 1996, the 5% was reapproved and remains unchanged at this time. The annual fund distributions have grown steadily since 1996. This improves the predictability and reliability of these funds for the departments.

The 5% matches the median of the Big 10 schools, although it is slightly higher than the NACUBO study participants. Also, realized gains as of June 30 are over $130 million, resulting in a significant buffer against future market declines. The best measure of the health of the fund is the "real" rate of return. Over the past five years, the Long Term Fund has managed a 7.8% real rate of return above inflation and the spending rate. For these reasons, no change to the spending rate is recommended at this time.

(4) Closed Session to Consider Trust Fund Matters, as Permitted by s.19.85(1)(e), Wis. Stats.

Upon the motion of Regent Gottschalk and the second of Regent Olivieri, the Business and Finance Committee adjourned to Closed Session at 3:33 p.m. to consider Trust Fund matters, as permitted by s.19.85(1)(e), Wis. Stats. Present were Regents Marcovich, Axtell, De Simone, Gottschalk, Olivieri and Orr.

The Business and Finance Committee adjourned at 3:58 p.m.

Donita R. Zintz, Recording Secretary