

Minutes
Business and Finance Committee
Board of Regents of the University of Wisconsin System
September 12, 2002

The Business and Finance Committee met in joint session with the Physical Planning and Funding Committee at 1:03 p.m. Present were Regents Klauser, Olivieri, Jones, Krutsch, De Simone, Gracz, and Randall.

a. Program Review: Outsourcing Services at UW Institutions

Ron Yates, Director, Internal Audit, UW System stated that the Office of Internal Audit reviewed UW institutions' use of outsourcing contracts, outsourcing trends in higher education, and methods to improve how UW System and the institutions use outsourcing as a business practice. Outsourcing, also referred to as contracting out, refers to an institution's decision to contract with an external organization to provide a campus function or service. The review took place because outsourcing was viewed as a potential method to curb costs, and also because of the prevalence of outsourcing as a business practice in higher education.

Director Yates stated that higher education institutions operate in a highly competitive environment offering many services to students in direct competition with the private sector, including housing, food service, entertainment, and retail sales. Based on national surveys, the Office of Internal Audit found that educational institutions are contracting for a greater number of services. In 1999, 43.6 percent contracted for 5 or more services compared to 35.1 percent in 1997.

Mr. Yates noted some advantages typically associated with outsourcing. Outsourcing can result in added expertise (especially for information technology projects), achieving economies of scale, and reducing costs. Also, advantages include increasingly flexible staffing arrangements (seasonal work for lawn cutting or snow removal) and the added ability to raise capital for facility renovations.

Director Yates noted several disadvantages typically associated with outsourcing. Outsourcing can result in lower service quality. It can result in reduced collaboration between institution and vendor, such as a food service provider unwilling to provide late night hours during finals if it affects their profit. Outsourcing can result in a loss of in-house expertise, the loss of management expertise to properly monitor contracts, and less control over future cost increases. Finally, outsourcing can result in a loss of service continuity due to the transition caused by a change in contractors or contractor bankruptcies.

Mr. Yates commented that, nationally, some of the most commonly outsourced higher education services are waste removal, travel agencies, textbook publishing, vending, architectural services, amusement, banking, and food services. The least outsourced services include admissions, fund raising, financial aid, student unions and housing. Some high profile examples include: 1) George Mason University contracts over 50 campus services and operations with a value of \$30 million dollars including bookstore, dormitories, and parking; 2) The University of Texas System has outsourced on a limited basis student housing with estimated annual savings of \$500,000, and; 3) The University of Tennessee outsourced janitorial services with estimated annual savings of \$565,000.

Director Yates noted some examples of outsourcing failures in higher education. Student health services at Radford University, Western Kentucky University and Boise State University were outsourced, but failed when the contractor went out of business. Another failure was the University of Pennsylvania's contract with Trammell Crow, which privatized their property management functions. This contract was followed closely in the higher education community through extensive coverage by the Chronicle of Higher Education. In September, 1999, the headline in the Chronicle read: "A Vice-President from the Business World Brings a New Bottom Line to Penn". The article noted the millions of dollars saved, and how over 500 positions of 25,000 had been eliminated. In March and April, 2000, the headlines read: "U. of Pennsylvania Scales Back Outsourcing Agreement". Another article read, "How the U. of Pennsylvania Learned That Outsourcing Is No Panacea", "A lucrative and controversial deal fails to meet expectations".

Specifically, the articles noted that the contract was reduced from \$18 million annually to \$11 million among allegations that the trash cans didn't get emptied and the roofs still leaked. Finally, in September, 2002, the headline was "U. of Pennsylvania Ends Landmark Outsourcing Agreement".

Mr. Yates stated that in Wisconsin, each UW institution operates in a decentralized manner when deciding whether to outsource a particular service. Examples of UW institution outsourcing activities exist primarily in operational and auxiliary areas:

- Operational activities - UW-Eau Claire outsources fire protection maintenance because the technicians are required to be certified; several institutions outsource elevator maintenance; and all campuses except UW-Madison outsource solid waste removal services;
- Auxiliary activities – Several institutions outsource bookstore operations which provide technology upgrades, guaranteed income and improved level of service; other areas such as laundry and food services are outsourced.

