

Minutes
Business and Finance Committee
Board of Regents of the University of Wisconsin System
September 6, 2001

The Business and Finance Committee met at 2:40 p.m. in Room 1920 Van Hise Hall, in a joint meeting with the Physical Planning and Funding Committee to discuss preventive maintenance goals. The meeting concluded at 3:07 p.m. Details of that discussion are covered in the Physical Planning and Funding Committee minutes.

Following the joint meeting with the Physical Planning and Funding Committee, the Business and Finance Committee reconvened at 3:15 p.m. in Room 1920 Van Hise Hall. Present were Regents Gottschalk, Axtell, Jones, Klauser, and Krutsch.

b. Committee Goals for 2001-02

Vice President Durcan and Regent Gottschalk discussed the Business and Finance Committee goals for 2001-02; 1) building the UW System's resource base, 2) developing the 2003-05 biennial budget, and 3) implementing investments in venture capital. Regent Krutsch asked to expand the first goal to include the strategic use of resources.

The Committee agreed to modify the agenda at this time in order to allow Regent President Smith to be present during the discussion of agenda item I.2.c., Building Our Resource Base. The Committee moved directly into Committee business.

d. Committee Business

1. Approval of minutes of the June 7, 2001 meeting of the Business and Finance Committee

Upon the motion of Regent Axtell and the second of Regent Jones, the minutes of the June 7, 2001, meeting of the Business and Finance Committee were approved as presented.

2. Auxiliary Reserves Report to Joint Finance

Associate Vice President Doug Hendrix noted that a letter will be sent to the Co-Chairs of the Joint Committee on Finance and the Secretary of the Department of Administration concerning projected auxiliary reserve balances as of June 30, 2002. By statute, the DOA Secretary and JFC must approve the accumulation of reserves for student fee funded auxiliaries that exceed 15% of the prior year's revenues. The term "reserves" refers simply to the projected ending cash for the coming fiscal year less advance deposits and encumbrances and does not represent a separately administered accumulation of resources.

Planned reserves levels are reported on institution-wide basis and the amounts shown represent the accumulation of cash balances from numerous, separately managed, self-supporting student fee funded operations at each institution including housing, food service and segregated fee funded operations such as student activities, health centers, and student centers. Other auxiliary operations that are not primarily student fee funded, such as parking, are not subject to this statutory reporting and approval requirement.

UW System policy requires that reserve accumulations be linked to specific programmatic and operating needs detailed in a multi-year plan. There is a formula in the policy that defines a reserve maximum and minimum for each operation. The elements of the formula relate to the reasons why reserves are needed, including: 1) meeting debt service requirements;

2) ensuring that equipment and facilities can be maintained, replaced, remodeled or refurbished as needed; 3) providing an operating cushion to offset short-term revenue losses or unanticipated expenditures; and, 4) to stabilize rate increases for students. The same policy that applies to the student fee funded auxiliaries also applies to the other auxiliary operations that are not subject to the statutory reporting requirement.

The letter will be sent with two attachments. The first attachment shows each institution's fiscal year 2001 revenue for student fee-funded auxiliary operations and the amount by which each institution's planned reserve level as of June 30, 2002, is greater or less than 15% of this revenue amount. The second attachment shows the planned use reserves for the ten institutions that exceed this 15% threshold by illustrating some of the major capital expenditures to which student fee funded reserves are committed.

The UW System reserve report is always given careful scrutiny by the budget analysts at the Department of Administration and the Legislative Fiscal Bureau, and the UW System expects that to be the case this year as well. Throughout the recently concluded budget cycle, UW System received many questions about the student fee funded reserve, as well as about reserves for other operations that are not subject to this reporting requirement. The Assembly version of the budget just adopted would have had the UW System lapse \$5 million in auxiliary funds to the state's general fund. Fortunately, this provision was not included in the final version of the budget. While the total accumulation of funds across the UW System appears sizable, it is not a single undifferentiated source of discretionary funds but rather the accumulation of relatively small balances held by numerous campus operations that are each self-supporting. These operations have accumulated these funds to meet specific programmatic and operating needs detailed in their multi-year plans.

