The Business and Finance Committee met at 1:22 p.m. in room 1920 Van Hise Hall. Present were Regents Klauser, Olivieri, and Krutsch.

a. Approval of the Minutes of the October 10, 2002 Meeting

Upon the motion of Regent Krutsch, and the second of Regent Olivieri, the minutes of the October 10, 2002, meeting of the Business and Finance Committee were approved as presented.

b. Overview of UW System Financial Management Structure

Doug Hendrix, Associate Vice President for Financial Administration, UW System, presented the second in a series of reports intended to provide members of the Board of Regents with information about the safeguards employed by the UW System to ensure the reliability of its accounting information. Mr. Hendrix described some of the key elements in the UW System that ensure the reliability of UW System’s financial records both from a “top-down” perspective and from a transactional level. A strong system of internal control starts with an effective management structure and clear lines of authority and responsibility.

Mr. Hendrix stated that the initial goal of any accounting system is to ensure that only valid transactions are recorded and that all valid transactions are recorded promptly and accurately. Within the UW System, most transaction processing takes place at the institutions and not at a System level. The Legislative Audit Bureau annually provides the Board of Regents with a letter reporting on the UW System’s system of internal controls and reports on any material weaknesses found.

Mr. Hendrix commented that the primary method of preventing or at least minimizing the risk of fraud is to establish an adequate set of control procedures with particular attention to separating job duties. Unfortunately, no system of internal control is perfect and frauds do occasionally occur in any large organization including the UW System. Mr. Hendrix briefed the Committee on the UW System policy for investigating and preventing fraud cases.

Regent Krutsch noted the Board’s independence from management, and asked whether the Office of Operations Review and Audit should report directly to the Board. Vice President Debbie Durcan noted that, like the UW System, most Big 10 institutions’ auditors go through the finance office, and have a dotted line reporting relationship to the Board.

Regent Krutsch asked which areas are most closely analyzed to ensure against fraud and misleading financial statements. Ms. Durcan commented that the grants and cash handling areas are closely analyzed, but most of these areas are at the campus rather than UW System office level. Mr. Hendrix noted that it is the responsibility of financial management to think carefully through each of its business processes such as revenue collection and cash disbursement.

c. Trust Fund Issues

(1) UW Foundation Perspective on Hedge Funds

John Feldt, Senior Vice President, UW Foundation, gave an overview on how the UW Foundation uses hedge funds in its portfolio. He described the process the Foundation went through when considering the asset class, and gave recommendations to the Committee on how the UW System could make use of hedge funds to further diversify its investment portfolio.

Mr. Feldt noted that hedge funds have been increasingly correlated to the equity markets, especially in severe bear markets like the current conditions of today. Hedge funds had double-digit
returns in the late 1990s, and have fallen to single-digit to negative returns in the 2000s.

Mr. Feldt noted the UW Foundation’s experience with its existing 10% allocation to hedge funds. The portfolio holds 22 individual funds, diversified across nine hedge fund strategies. UW Foundation’s overall strategy regarding the use of hedge funds is a fixed-income replacement strategy. The program has been in place 14 months as of August 31, 2002. The cumulative return has been +7.81% (net of fees).

Mr. Feldt commented that the UW Foundation Board recently voted to increase their hedge fund exposure to 20%. The UW Foundation 2002 capital market assumptions estimate that hedge funds will return 9.0% with a standard deviation of 9.0%, consistent with a fixed income replacement strategy.

Regent Klauser noted that the key to successful hedge fund investing is competent, continuous oversight. Mr. Feldt stated that the UW System should strongly consider using a fund of funds investment strategy. Also, the key factors that the UW System should consider in hedge fund investing are fund performance, fee structure, the number of funds in which to invest, and the ease with which the UW System can move in and out of funds.