Director Yates noted that there are factors unique to higher education, and the UW System specifically, to be considered when outsourcing services including:

- Mission - An institution's mission may take precedence over business decisions. For example, UW-Stout's food service is self-operated because it supports the restaurant and hotel management core academic program.
- Service Hours - Many UW campus facilities, such as residence halls and student unions, operate 24 hours a day, seven days a week.
- Academic Calendar - The business year for an institution revolves around an academic calendar, typically nine months with semester breaks. As a result, many service-oriented businesses are not accustomed to the reduced activity during the summer and holiday breaks, and are unable to be profitable in this environment.
- Societal Issues - Students, faculty, and academic staff often support goals that are contrary to those of outsourcing. Specifically, the campus community may be more conscious of larger social issues such as minority hiring or equal pay issues. For example, UW-Stevens Point contracted janitorial staff receives health benefits paid for by the institution, in part because of pressure brought by student groups on campus.
- Decision-Making Process - The tradition of shared governance in higher education may require a more extensive level of communication than for some governmental entities. For example, outsourcing a bookstore operation often requires the involvement of faculty, staff, and students.

Mr. Yates stated that, in addition to these concerns, UW institutions also face statutory and administrative obstacles in making decisions on outsourcing. First, funding sources are generally provided each year for increases in personnel costs, but not for supplies and expenses where contracts are paid from. This area is extremely important as increases to the supply and expense appropriations have not occurred for several years. Second, State agencies may not enter into contracts that are in conflict with collective bargaining agreements. Third, the Department of Administration guidelines require any service contract to be re-bid every five to seven years, which raises the potential of losing a good provider to a low bidder.

Director Yates noted that, despite the obstacles and concerns to higher education's use of outsourcing, its use as a business management practice continues to grow. In that context, the Office of Internal Audit recommends that the UW System Office of Procurement work on a more formal and regular basis with UW System groups and entities, such as chief business and student affairs officers, to provide a central forum for addressing outsourcing issues. Among the services the Office of Procurement could provide or coordinate are monitoring outsourcing developments at the state and federal level, developing model criteria or documentation for UW institutions to use to support a decision to outsource services,

discussing strategies for effective and consistent contract monitoring, expanding the use of joint purchasing agreements so UW institutions can better leverage down the cost of services, and expanding the use of collaborative agreements with other public or non-profit entities.

Regent Krutsch stated that outsourcing could be valuable to enhancing the academic mission of the UW System, as cost savings could be plowed back into the institutions' core programs and services.

Regent Klauser commented that the key to successful outsourcing is tight contract management. Institutions should be cautious when entering into outsourcing agreements, because short-term cost savings could lead to long-term losses in quality.

Regent Olivieri noted that, since each campus is unique, the Board should not hand down any steadfast policy on the issue. However, it may be beneficial for the Board to make a statement of general guidance regarding the use of outsourcing.

Ruth Anderson, Director of the UW System Office of Procurement, stated that her Office is developing a model of criteria to assist campuses in making outsourcing decisions. The model includes guidance in the analysis of hard and soft costs, an information database, and contract administration standards.

Upon the motion of Regent Randall and second of Regent Olivieri, the joint session adjourned at 1:42 p.m. The Business and Finance Committee reconvened at 1:44 p.m. Present were Regents Klauser, Olivieri, Jones, and Krutsch.

b. Committee Themes and Goals for 2002-03

Vice President for Finance Debbie Durcan noted four of the Business and Finance Committee themes and goals for 2002-03 based upon the discussion of the Regents' Retreat last month. The first goal is to implement the "Building Our Resource Base" recommendations, including federal fund raising, differential tuition, expanded investment earnings, and service based pricing. The second goal is to advocate and develop new initiatives for the 2003-05 Biennial Budget, including updates on the UW System budget status and pursuing a unified budget concept. The third theme is to review policies and procedures to ensure fiscal management and accountability, including the financial statements, financial management of auxiliaries, and fiscal elements of new programs. The final theme is to ensure stewardship responsibilities are fulfilled with respect to the UW System Trust Funds, including the annual investment forum and maximizing performance while minimizing risk.

Regent Krutsch noted that one of the Board's responsibilities is to ensure that the fiscal incentives that campuses receive should fit in line with Board priorities. For example, the Board priority of retention should be reflected in the fiscal incentives that campuses receive.

c. Building Our Resource Base Implementation Plan

Acting Associate Vice President for Budget Planning Freda Harris stated that, last year, the Board of Regents were presented with 25 options for increasing the revenue stream to support and maintain quality in the UW System. Of the 25 options presented, the Board decided to consider immediately implementing 10.5, make 6.5 a priority for study, and pilot one option before deciding whether to implement it on a systemwide basis.

