

**Minutes**  
**Business and Finance Committee**  
**Board of Regents of the University of Wisconsin System**  
**May 10, 2001**

The Business and Finance Committee met in Room 137 Rodli Commons, UW-River Falls at 2:55 p.m. Present were Regents De Simone, Krutsch, Barry, Gottschalk, and Marcovich.

**a. Approval of minutes of the April 5, 2001 meeting of the Business and Finance Committee**

Upon the motion of Regent De Simone and the second of Regent Gottschalk, the minutes of the April 5, 2001, meeting of the Business and Finance Committee were approved as presented.

**b. Presentation by UW-River Falls: Update on Service Based Pricing Masters in Management Program**

Virgil Nylander, Vice Chancellor for Administration and Finance, University of Wisconsin – River Falls, gave an update on the Master in Management program, their first Service Based Pricing program.

UW-River Falls worked with the UW-System Market Research Unit to determine if a Master in Management program met a regional need. The evidence from the surveys they conducted indicated that there was a need for this type of program, plus they found that a significant number of regional employers would be willing to support the continuing education of their employees. The program has exceeded their expectations.

The Master in Management program is designed, as the brochure points out, to help working adults acquire the competencies they need to become successful managers in today's working environment.

UW-River Falls initially projected that they would offer three evening courses each semester to approximately 35 students. At the end of this year there are 70 students in the program. Also, instead of offering three courses per semester, UW-River Falls will be offering five courses next fall.

The adult students range in age from 23-54, with an average age of 36. Women make up 61% of the class, and 81% of students are from Wisconsin. This program is truly meeting the need of the second fastest growing area within Wisconsin, the St Croix and Pierce County region.

Mr. Nylander noted that only 26 of the 70 students have undergraduate degrees in business related majors. This is ideal because the program was designed to assist those individuals who now find themselves in a business/managerial related position but do not have a business academic background.

Without the new Service Based Pricing option, UW-River Falls would not have been able to offer this type of new program to the area's constituents. The School of Business is primarily concerned with offering undergraduate courses and programs, and UW-River Falls does not have the resources to expand into this new arena. Offering courses at a tuition level that is representative of the current market means that UW-River Falls can branch out to meet the educational needs of the region.

Mrs. Carrie Fisher, a Master in Management student at UW-River Falls, commented on her experience in the program. She noted that the program has flexibility for a full time worker to schedule courses, and a broad based course content. She noted that from her experience, employers have been very supportive of employees attending this program. Finally, she noted that the program has been an excellent fit for her personal and professional needs.

Regent Krutsch asked whether the market based pricing has offset the cost of the program. Mr. Nylander responded that the revenue generated from the program has more than offset the cost.

### c. Draft Guidelines for private capital investing

Tom Reinders, Investment Analyst, noted that the legality of adopting private capital as an asset class has been reviewed in prior Committee meetings and documentation, therefore this discussion will focus on the financial impact of adding private capital to the endowment portfolio. He noted that in order to determine the impact of adding private capital to the asset allocation of the UW System Trust Funds, an analysis of the resulting portfolio's return and risk statistics was completed. The current allocation results in an expected return of 9.7%, and annualized standard deviation of 14.8%. In the second scenario, private capital is added while holding expected return constant (achievable with a 6% allocation to private capital). The result is lower levels of risk (annualized standard deviation of 13.5%) with the same level of expected return. In the final scenario, private capital is added while holding standard deviation constant (achievable with a 10% allocation to private capital). The result is greater expected returns of 10.2% with the same level of risk (annualized standard deviation of 14.8%). This analysis confirms that the addition of private capital can reduce the risk level or enhance the return of a well-diversified portfolio.

Due to the considerable stand-alone risks of private capital investing, and the investment expertise that is needed to mitigate these risks, it is recommended that any allocation to private capital investments be made through a fund to funds arrangement. While direct costs paid for investment management will be slightly higher than if the investments were handled internally, the high administrative costs will be eliminated.

It was recommended that 10% of the Long-Term Fund be dedicated to private capital. The 10% allocation should be diversified among private capital asset classes. A recommended allocation was venture capital (5%), domestic private equity (3%) and international private equity (2%). The allocation would generate an additional 0.5% of return with no additional risk.

To accommodate for the 10% allocation to private capital, reductions would be made in the Equity and Fixed Income classes. The Long Term Portfolio would in effect be moving to 77% equity (including the 10% allocation to private capital) and 23% Fixed Income.

The recommended allocation closely mirrors the NACUBO universe. The 10% allocation to private capital is comparable to the 11.6% NACUBO average for total alternative investments (private capital plus other alternative asset classes). A February 2001 survey conducted by Penn State University found (for 25 peer institutions) an average allocation to alternative asset classes of 16%.

Commitments to a private capital program are drawn out over time (normally a 4 to 6 year period). As a result, cash invested at any time is less than the original commitment. To achieve the target allocation of 10% eventually, it is recommended that the Trust Funds commit 15% of the Long Term Portfolio.

In order to accommodate the new asset class, some minor modifications to the Investment Objectives and Guidelines must be made. Private capital would need to be added to the existing benchmarks, approved asset classes, and exceptions sections of the guidelines.