3. Report on Base Salary Adjustments to Recognize Competitive Factors

Assistant Vice President Freda Harris noted that the UW System is allowed to grant salary increases to faculty and academic staff to recognize competitive factors. A total of 93 individuals at 7 institutions received \$762,336 for normal equity and retention issues in 2000-01. By comparison, there were a total of 528 individuals at 9 institutions receiving \$980,428 in 1999-00. In addition, 2,129 individuals at UW-Madison were awarded \$6,453,284 of competitive compensation as part of the Madison Initiative in 2000-01 compared to 2,106 individuals awarded \$6,942,326 in 1999-00. This represents less than one-quarter (23.4% in 2000-01 and 23.5% in 1999-00) of the faculty and academic staff at UW-Madison.

Regent Axtell inquired as to what time of year salaries are reviewed based on competitive factors. Assistant Vice President Freda Harris noted that salaries can be reviewed at any time of the year. For example, they can be reviewed at the time of recruitment, when deciding whether to make a counter offer, when determining a specific area of need, or in the merit salary adjustment process.

Upon the motion of Regent Axtell and the second of Regent Krutsch, the Committee approved Resolution I.2.d.3.

[Resolution I.2.d.3.]

That, upon the recommendation of the President of the University of Wisconsin System, the Report on 2000-01 Base Salary Adjustments to Recognize Competitive Factors Required by Section 36.09(1)(j), Wisconsin Statutes, be accepted for transmittal to State Officials.

4. 4th Quarter 2000-2001 Gifts, Grants and Contracts

Vice President Deborah Durcan noted that total gifts, grants and contracts for this period were \$867.4 million, an increase of \$99.3 million from the comparable period of the previous fiscal year. Federal awards increased \$68.5 million while non-Federal awards increased \$30.9 million. Vice President Durcan noted that 80% of these totals are generated by UW-Madison.

Compared to the previous fiscal year, Federal awards increased most significantly in research (\$57.7 million, \$55 million of that being generated by UW-Madison), Extension (\$7.5 million), physical plant (\$2.7 million) and instruction (\$2.3 million). These increases were offset most significantly by a decrease in student aid (\$1.9 million). As stated in previous reports, student aid would have increased if some institutions had not mistakenly reported about \$4 million of student aid for FY 2000-2001 in the fourth quarter of FY 1999-2000. This negative effect will reverse to a positive effect in FY 2001-2002 when the institutions again properly report first quarter financial aid.

Compared to the previous fiscal year, non-federal awards increased most significantly in physical plant (\$16.5 million), research (\$7.3 million), miscellaneous (\$4.9 million) and Extension (\$2.7 million). These increases were offset most significantly by a decrease in student aid (\$1.2 million).

Vice President Durcan noted that although UW-Madison has by far the largest amount, other institutions do generate a significant amount of gift, grant, and contract dollars.

5. UW-Stout Contractual Agreement with Compaq Computer Corporation

Chancellor Charles Sorensen, UW-Stout, discussed UW-Stout's proposed contractual agreement with Compaq Computer Corporation. Chancellor Sorensen has engaged the campus in discussing digital technology since the mid-1990's. This included visits to campuses that had already deployed a laptop program, reading current literature on higher education successes and failures, and engaging a higher education consultant to review the UW-Stout's technology position.

The Compaq Computer Corporation contract will provide laptop computers to the students and staff at UW-Stout through a leasing arrangement with the university. The contract will begin the fall of 2001 to satisfy the requirements of 2002 fall semester rollout, when all entering freshmen will be required to have a University-provided laptop computer. This will continue over the next three years, until all full-time students attending UW-Stout will be provided a laptop computer.

There is a two-year refresh cycle, which means the laptops are replaced every two years. Compaq retains title to machines unless UW-Stout chooses to buy them in order to sell them to individual students.

Regent Axtell asked what would happen if an incoming UW-Stout freshman already owned a laptop computer. Chancellor Sorensen responded that they have to lease a Compaq computer from UW-Stout. This is due to the need for standardized computers that are compatible with the wireless infrastructure built on campus. Student focus groups have shown that demand for this program has increased in the student body. Also, parents were notified over the previous two years that incoming freshman would be included in the computer leasing program, and they were told not to purchase laptops for their children.