Ms. Harris noted that action has been taken to implement all of the 10.5 items recommended for immediate consideration. The biennial budget request approved by the Board in August included statutory language and cost to continue initiatives. These initiatives would, if approved, allow the UW System to keep interest earnings on tuition revenue, support the development and operation of distance education programs, grant full authority to set resident undergraduate tuition which would allow the Board to begin reaching its goal of having resident undergraduate tuition be 95% of the peer midpoint, and, finally, expand the definition of cost to continue to include such core costs as libraries, supplies and expenses, preventive maintenance and information technology costs.

Acting Associate Vice President Harris stated that the Budget Reform Bill, Wisconsin Act 109, linked state increases for the university related portion of Wisconsin Higher Education Grants (WHEG) and the Lawton program to increases in tuition at the UW System.

Acting Associate Vice President Harris commented that UW System Administration has taken steps to implement the Board's recommendations. UW System has begun developing alternatives for investment of auxiliary funds in longer-term securities. UW System has hired a private consultant who developed a feasibility/marketing study on private fund raising. The System Federal Relations coordinator will be working with the Federal Funding Advisory Council of Chancellors to implement the plan. UW System has started discussions with the institutions about the development of more "corporate college" efforts, seeking to discover any barriers that need to be removed. A new corporate college effort is a program that begins this fall between UW-Whitewater and American Family Insurance. Finally, UW System has encouraged greater use of the differential tuition option to meet unfunded high priority needs.

Ms. Harris commented that the Board will receive reports on the progress of several items at future Committee meetings. First, the Federal Relations coordinator will report periodically to the Business and Finance Committee on progress made in attracting federal funds. Second, a report of service based pricing programs approved by the President of the UW System will be brought to the Board later this year, including enrollments in the programs. Third, the Board will receive a report on the progress of the Executive Group of Online Learning (EGOLL) in implementing its goals along with the annual report on Information Technology/Distance Education (the last report was in November 2001). Finally, the Board will receive reports on the initiatives and statutory language changes included in the biennial budget request.

Acting Associate Vice President Harris stated that, in regards to the progress of the 6.5 Items that were recommended for study and possible action, action has been deferred on seeking the ability to invest earnings for gifts, grants, contracts and federal indirect cost reimbursement funds due to the state's current fiscal situation. Action has also been deferred on seeking full cash management responsibilities for all Program Revenue operations. Institutions have indicated that there is no need to make changes to the flexibility to transfer or loan funds from auxiliary operations. UW System Administration will be proactive in reminding institutions that the authority is available. No proposals have been brought forward, although interest has been expressed, to allow professional schools to bring forward cohort tuition proposals, or to allow institutions to pilot a tuition differential or reduced rate for children of non-resident alumni. The biennial budget request submitted by the Board in August included a request to consolidate several appropriations and allow the UW System to submit its pay plan directly to The Joint Committee on Employment Relations (JCOER). UW System Administration will continue to study alternatives for reducing the processes in place for both compensation and the operating budget. Also, full Board discussion is planned for either November or December regarding financial and administrative strategies for decreasing total credits to degree.

Ms. Harris noted that the UW System was asked to evaluate existing per credit pilots and permit additional pilots under the current board review process. UW System will work with institutions interested in proposing a per credit tuition pilot, and will continue to monitor the effect of per credit tuition on revenue and student behavior in other states.

Regent Krutsch noted that the discussion should also include the important topic of time to degree. Student tuition is only one of the costs that students must pay. Other significant costs of living, such as room and board, are greatly affected by time to degree. Acting Associate Vice President Harris commented that the Board discussion from earlier this year looked at both time to degree, credit to degree, and graduation rates, to see how they interconnect. The upcoming report will reflect a comprehensive look at all these issues.

d. UW-Eau Claire Differential Tuition

Andrew Richards, Acting Assistant Vice President for Budget Planning, noted that this topic was for information only, and the Board was not being asked to take any action at this time. Mr. Richards

briefly explained the differential tuition policies of campuses around the UW System, including UW-Madison, UW-La Crosse, UW-Whitewater, UW-Stout, UW-Milwaukee and UW Colleges. UW-Eau Claire was the first campus to adopt a differential tuition program. It was approved in December, 1996, at a flat rate of \$50 per semester. The rate has not changed since it was implemented in the fall of 1997, and it is for undergraduate students only.