(2) Review of Emerging Markets and High Yield Fixed Income

Assistant Trust Officer Doug Hoerr noted that high yield fixed income and emerging market equities were included in the initial asset allocation study presented to the Committee in September. These were presented as additional traditional asset classes worth consideration for the Long Term Fund in that they could improve the Fund's risk/return profile. Mr. Hoerr noted that, as part of the final asset allocation recommendations, a recommendation will likely be made that the investment guidelines for the Long Term Fund include high yield fixed income and emerging market equities as approved asset classes, within certain ranges.

Mr. Hoerr stated that high yield fixed income represents debt of issuers with below investment grade creditworthiness, which must provide high coupon rates or high enough yields to compensate investors for the higher risk. UW System investment guidelines currently preclude fixed income managers from buying below investment grade or retaining securities that fall below this level without the Board’s permission. This effectively shuts out a large pool of investments that have historically offered higher risk-adjusted returns and significant portfolio diversification benefits. However, the unique characteristics of high yield and the market they trade within, suggest specialized high yield investment managers.

Mr. Hoerr commented that emerging market equities are stocks of companies domiciled in lesser-developed countries that are beginning to experience rapid economic growth and market liberalization. The capitalization of emerging markets has grown rapidly over the past decade, and yet still comprises only eight percent of the world's total stock market capitalization. Although emerging market stocks should theoretically benefit from greater underlying economic growth, they are subject to risks that developed market equities are by and large not: political, regulatory, taxation and profit repatriation, and currency risk (which cannot be hedged). The uniqueness and inefficiencies of this market suggest specialized managers.

Regent Olivieri commented that the asset allocation recommendations should address the issues of transparency and lack of regulation inherent to hedge fund investing, in light of the UW System being a public entity. The recommendations should also address how the UW System Trust Funds plans to manage the increased risk that goes along with these asset classes. Mr. Hoerr responded that these are important issues; however, by using a fund-of-funds approach, the UW System should be able to access the expertise needed to manage and monitor the risks of hedge fund investing, and achieve the desired level of transparency.

(3) Request to Expend Principal of Mary W. Enerson Bequest

Assistant Trust Officer Hoerr stated that, in the event a donor gives no direction as to the use of principal, current Regent policy requires that all gifts greater than $50,000 be identified as designated endowments.
Mr. Hoerr stated that the Board of Regents has received a partial distribution in the amount of $213,000, from the estate of Mary W. Enerson for the benefit of the UW-Madison Medical School, to be used for heart research.

Mr. Hoerr noted that Dean Philip Farrell of the UW-Madison Medical School has requested that this bequest retain quasi-endowment status so that both principal and income is expendable. Mr. Hoerr noted that Dean Farrell stated that the single most important research need is additional research space. As with other recent sizable principal unrestricted gifts for research, the Medical School believes that the best use for such funds is to help expedite the construction of the Interdisciplinary Research Center (IRC), which is part of the overall Healthstar project. The bequest would, therefore, be used for building heart research space, and an appropriate naming opportunity would be identified.

Upon the motion of Regent Krutsch, and the second of Regent Olivieri, the Committee approved Resolution I.2.c.(3).

**Resolution I.2.c.(3)**

> That, upon recommendation of the President of the University of Wisconsin System and the Dean of the University of Wisconsin-Madison Medical School, the principal and income balance of the Mary W. Enerson bequest becomes available for spending.

**d. Committee Business**

**1. Annual Sick Leave Report**

George Brooks, Associate Vice President for Human Resources, UW System, stated that, fifteen years ago, the legislature amended the statutes to reduce the number of unused sick leave credits that could be accrued each year by faculty and academic staff to help pay health insurance premiums upon retirement. Full-time faculty and academic staff earn 12 sick leave days each year and, prior to the statutory amendment, all unused sick leave could be accumulated to help pay a retiree’s health insurance premiums.