Regent Jones asked what would happen if the computer malfunctions, and who would be responsible if a student breaks the computer. Vice Chancellor Diane Moen, UW-Stout, noted that the contract specifies the terms and conditions of the lease, and Compaq will provide an insurance policy for each laptop. Also, as a result of questions posed by UW-Stout, Compaq made commitments regarding free replacement computers while the original laptop is repaired.

Regent Klauser asked how many computers will be leased to students the first year, and how many computers will be involved once the program is fully operational. Chancellor Sorensen noted that 1,300 computers will be leased during the first year, and after the program is completely phased in, up to 8,000 computers will be leased. This should lead to a decrease in the need for students to use general access computer labs.

Regent Axtell asked what the total impact on the student's cost would be to attend UW-Stout, due to the computer leasing program. Vice Chancellor Diane Moen, UW-Stout, noted that it would be about \$500. Associate Vice President Kathleen Sell noted that this cost is folded into student fees, making the cost available to be covered by student financial aid.

Regent Jones asked whether the program only pertains to undergraduate students, or also provides leasing opportunities to graduate students. Chancellor Sorensen noted that the program only includes undergraduate students at this time, but may include graduate students in the future.

Regent Klauser asked how the UW-Stout chose Compaq as the leasing provider. Ellen James, Assistant Vice President of Division of Administrative Services, UW System, described the request for proposal, noting that the UW System had flexibility in choosing Compaq, and did not simply take the lowest bid.

Upon the motion of Regent Klauser and the second of Regent Axtell, the Committee approved Resolution I.2.d.5.

[Resolution I.2.d.5.]

That upon recommendation of the President of the University of Wisconsin System and the Chancellor of the University of Wisconsin-Stout, the Board of Regents accepts the contract with Compaq Computer Corporation to provide a laptop leasing program for the students and staff at University of Wisconsin-Stout.

e. Trust Funds

1. Request to Expend Principal of Lois W. Backus Bequest

Assistant Trust Officer Doug Hoerr noted that WHA-TV has received a bequest totaling \$80,069 from the estate of Lois W. Backus. WHA-TV has requested an exception to the Regent policy that would limit the use of gifts over \$50,000 to income earned. (Note: This request was originally submitted at the June 7th Board of Regents meeting, but the Committee asked that it be resubmitted and more fully supported by having an appropriate representative of WHA-TV in attendance.) The existing policy allows university officials to request the use of principal when they feel it is in the best interest of the institution. This exception must, however, be consistent with the original gift instrument. In this case, the bequest has no restriction on the use of principal. Therefore, the request is not inconsistent with the terms of the bequest, and, upon favorable determination by the Committee that it is in the best interest of the institution, approval of this request is recommended.

Malcolm Brett, Director of Radio/TV of WHA-TV, noted that the intended use of these funds will be to help fund the production and promotion of the current ten-part series, "Wisconsin Stories." He further explained that certain elements of the production make it more costly than other programming, and that this project, in its second year, remains under-funded.

Regent Axtell asked whether the program will be aired more than once. Mr. Brett explained that the program will be aired six times, and that copies of it will be made available to teachers at cost.

Regent Gottschalk asked whether the Backus estate would be credited in the closing credits of the program. Mr. Brett noted that if the Backus estate approves, the closing credits would include a statement that the program was partially funded through the Backus bequest.

Upon the motion of Regent Axtell and the second of Regent Jones, the Committee approved Resolution I.2.e.1.

[Resolution I.2.e.1.]

That, upon recommendation of the President of the University of Wisconsin System and the Chancellor of the University of Wisconsin-Extension, the principal and income balance of the Lois Backus bequest becomes available for spending.