Regent Gottschalk asked what *Venture Economics* is, and why UW System Trust Funds will use that as the benchmark plus 2% to measure performance. Mr. Reinders noted that *Venture Economics* is the leading trade publication for private capital, and most endowments use it for benchmark purposes. UW System Trust Funds has always asked investment managers to outperform their benchmark by 200 basis points, and this figure is being suggested for private capital to remain consistent with other UW System Trust Funds policies.

Regent Marcovich noted a newspaper article that highlighted some of the risks associated with venture capital investment. He noted that investing in venture capital is a great opportunity, but also urged caution because of the associated risks and possibility that future rates of return may not be as great as the recent past.

**d. Report of Vice President**

Vice President Debbie Durcan noted that total gifts, grants and contracts for this period were \$676.4 million, an increase of \$89.9 million from the comparable period of the previous fiscal year. Federal awards increased \$59.1 million while non-Federal awards increased \$30.8 million. She noted that when the numbers are finalized for the fiscal year, UW System will present a report comparing campus and historical data.

Ms. Durcan discussed the UW System projected utility shortfall. Last year, there was a \$1.2 million shortfall (\$900k GPR), which was solved by using unspent fringe benefits funding. The latest utility shortfall projection for this year is \$11.5 million (\$8.7 million GPR). UW System has advised Department of Administration Secretary Lightbourn and the Co-chairs of Joint Finance, and will report back to the Committee with an update from the June 13.10 Hearing. The Department of Corrections received authorization to transfer \$2.0 million of unused funds for prison beds to cover their utility shortfall. UW System is working to identify some possible funding sources for consideration.

Ms. Durcan noted that the UW System is requesting a \$9.4 million supplement for increased fringe benefit costs for fiscal year 2001 from the State of Wisconsin's compensation reserve. This funding is for increased health insurance costs and full funding of the fringe benefits related to salary increases. This figure is down from the \$20 million built into the Regent approved (Red Book) budget. The State of Wisconsin Department of Administration is assessing fringe benefit needs for all agencies before they make any funding decisions on full funding of the 2000-01 pay plan.

Ms. Durcan noted that the Legislative Audit Bureau recently released the federally required A-133 audit of the State of Wisconsin including the UW System. The UW System's federal grants and financial aid totaled \$738.3 million. UW System had only \$12,640 of questioned costs or .0017%.

The Business and Finance Committee recessed and the Audit Subcommittee convened at 3:30 p.m. Present were Regents Marcovich, De Simone, and Gottschalk. Regents Barry and Krutsch were also present.

**e. Audit Subcommittee**

Director Yates provided a brief overview of the major projects the Office of Internal Audit is conducting, noting that all projects are proceeding as planned. He discussed successful outsourcing models, and some roadblocks that deter outsourcing. For example, shifting the funding classification from salaries to supplies discourages outsourcing, due to the fact that salary funding tends to increase, while supply funding tends to stay static or decrease from year to year.

Mr. Yates provided a description of the process followed by the Office of Internal Audit for selecting areas to be reviewed. An explanation of two future changes on how reports will be presented to the Board was provided:

- As often as possible, a response will be included with the report from the UW System Administration office responsible for implementing the report's recommendations.
- On selected reviews, the reports may be presented during a joint session with other Committees.

An overview of other activities of the Office Of Internal Audit was provided. These included performing financial audits for the campuses such as UW-Milwaukee and UW-Green Bay NCAA audits, and audits required by the Corporation for Public Broadcasting. The Office also assists in investigating allegations of fraud, and in management consulting services on a range of issues.

Director Yates reported that the Legislative Audit Bureau is conducting reviews on two projects in the UW System. First, work has begun for the federally-mandated FY 2001 audit of federal funds. Second, work is nearly complete on a statutorily-required five year review of the lease and affiliation agreements between the Board and University of Wisconsin Hospitals and Clinics.

Regent Krutsch noted that it is a good idea to involve other Committees and Board members in selecting programs that the Office of Internal Audit reviews. In this way, the Board could ensure that the Office will most effectively target areas that are important to the Board. Mr. Yates explained the current process that the Office uses to select programs for review, and noted that there is a place for the Board in this process.

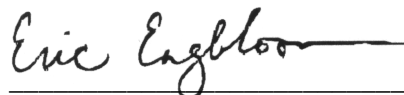
Regent Gottschalk asked whether there would be a role for the Office of Internal Audit in reviewing private capital investing. Mr. Yates noted that the Office does not review performance of the UW System Trust Funds. However, the Office could review whether private capital investment policies are up to date, and ensure that Board mandated investment guidelines are being followed.

The Audit Subcommittee adjourned and the Business and Finance Committee reconvened at 3:45 p.m. Present were Regents Marcovich, De Simone, Gottschalk, Barry, and Krutsch.

**f. 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 Krutsch, the Business and Finance Committee adjourned to Closed Session at 3:46 p.m. Present were Regents Marcovich, Gottschalk, De Simone, Barry, and Krutsch.

The Business and Finance Committee adjourned at 4:06 p.m.



Eric Engblom, Recording Secretary