Mr. Brooks noted that the 1987 law capped the annual sick leave accumulation at 8.5 days for those on annual appointments, and 6.4 days for those on academic year contracts, but the law allows the Department of Administration Secretary to waive those caps if certain conditions were met. Waivers have been approved for all faculty and academic staff because UW System developed a sick leave accounting system, established rules for sick leave usage and colleague coverage, and provides a sick leave accounting report to the Board each year as an informational item.

Mr. Brooks commented that in fiscal year 2001-02, UW System faculty and teaching academic staff on average, used 1.1 days of sick leave and non-teaching academic staff used an average of 3.3 days of sick leave. These usage rates are within the normal range of UW System experience for the past 12 years. Faculty and teaching academic staff average sick leave usage had a low of 1 day in 1996-97 and a high of 1.4 days in 1995-96. Non-teaching academic staff usage had a high of 4.4 days in 1991 and a low of 3.2 days last year. This means that faculty and teaching academic staff saved 10.9 days of pay and non-teaching academic staff saved 8.7 days of pay to help defray health insurance premium costs when they retire. UW System faculty and teaching academic staff save sick leave in amounts comparable to all state classified employees.

Mr. Brooks noted that the ability of the UW System’s faculty and academic staff to save sick leave to help pay health insurance premiums upon retirement is a feature of the staff benefits plan that is extremely useful in UW System’s recruitment and retention efforts. As health insurance premium rates continue to rise at double-digit rates, 13.4% for 2003, this is a benefit that continues to grow in importance.
(2) Quarterly Gifts, Grants, and Contract Report

Vice President Durcan presented the report on gifts, grants and contracts awarded to the institutions of the UW System for the three-month period ended September 30, 2002. Total gifts, grants and contracts for this period were $358 million, an increase of $53.6 million from the comparable period of the previous fiscal year. Federal awards increased $31.9 million while non-Federal awards increased $21.7 million. The majority of these grants are to UW-Madison.

Ms. Durcan stated that, compared to the previous fiscal year, non-Federal awards increased significantly in Extension ($12.8 million), Instruction ($4.7 million) and Libraries ($1.3 million). The increase in Miscellaneous ($26.5 million), and decrease in Research ($23.9 million), is due to a classification error that will be corrected for the second quarter report.

(3) Annual Broadcast Report

David Olien, Senior Vice President for Administration, gave a brief overview of the changes that have occurred since the previous annual broadcast report. Mr. Olien introduced Kerry Niemecck, Policy Analyst, UW System, who provided further details.

Ms. Niemecck noted that the first on-air broadcast of WSUM, UW-Madison’s student radio station, was held on February 22, 2002. The station was broadcasting via the Internet since 1996. WSUM broadcasts throughout Dane County on 91.7 FM. UW-Madison was the last Big 10 university to have a student radio station broadcast on air. The station is staffed by more than 200 students.

Ms. Niemecck commented that stations WWSP (Stevens Point), WSUM (Madison) and WSUW (Whitewater) discontinued webcasting this year due to increased fees for copyrights to performers. Stations incur royalty fees to webcast sound recordings, which are set by the Librarian of Congress per the Digital Millennium Copyright Act of 1998. According to many college station broadcast directors, the fees are too cost-prohibitive and many stations nationwide have stopped webcasting. Stations which continue to webcast include Wisconsin Public Radio (WPR) NPR News & Classical Music and Ideas Network programming.

Ms. Niemecck stated that two stations webcast programming during 2001-02, and they are not affiliated with an on-air radio station. These stations, WUWW (formerly WYRE) at UW-Waukesha County and Student Radio Initiative (SRI) at UW-Eau Claire, are not licensed with the FCC for this reason, but are registered to the Board of Regents for copyright protection purposes. WUWW stopped webcasting temporarily to assess the financial feasibility of continued webcasts.

Regent Klauser asked whether all stations are being fully digitally broadcast, and how the cost associated with bringing the stations on-line is covered. Malcolm Brett, Director of Public Television, responded that all stations are not yet on-line; however, all stations gradually will become fully digitally broadcast over the next few years. The largest share of the cost of transmission and production equipment is expected to be funded by state dollars. Wisconsin Public Television also seeks federal grants and private gifts to fund a portion of the cost.