2. Request to Expend Principal of Margaret Emma Williams Bequest

Assistant Trust Officer Doug Hoerr noted that the University of Wisconsin-Madison, Medical School has received a bequest totaling \$653,216 from the estate of Margaret Emma Williams. The existing policy allows university officials to request the use of principal when they feel it is in the best interest of the institution. This exception must, however, be consistent with the original gift instrument. In this case, the bequest has no restriction on the use of principal. Therefore, the request is not inconsistent with the terms of the bequest, and, upon favorable determination by the Committee that it is in the best interest of the institution, approval of this request is recommended.

Ken Mount, Assistant Dean of the Medical School, UW-Madison, noted that, regarding the bequests for cancer and heart research (\$435,477), the Medical School has requested expenditure of principal to provide funding for new cancer and heart research space as part of the Interdisciplinary Research Center, which is part of the overall Healthstar project. Regarding the bequest for eye research (\$217,739), the Medical School's discussions with the donor's surviving family members have prompted them not to request an exception for this portion. This portion of the bequest will be designated an endowment, and will not be spendable.

Upon the motion of Regent Krutsch and the second of Regent Jones, the Committee approved Resolution I.2.e.2.

[Resolution I.2.e.2.]

That, upon recommendation of the President of the University of Wisconsin System, and the Chancellor of the University of Wisconsin-Madison, the principal and income balance of the Margaret Emma Williams bequest becomes available for spending.

c. Building Our Resource Base

Associate Vice President Kathleen Sell noted that in July, at the Board's annual retreat, the Board selected as one of the three themes for this year, an examination of alternative approaches to increasing the funding base for public higher education. Regent President Smith indicated at that time that it is vital for the UW System's long-term viability to get some predictability in the state investment in ongoing costs. At the same time, he challenged the UW

System to consider more creative and assertive ways of increasing funding resources from fundraising and program revenue of every kind. Associate Vice President Sell reviewed: 1) the Wisconsin fiscal context; 2) the principles to guide Board consideration of possible funding strategies; 3) a brief history of UW System budget strategies since the merger; and, 4) the major approaches other states and universities have considered or used for higher education funding.

Associate Vice President Sell noted a shift in state priorities away from higher education, which received 14.4% of GPR funds at merger in 1974, to 9.4% in 2001. This does not mean that state support in absolute dollars has declined. It has gone from nearly \$279 million to nearly \$1.2 billion today. This level of increase has just kept up with inflation. Considering the low inflation rates in the last decade, this is a special concern. From 1990 to 2000, state GPR spending went up 76% and UW System GPR increased by 40%, or about half the rate for overall state spending. In effect, state spending increased by \$4.8 billion and UW System by \$293 million.

The higher education funding bulletin, *Grapevine*, indicates that Wisconsin has declined in GPR per capita spending for higher education from a rank of 19th of 50 states in 1989, to 26th in 2001. It is true that, in spending effort, or GPR to higher education per \$1000 in personal income, Wisconsin has remained at 23rd nationally throughout this period. However, that is not because Wisconsin has maintained its growth rate in spending for the university. It is because the state's per capita income is on a downward slope compared with the national average.

The Kansas City Federal Reserve notes that states get maximum benefit from their universities, including graduates who contribute to the economy, by maintaining modest but steady increases in state investments. In Wisconsin during the 1990's, UW System had a year of absolute cuts in GPR base in 1995, and its expenditures grew by only \$6 million the next year, less than \$20 million the year after that, \$20 million the following year, \$40 million in 1999-00. For 2000-01, the state provided a \$90 million increase, but \$30 million was to buy a one-year tuition freeze. The UW System expects another \$37 million this year. This is not predictable funding.

Meanwhile, from 1995 forward, the UW System has grown by 7,801 FTE students, only 1,000 of which have been funded by the state. There has been a decline in GPR support per student since 1997. The UW System is now \$808 below the national average. Calculating the gap with tuition revenues and GPR, the 1999 gap declines by \$110, to \$698 below the national average. Despite the UW System's increased reliance on student tuition revenue, that funding source has actually contributed less to reducing the gap in support per student funding today than in 1990, when the \$846 GPR gap was mediated by the state being \$246 above the national average in tuition, or really down \$600 GPR fees below the national average. Therefore, the UW System contributed \$246 more than the average from tuition in 1990, and \$110 more than the average today. The UW System's resident undergraduate tuitions remain low in their Midwestern peer groups. The UW System's dilemma is that tuition is not enough to fund 100% of growth, nor should students fund all of their education at public institutions with public missions. The UW System is now one of 7 states with single digit GPR increases for the total five-year change from 1995-2000.

