

Minutes
Business and Finance Committee
Board of Regents of the University of Wisconsin System
October 10, 2002

The Business and Finance Committee met in joint session with the Physical Planning and Funding Committee at 1:00 p.m. to hear a presentation about UW-Whitewater student success through fiscal and facility planning connections, and an update on the UW-Madison cogeneration project. 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 2:45 p.m. Present were Regents Klauser, Olivieri, Jones, and Krutsch.

a. UW-Eau Claire Differential Tuition

Andrew Soll, Vice Chancellor, UW-Eau Claire, noted that the Committee held a discussion at the September meeting detailing the UW-Eau Claire Differential Tuition proposal.

Regent Klauser asked whether the differential tuition program is rolled into tuition, and whether UW-Eau Claire will be able to track the differential portion of tuition. Regent Klauser also asked whether student input into program would continue in the future. Vice Chancellor Soll responded that the differential tuition will be rolled into tuition, and UW-Eau Claire will be able to track the differential portion. He also noted that student input would be an ongoing part of the tuition differential discussion regarding how the funds will be spent.

Regent Jones thanked the students of UW-Eau Claire for approving the differential tuition resolution and noted that students should continue to be involved in shaping tuition options in the future.

Upon the motion of Regent Jones, and the second of Regent Olivieri, the Committee approved Resolution I.2.a.

Resolution I.2.a.

That, upon the recommendation of the President of the University of Wisconsin System and the students and Chancellor of the University of Wisconsin-Eau Claire, the Board of Regents approves the differential tuition rates for undergraduate students at UW-Eau Claire beginning in the spring semester of 2002-03.

b. Fiscal Accountability Topics and Schedule

Vice President Debbie Durcan listed the topics and schedule of discussion for fiscal accountability that will be taking place over the fall and spring meetings of the Business and Finance Committee. Ms. Durcan asked the Committee to bring forth any topics that they wish to discuss that may not be on the list.

Regent Klauser invited the Board of Regent President and Vice President to sit in on these important discussions at future Committee meetings.

c. AGB Article: Be Vigilant on Financial Statements

Doug Hendrix, Associate Vice President for Financial Administration, noted that the Board has raised questions about the UW System's fiscal accountability. Mr. Hendrix noted three major factors that mitigate against an Enron-like perversion of the UW System's financial statements.

First, management has no incentive to falsify financial statements. In cases of corporate fraud, the motivation is the personal enrichment of those in upper management who perpetuate the fraud. In the corporate sector, performance is measured by profit, which in turn leads to higher share values and executive compensation. This does not apply to UW System management. Second, the UW System's financial statements are scrutinized by independent auditors. The potential for the compromise of auditor independence does not exist with respect to the Legislative Audit Bureau in the same way it does for private auditing firms that depend on audit and consulting fees. Third, the UW System's financial statements revolve around the adherence to the state budget. The state budget provides a starting point for the financial statements, and accrual adjustments are carefully scrutinized.

Mr. Hendrix discussed some recent news articles that reported remarks made by the State's Capital Finance Officer. The Capital Finance Officer commented that the State's budget situation is even worse than it has been popularly portrayed due to the fact that the publicly discussed numbers are not rooted in generally accepted accounting principles (GAAP). The response from the Secretary of the Department of Administration, noted that, by law, the State's budget numbers must be reported on a cash basis. The state prepares GAAP basis financial statements, but these have little visibility and are not considered for budgetary purposes. Mr. Hendrix noted that the UW System has a responsibility to report financial numbers on a cash basis in compliance with state statutes. He noted some differences between the UW System's GAAP and cash basis reporting, including the use of a strict June 30 cutoff, and unreported liabilities such as compensated absences. None of these differences have a large impact on the figures that the UW System reports.

d. Federal Relations Update

Margaret Lewis, Associate Vice President of University Relations, commented that a year and a half ago, a federal relations council recommended a more formal federal relations strategy, and suggested hiring a federal relations coordinator. Ms. Lewis introduced Kris Andrews, Federal Relations Coordinator, to report on the progress that has been made over the nine months since she was hired.

Ms. Andrews stated that the goal of the federal relations strategy is threefold:

- Increase the System's visibility in both the Congress and the federal agencies;
- Provide the delegation with a central contact, a common voice, and support for their work; and,
- Provide the System with the tools to annually articulate its goals, strengths and priorities.

Ms. Andrews noted four standards delineated to measure the success of the Systemwide federal relations effort:

- Level of support for research and education initiatives;
- Relations with the congressional delegation;
- Services provided to the delegation; and,
- The campus' perception of the benefits of this process.