(4) Acceptance of Bequests over $50,000

Assistant Trust Officer Hoerr noted that the Board of Regents and the UW-Milwaukee has received a sizable bequest from the late Robert Kuehneisen. UW-Milwaukee wishes to express their deepest thanks and appreciation to the late Robert Kuehneisen for this exceptionally generous gift, which will be used as a memorial fund to sustain and further the quality of the School of Education. It is anticipated that the School of Education will receive a total of approximately $1,250,000 from the Kuehneisen estate.

Upon the motion of Regent Olivieri, and the second of Regent Krutsch, the Committee approved Resolution I.2.d.(4).
Resolution I.2.d.(4)

That, upon the recommendation of the President of the University of Wisconsin System and the Chancellor of the University of Wisconsin-Milwaukee, the bequest of the late Robert Kuehneisen be accepted, and that the Trust Officer or Assistant Trust Officers be authorized to sign receipts and do all things necessary to effect the transfer for the benefit of the University of Wisconsin-Milwaukee.

Let it be herewith further resolved, that the President and Board of Regents of the University of Wisconsin System, and the Chancellor and Dean of the School of Education at the University of Wisconsin-Milwaukee express their deepest thanks and appreciation to the late Robert Kuehneisen for this exceptionally generous gift, which will be used as a memorial fund to sustain and further the quality of the School of Education.

(It is anticipated that the School of Education will receive a total of approximately $1,250,000 from the Kuehneisen estate. It should be noted that the Swimming Program at UW-Milwaukee is potentially the beneficiary of Mr. Kuehneisen's IRA, with a value of some $215,000.)

e. Report of the Vice President

(1) Status of Classified Represented Pay Plan

Associate Vice President Brooks stated that negotiations are continuing on compensation and language issues with the Wisconsin State Employees Union, the union that represents the largest number of state and university classified employees, including the Science and Engineering units.

Mr. Brooks noted that five units have ratified their tentative agreements, including the Teaching Assistants Association at UW-Madison and the Milwaukee Graduate Assistants Association at UW-Milwaukee. Those units are waiting for the Legislative Joint Committee on Employment Relations (JCOER) to decide whether the state will accept or reject the tentative agreements.

Associate Vice President Brooks commented that, under the current process, once a tentative agreement is reached between the Department of Employment Relations (DER) and the union negotiating team, the contract is presented to the union members for ratification. If and when the proposed agreement is ratified, DER requests that JCOER schedule an open hearing to hear testimony and vote on the agreement. Any agreement approved by JCOER is submitted to the legislature as session law. If the legislation passes and is signed by the Governor, the contract becomes effective on the date of publication. Mr. Brooks noted that it is not clear when the 2001-03 contracts will be put into place. The protracted negotiation process is unprecedented on such a large scale. This contract should have been in place 18 months ago. Contract negotiations for the 2003-05 contracts are tentatively planned to begin in March.

Associate Vice President Brooks stated that UW System represented employees have not had a pay increase for more than two years. UW System asked DER to present the Teaching Assistant contracts to JCOER when those contracts were ratified 9 months ago, but DER refused. The UW System is very disappointed by the lack of progress.

(2) Discussion of “Direct” versus “Full” Cost Recovery Programs

In response to questions raised at the October meeting, UW-Madison Vice Chancellor John Torphy led a discussion about the differential tuition programs that campuses have entered into over the past couple of years.
The Board of Regents have adopted numerous goals regarding differential tuition, including:

- Building the Resource Base;
- Greater Access through Distance Education;
- Service-Based Learning for Non-Traditional Students; and,
- Alternative Pricing Structures Which Go Beyond Covering Cost (150% of the resident undergraduate tuition rate).