As the Board considers what to do in response to these trends, the UW System has created a set of proposed principles to guide the Board's year of deliberations. These seven principles come from the Regents' tuition policy and the recommendations of the Regents' *Study of UW System in the 21st Century*.

Principles Guiding UW System Funding Strategies

1. The UW System is committed to affordability.
2. State-funded financial aid increases should be linked to tuition increases.
3. The UW System will provide accountability to its stakeholders.

4. UW System educational quality requires a predictable and fair share investment by the state.
5. UW System institutions commit to continuous reallocation of base resources to meet a portion of system and institutional priorities.
6. UW System will continue to manage and measure its success against specific targets and benchmarks such as enrollment targets, graduation rates and other benchmarks, in order to continue its mission as a public university.
7. At the same time, the University System requires operational flexibility commensurate with its responsibilities to its multiple stakeholders.

The Committee added two additional principles to the seven listed above; 8) the UW System is committed to quality and access, and 9) the UW System will strive to maintain and attract a high quality instructional and research faculty.

Associate Vice President Kathleen Sell noted several options to consider that other states use as a long-term vehicle for obtaining moderate but predictable state funding: 1) a return to formula budgeting is an option; 2) staying with program budgeting but linking a portion of our budget to a guaranteed rate of increase in return for performance improvements on commonly accepted benchmarks; 3) staying with program budgeting, but focusing more determinedly on either a compact with the state or some other common accepted funding baseline; and, 4) seeking charter status or requesting lump-sum budgeting. Minnesota and Michigan have this authority. It enables them to ask the state for an overall sum, which the state will fund to the degree that it chooses, as an aggregate amount. Then, the university system is free to supplement by tuition as the Board sees fit, and to allocate the total among priorities as the Board sees fit. This would require more statutory flexibility (in some states, a constitutional amendment establishes this flexibility).

Associate Vice President Kathleen Sell noted the proposed Regents' schedule over the next year of topics related to "Building Our Resource Base", pointing out that the order of topics is meant to match the biennial budget cycle for 2003-05. That is, the Committee will look first at program revenue options and then, in February, when the UW System is turning to budget development, the Committee will look at options for more predictable GPR increases.

Regent President Smith noted that time needs to be spent on fund raising and federal funding strategy, as these are large elements of program revenue options. Regent President Smith also suggested covering the alternative tuition models at a single month's meeting rather than at two meetings. Regent President Smith will work with the Committee chairs to revise the schedule for final approval in October.

The committee amended the resolution to approve only the list of topics to be discussed.

Upon the motion of Regent Axtell and the second of Regent Jones, the Committee approved the amended Resolution I.2.c.

[Resolution I.2.c.]

That the Board of Regents approve the topics of 2001-02 presentations on the theme, "Building Our Resource Base."

The Business and Finance Committee recessed and the Audit Subcommittee convened at 5:15 p.m. Present were Regents Axtell, Klauser, and Gottschalk. Regents Jones and Krutsch were also present.

h. Audit Subcommittee

Regent Gottschalk began the meeting with a discussion on the current role of the Audit Subcommittee. Since the Office of Internal Audit performs program evaluation reports, in addition to financial reviews, a committee with representatives from all of the standing committees could provide improved feedback on the reports presented. Regent President Smith agreed to discuss a possible change in the composition of the Audit Subcommittee with the chairs of the other committees.

Ron Yates, Director Internal Audit, provided a brief overview of the major projects the Office of Internal Audit is conducting, noting that all projects are proceeding as planned.