Ms. Andrews commented that the new federal fiscal year started October 1st, and lawmakers have finished none of the 13 annual bills that keep agencies in business. Congress has approved two, short-term continuing resolutions. A continuing resolution is expected later this fall that will fund existing programs at their current rate, will not create any new programs, will contain no increases in spending, and will not contain extraneous provisions. Leadership on both sides are telling members to go home in October, claim credit for the work put into earmarks, and that there will either be separate appropriations bills passed or a comprehensive post-election continuing

resolution. There is strong sentiment to operate at 2002 levels and hold down federal spending for now.

Ms. Andrews noted that the *Chronicle of Higher Education* article, “Another Record Year for Academic Pork”, indicates, for fiscal year 2002, which ended September 30, that Congress directed federal agencies to award at least \$1.8 billion to projects involving specific universities and colleges. That total is \$169 million higher than last year’s, and a fivefold increase since 1996. Although Congress provided more earmarks, the median earmark actually decreased from \$625,000 to \$550,000. A record 668 institutions received earmarks, a 27% increase over the previous year. The main players helping Wisconsin on the appropriations committees are Congressman David Obey, the senior Democrat on the powerful House Appropriations Committee, and Senator Herb Kohl on the Senate Appropriations Committee. Most people expect the earmarking trend to continue next year and that, in turn, will limit the number of competitive grants available.

Ms. Andrews stated that in the federal grants arena, UW System institutions received \$920.5 million in gifts, grants and contracts for the fiscal year that ended June 30, 2002. That represented a \$53 million increase over 2000-2001, the largest amount generated by UW-Madison, which generates 95% of the research funding to the UW System. This past week, UW-Madison received a \$35 million grant for mathematics and science education, consistent with the Regents desire to enhance PK-12 education.

Ms. Andrews commented that the Academic Advanced Distributed Learning (ADL) Co-Lab was formed by the Department of Defense (DoD) to further education and training through technology that offers learning anytime and anywhere. The Co-Lab, headquartered at the University of Wisconsin-Extension, is testing the technology for use in academia. Working with Congresswoman Tammy Baldwin’s office, all members of the Wisconsin delegation sent a joint letter to Secretary Rumsfeld seeking DoD funding in fiscal year 2002. For fiscal year 2003, Senator Herb Kohl included \$1 million in federal funding in the DoD Appropriations Bill. The Wisconsin delegation has signed a joint letter to conferees urging that the Senate provision be maintained in the DoD conference report. President Lyall and Dr. Richard Carpenter, President of the Wisconsin Technical College System, also sent a joint letter to Congressman Obey requesting his assistance in maintaining the conference report language.

Ms. Andrews noted that a University Relations team led the effort to submit a proposal to address the healthcare workforce crisis using skills gap assessment and distributed learning technology. The proposal was built on some of the recommendations of the Governor’s Workforce Shortage Committee that addressed the labor shortage threatening the state’s health care industry. The team forwarded the proposal to the Department of Labor for funding consideration. If successful, the grant proposal, for approximately \$2 million per year for two years, will ensure that skills gaps are identified, and an educational process for incumbent workers to advance is quickly put into place.

Ms. Andrews stated that the Higher Education Community was successful in securing \$1 billion for the Pell Grant shortfall in the fiscal year 2002 supplemental. In fiscal year 2003, there is a discretionary spending difference of approximately \$3 million between the Senate and House versions of the fiscal year 2003 Labor, Health and Human Services Appropriations bill.

Ms. Andrews commented that Congress is on track to increase funding for the National Institutes of Health (NIH) by 15.7%. This completes a five-year drive to double the agency’s budget. Also, a \$614 million increase to the National Science Foundation (NSF) budget for fiscal year 2003, which, if ultimately enacted, would provide the agency \$5.4 billion – it’s largest budget ever. Increases in NIH and NSF agency budgets are important to Wisconsin, due to the fact that this is where the vast amount of research funds that come to the state originate.

Ms. Andrews noted that the Federal Relations Council has continued to meet, and it has been instrumental in establishing UW System appropriation priorities for 2003. The priorities include creating a task force focused on reauthorization of the Higher Education Act (scheduled for review in 2003), and working on a possible initiative to establish a “State of Wisconsin Federal Opportunities Grant Fund.”

Ms. Andrews stated that, over the past year, the effort to increase UW System's visibility has been expanded. Most UW System campuses have been visited, and presentations were made to statewide audiences, including continuing education deans, financial aid administrators, and grants administrators. Working relationships have been established with each office of the Wisconsin Congressional delegation, several federal agencies, and leadership in the House of Representatives and Education Committees. On February 26, 2003, the UW System will host a "UW Day in D.C." reception in the House of Representatives for Members of Congress, their staff, and UW Alumni who live and work in the greater metropolitan Washington D.C. area. Ms. Andrews formally invited members of the Board of Regents to attend.