Vice Chancellor Torphy stated that clarification of terms and goals is needed to ensure that institutional implementation is consistent with Regent intent. Mr. Torphy gave an example of a UW-Madison laboratory certificate program which fit many of the criteria of the Board’s goals concerning differential tuition programs. The program is web-based, and geared towards distance education students over 25 years old. However, due to market pricing issues, UW-Madison decided to charge the regular tuition rate for the program. Therefore, this program does not qualify as a differential tuition program. UW-Madison has an increasing number of these types of programs, and the programs are ambiguous in terms of whether they qualify for differential tuition.

Regent Krutsch noted that the Board should list a series of principles and priorities concerning differential tuition programs. The Board does not want to subsidize these types of programs with resident undergraduate tuition. Also, service-based learning is a confusing term, and the Board should better define what qualifies as service-based learning.

Regent Olivieri noted that institutions should make use of differential tuition programs as much as possible. Institutions could make use of differential tuition programs for many different purposes. The programs could be revenue generating, and do not have to be service based. However, the pricing for these programs is very important, and institutions must be very careful not to lose students due to the alternative pricing structure.

Andy Richards, Acting Assistant Vice President for Budget Planning, noted that, in the past, there have been three basic types of differential tuition programs; 1) campus based; 2) program related; and, 3) a tuition plateau for summer session programs. Also, student groups such as the United Council, remain very concerned about programs that affect the undergraduate tuition rate.

Vice President Durcan suggested that charging 150% of resident undergraduate tuition for differential tuition programs may not need to be an absolute component to institutions’ differential tuition programs.

Vice President Durcan mentioned that Regent Jones remains very concerned about the increase in non-resident tuition. The question remains whether the UW System is pricing itself out of the market, and losing the subsidy that non-resident students provide. Vice Chancellor Torphy reported that, this year, UW-Madison had the lowest yield rate of non-resident students in 15 years. Regent Klauser noted that this issue should be encapsulated and presented to the Committee in a formal report.

(3) Blue Cross/Blue Shield Agreement Modification – Technical Adjustment

Upon the motion of Regent Krutsch, and the second of Regent Olivieri, the Committee approved Resolution I.2.e.(3).

Resolution I.2.e.(3)

That upon the recommendation of the President of the University of Wisconsin System and the Chancellor of the University of Wisconsin-Madison, the Board of Regents:

- Approves the “Agreement to Accept Gifts between the Wisconsin United for Health Foundation, Inc., the University of Wisconsin Foundation and the University of Wisconsin System Board of Regents” with technical adjustments made from the last agreement, which technical adjustments reorder
information in the last agreement, incorporate other minor language changes which do not change the meaning, and establish the UW Medical School, not the UW Foundation, as the entity which will expend the funds in accordance with the Insurance Commissioner’s Order of March 28, 2000 and under Board of Regents oversight.

- Authorizes John Torphy, Vice Chancellor of Administration, University of Wisconsin-Madison to sign the Agreement on behalf of the Board.

f. Additional items which may be presented to the Committee with its approval

No additional items were presented to the Committee.

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

Upon the motion of Regent Krutsch and the second of Regent Olivieri, the Business and Finance Committee adjourned to Closed Session at 2:55 p.m. Present were Regents Klauser, Olivieri, and Krutsch.

The Business and Finance Committee recessed at 3:02 p.m.

h. Public Forum on Trust Fund Investments

The Business and Finance Committee reconvened at 3:33 p.m. in the Directors Room, 4151 Grainger Hall. Present were Regents Klauser, Schneiders and Krutsch.

The Committee first outlined the Board’s policies and fiscal responsibilities regarding the UW System endowment. Investment Analyst Reinders commented on the 2002 proxy-voting season. The Committee heard from six speakers who asked the Board to be more active in following its guidelines on investments and social responsibility. The speakers were supportive of the Board’s increased activity in proxy voting as a positive first step, but hoped that the Board would take a more active role in the future.

The Business and Finance Committee adjourned at 4:40 p.m.

Eric Engbloom, Recording Secretary