In the area of outside audit activities, Director Yates reported that the Legislative Audit Bureau (LAB) has begun work on the federally mandated FY 2001 audit of federal funds. The report will be completed in March 2002. LAB also issued an evaluation report on the UW Hospital and Clinics Authority in June 2001. The report included no recommendations and found that the agreements between the new Authority and the University are working well. Finally, an audit by the Office of Inspector General, U.S. Department of Health and Human Services, was resolved with a settlement payment of \$214,867 being paid by the UW Medical Foundation. This type of audit was reportedly conducted at 50 to 60 teaching hospitals and medical schools.

A list of potential review topics was discussed and reviewed by the Audit Subcommittee. The list is reviewed periodically and can be amended in response to national issues, institutional requests, or Audit Subcommittee direction.

The Audit Subcommittee adjourned and the Business and Finance Committee reconvened at 5:40 p.m. Present were Regents Gottschalk, Axtell, Jones, Klauser, and Krutsch.

e. Trust Funds

3. RFP for Private Capital Fund of Funds Manager

Doug Hoerr, Assistant Trust Officer, noted that the Business and Finance Committee resolved that the UW System Trust Funds' Statement of Investment Objectives and Guidelines be revised to allow the Principal Long-Term Fund to invest in "private capital." Private capital can be broadly defined as direct or indirect private, equity-like investments in businesses at various stages of their development. These investments include venture capital, buyouts, mezzanine/subordinated debt, etc. Such private investments are not publicly traded and priced, they are not SEC-registered securities, and they are primarily available to and suitable for sophisticated, institutional investors. They are also characterized by a generally long-term investment horizon and commitment, as well as a lack of liquidity.

The Committee's resolution was preceded by numerous presentations and discussions with the Committee regarding private capital investing. These discussions prompted a consensus that the best approach for the Long-Term Fund would be to invest in private capital via one or more "funds-of-funds." A fund-of-funds is a structure whereby a professional investment manager commingles assets from many investors, and invests these in underlying "funds" (generally, limited partnerships in which a general partner team makes, in turn, underlying direct individual investments).

Trust Funds has begun the search process for one or more private capital funds-of-funds. A formal Request for Proposal ("RFP") was created, and an advertisement soliciting interested parties was placed in the trade publication "Pensions & Investments". Proposals are due back from respondents on September 25th.

Regent Axtell asked how much of the endowment will be invested in private capital, and was there a discussion about the possibility of investing in Wisconsin based companies. Mr. Hoerr noted that 10% of the portfolio, approximately \$30 million, will be invested in private

capital. Elizabeth Rindskopf Parker, General Counsel, noted that investing in Wisconsin based companies was discussed, but the fiduciary responsibility of the UW System to these assets was a major factor in dismissing the option. Regent Klauser noted that the State of Wisconsin Investment Board is large enough so that it can invest a certain percentage in Wisconsin based companies, but the UW System Trust Funds would likely not be large enough to take on this added risk.

In reviewing the proposed timeline for the manager search process, the Committee asked that the schedule be amended so that the Committee can interview the finalists.

4. Asset Allocation and Spending Plan Review

Doug Hoerr, Assistant Trust Officer, noted that the asset allocation was amended in March to allow private equity up to 10% of the portfolio. Also, the current spending plan of 5% (per annum) has been capably supported by the Long-Term Fund, and no change is recommended.

f. Report of the Vice President

Vice President Durcan noted the outcome of the 13.10 meeting, noting that the Joint Finance funded \$6 million of the UW System's \$8.5 million utility shortfall in 2001, but allowed the UW System to roll forward \$2.5 million of expenditures to the new fiscal year. She also noted that the UW System only lapsed \$2.4 million out of a GPR budget of \$1 billion. Of the amount lapsed, \$2.1 million was a required lapse.

g. Additional items which may be presented to the Business and Finance Committee with its approval.

No additional items were presented to the Committee at this time.

i. Closed Session to consider trust fund matters, as permitted by s.19.85(1)(e), Wis. Stats.

Upon the motion of Regent Klauser and the second of Regent Krutsch, the Business and Finance Committee adjourned to Closed Session at 6:00 p.m. Present were Regents Gottschalk, Axtell, Jones, Klauser, and Krutsch.

The Business and Finance Committee adjourned at 6:15 p.m.


Eric Engbloom, Recording Secretary