Ms. Andrews commented on the challenges of federal relations relating to infrastructure. The UW System faces heightened regulations, especially for the conduct of research, greater demands for cost sharing, and a more competitive environment.

Ms. Andrews noted that a list of campus-by-campus goals and priorities for fiscal year 2004 is currently being compiled. The priorities will be shared with the Federal Relations Council at its meeting in November, and the UW System will define a set of three to four systemwide priorities.

Regent Krutsch noted that the trend seems to be moving towards earmarks over merit, which does not favor the UW System. Ms. Andrews noted that the UW System favors peer review and competition for grants, rather than earmarks, and it is unfortunate that, on a national level, the trend is moving toward earmarks.

e. Trust Funds Issues

(1) Introduction to Hedge Funds

Doug Hoerr, Assistant Trust Officer, gave a brief background on the possible use of hedge funds within the UW System endowment asset allocation. Mr. Hoerr introduced two speakers from JP Morgan Partners, Kathleen Riorda, Vice President, and Jason Ciaglo, Client Advisor, who were invited to give an educational presentation on the topic.

Ms. Riorda noted that the term "hedge fund" is not defined or used in the federal securities laws. The term refers to a variety of pooled investment vehicles loosely regulated and not registered under federal securities laws as public corporations, investment companies, or broker-dealers. Hedge funds differ substantially in their investment objectives, use of different financial instruments, exposure to various markets, and risk and return objectives. Hedge funds, in general, use leverage, use short sales to mitigate or increase risk, and use performance-based compensation schedules.

Ms. Riorda stated that the hedge fund industry has grown from \$50 billion to \$600 billion over the prior 12 years. A breakdown of investors shows that individuals account for 45% of hedge fund investors, endowments and foundations account for 11%, and fund of funds account for 12%. The primary advantage of hedge fund investing is portfolio diversification. Other benefits include an absolute return orientation, skills-based investment strategies, and more liquidity than many other alternative investments.

Ms. Riorda noted some keys risks in hedge funds including fund-specific risks and systematic risks. Fund-specific risks are the single most significant risk of hedge funds. The performance of hedge funds is largely dependent on manager specific skills, rather than broad exposure to a particular market. Also, hedge funds often use leverage, sometimes at significant levels, to enhance potential returns. Systematic risks include the fact that the hedge fund industry is largely unregulated with little or no public market coverage.

Regent Jones, noting the Board of Regents' fiduciary responsibility regarding the UW System endowment, asked how hedge fund managers report to their clients. Ms. Riorda stated that both quantitative reports, in the form of monthly net asset value reports of holdings, and qualitative reports are provided to clients. Mr. Hoerr commented that most hedge fund assets are composed of marketable securities.

Ms. Riorda noted that a diversified portfolio utilizing multiple managers and multiple strategies is recommended to reduce risk and volatility. Using multiple managers mitigates manager specific risk.

Ms. Riorda described the various hedge fund strategy classifications. These include long/short equities, distressed securities, relative value, merger arbitrage/event driven, opportunistic/global macro, and short selling classifications.

Ms. Riorda noted four critical factors for the successful implementation of a hedge fund investment program. The most important factor is 'best in class' manager sourcing and selection. Important points to consider include an analysis of the people, process, performance, portfolio, and the prospectuses of potential managers. The other critical success factors include a disciplined up-front, as well as ongoing, due diligence process, dynamic and ongoing portfolio management, and a multi-tiered risk management process.

(2) Report on 2002 Proxy Voting Season

Tom Reinders, Investment Analyst, briefly reported on the UW System Trust Funds 2002 proxy voting season.

(3) Briefing on Forum Issues

Mr. Hoerr and Mr. Reinders briefed the Committee on the relevant issues concerning the upcoming investment forum. Vice President Durcan noted that there is a broad perception in the student population that the UW System invests tuition dollars. The Committee should make it clear at the forum that these funds are not tuition dollars, and that the dollars are gifts from donors that have a specific purpose. Also, it is important that the Committee outlines the Board's policies and obligations regarding the UW System endowment. Regent Jones noted that the Committee should outline the policies and procedures that the UW System goes through before gifts are accepted and invested.

(4) Applied Security Analysis Program (ASAP)-Review of the Student-Managed Investment Fund

Ron Yates, Director, Office of Operations Review and Audit, introduced Mark Fedenia, Associate Professor, UW-Madison, and director of the Applied Security Analysis Program (ASAP). Mr. Yates noted that the Office of Operations Review and Audit analyzed the ASAP program to ensure that all Board of Regent policies and guidelines were being met. Regarding investment performance, during fiscal year 2001, the ASAP program outperformed their market index benchmark, but narrowly missed the Board's performance standards (index plus 0.75%). However, during the prior nine months, the ASAP program outperformed both performance standards. Mr. Yates stated that the Office made one recommendation, which is that the Board and ASAP put forth a memorandum of understanding regarding the educational objectives of the program.

Mr. Fedenia thanked the Board for endorsing the ASAP program, and noted that the program's performance this year has been very good because the program has a conservative investment strategy. The size of the programs allocation, only \$10 million, poses some challenges, such as needing to purchase odd lots frequently. However, the program is very important to both the students directly involved and the UW-Madison School of Business as a whole.

f. Committee Business

(1) Approval of the Minutes of the September 12, 2002 Meeting

Upon the motion of Regent Olivieri, and the second of Regent Krutsch, the minutes of the September 12, 2002, meeting of the Business and Finance Committee were approved as presented.

(2) Report on Using the Continuing Appropriation to Serve Adult Students

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

Resolution I.2.f.(2)

That, upon recommendation of the President of the University of Wisconsin System, the Board of Regents accepts the report on Cost Recovery Activity, Credit Enrollment and Unduplicated Student Headcount by Program and Age, 2001-02 Academic Year for submission to the Joint Committee on Finance.

(3) Acceptance of Bequests over \$50,000

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

Resolution I.2.f.(3)

That, upon the recommendation of the President of the University of Wisconsin System and the Chancellors of the benefiting University of Wisconsin institutions, the bequests detailed on the attached list be accepted for the purposes designated by the donors, or, where unrestricted by the donors, by the benefiting institution, and the Trust Officer or Assistant Trust Officers be authorized to sign receipts and do all things necessary to effect the transfers for the benefit of the University of Wisconsin.

Let it be herewith further resolved, that the President and Board of Regents of the University of Wisconsin System, the Chancellors of the benefiting University of Wisconsin institutions, and the Deans and Chairs of the benefiting Colleges and Departments express their sincere thanks and appreciation to the donors and their families for their tremendous generosity and devotion to the values and ideals represented by the University of Wisconsin System. These gifts will be used to sustain and further the quality and scholarship of the University and its students.

(4) Annual Gift- in-Kind Report

Vice President Durcan presented the annual report of gifts-in-kind, and the Committee accepted the report as presented.

g. Report of the Vice President

(1) Report on GPR Positions Created

Acting Associate Vice President for Budget Planning Freda Harris commented on the UW System report on GPR positions created. Ms. Harris noted that the report is required by statute to be presented to the Joint Committee of Finance and Department of Administration. Ms. Harris stated that the UW System created 88.95 GPR positions to accommodate an additional 1,800 students that were enrolled as a part of the Economic Stimulus Package requirement for the fall, 2002 semester. These positions were critical to UW System's ability to jump-start the Economic Stimulus Package.

Ms. Durcan stated that the UW System received notification that the insurance provided by National Guardian is being cancelled. National Guardian is too small to cover a catastrophic loss, and, as a result, is canceling the relationship. The fixed cost premium of the mandatory declining

term insurance is \$24, which has been the same rate since 1968. The contract with National Guardian will be in place for another year while UW System solicits for a replacement vendor.

Vice President Durcan noted that the Department of Administration is conducting a study on the availability of UW System building space that could be leased for satellite and telecommunications purposes. The UW System's position is that these are Board of Regent titled facilities, and the Board is entitled to the proceeds from these arrangements. The Board of Regents approved a lease arrangement for UW-Milwaukee last year for leasing rooftop space to four companies over twenty-five years. Other campuses either have these arrangements or are pursuing them.

Ms. Durcan alerted the Committee to the membership dues lapse of program revenue dollars to the general fund in the amount of \$300,000. The corresponding GPR share of this lapse was \$90,000.

Vice President Durcan made the Committee aware of a credit card billing error that has occurred on some UW System campuses where Taco Bell was listed as the vendor for tuition charges rather than the UW institution.

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

Regent Olivieri introduced a resolution that encourages more campuses to bring forward differential tuition programs and encourage campuses to use the flexibility to serve adult students. The UW-Eau Claire and UW-Whitewater programs are good examples for other campuses to pursue regarding alternative revenue and service providing programs.

Upon the motion of Regent Olivieri, and the second of Regent Krutsch, the Committee approved Resolution I.2.h.

Resolution I.2.h.

That, after reviewing differential tuition programs at UW-Whitewater and UW-Eau Claire and considering the educational quality enhancements and campus life benefits that students derive from differential tuition revenues, the Board of Regents strongly encourages students and institutions to consider and bring forth to the Board additional differential tuition initiatives.

And that, in keeping with the recommendations embodied in the Building Our Resources Base Report, the Board of Regents requests that institutions aggressively pursue the development and implementation of programming for nontraditional students that has strong market demand and that will be priced to cover, at minimum, its full cost.

The Business and Finance Committee adjourned at 4:50 p.m.


Eric Engbloom, Recording Secretary