Donald Mash, Chancellor, UW-Eau Claire, noted that revenues generated through the differential tuition assessment were directed to improving the quality of the undergraduate experience for UW-Eau Claire students. The revenue generated from the program has been relatively constant at about \$1 million per year. Over the past two years, student leadership and campus administration have discussed the need to review the differential tuition rate and allocation plan. Students remain very committed to differential tuition because of the positive effect it has on their undergraduate experience. At its last meetings in the 2002 spring term, the Student Senate unanimously passed legislation to increase the rate over the next two years to bring the rate to \$65 by the spring, 2004 semester. Beginning with the 2004-05 academic year, the rate will increase by 4.5% annually.

Chancellor Mash introduced Craig Smith, a student active in the Student Senate at UW-Eau Claire, who helped draft the differential tuition proposal. Mr. Smith noted that UW-Eau Claire has special programs that are essential to the college experience. Programs such as service-learning, undergraduate student/faculty collaborative research, experience learning and internship programs are very important. The Student Senate's goal was to ensure that these programs are available to all UW-Eau Claire students in the future.

Regent Jones and Regent Klauser commended Chancellor Mash and Mr. Smith for the collaboration that occurred between UW-Eau Claire's administration and student body in the drafting of this proposal.

e. Stock Market Impact on Trust Funds, Foundations and Auxiliaries

Doug Hoerr, Assistant Trust Officer, stated that, behind the general decline in the stock market and the increased volatility in all capital markets, there has been a multitude of unusual events: the terrorist attacks and the on-going threat of more, corporate accounting fraud on a seemingly unprecedented level, record levels of corporate bankruptcy and credit deterioration, illiquidity in the corporate bond market, historically low interest rates, the bursting of the tech-bubble beginning in early 2000, and particular turmoil in the technology, telecommunications, energy, airline and travel industries due to many of the above events. The purpose of this discussion was to try to make the impacts of recent market turmoil a bit more tangible. In most cases, an exacting financial analysis was not undertaken to arrive at precise dollar impacts. However, averages and some broad assumptions were used to generate a reasonable feel for the overall impacts.

Assistant Trust Officer Hoerr stated that, currently, all auxiliary reserve assets are invested in the short-term, money market-like State Investment Fund (SIF). The historically low interest rate environment, particularly on the short end of the yield curve due to the weak economy and the Fed's aggressive rate reductions, has resulted in the SIF rate falling from 5% two years ago to only 1.75% today. It is estimated that up to \$5 million may need to be recovered in future rate increases in order to offset these lower interest earnings. Although, on a positive note, general inflation has fallen somewhat from levels of two years ago, real inflation-adjusted short-term returns are now virtually zero.

Mr. Hoerr noted the impact on specific holdings of the UW System Trust Funds Endowment and UW Foundations. Losses from holdings of companies involved in recent accounting scandals and other corporate malfeasance resulted in \$1.6 million realized losses for UW System Trust Funds, an estimated \$3.2 million in realized losses for UW-Madison Foundation's Endowment, and an estimated \$1.2 million in realized losses for other UW-related Foundations. This totaled an estimated \$6 million, or 0.5%, in losses as a percentage of total assets.

Regent Vice President Marcovich joined the Business and Finance Committee meeting at this time.

Assistant Trust Officer Hoerr stated that most of the UW's endowments and foundations pay out a set distribution rate as a percent of average fund market value over the prior 3 years (generally 4% to 5%). This acts to greatly smooth out the variability of annual distributions and makes spending levels more predictable. However, the high or peak market values experienced by these funds prior to the huge market declines beginning in early 2000, have continued to factor into the average market value used for calculating distributions. As these peak values drop out and the much lower market values begin to dominate, reductions in current levels of support can be expected over the coming years. Although new contributions can mitigate some of this as lower market values become more dominant, levels of support will certainly be less than they would otherwise have been. UW Trust Funds ran some projections of how these declines will likely impact the current level of support being provided by the Trust Funds Endowment (which was \$13.4 million for the year ended 6/30/02). The primary assumptions were the following: new gift levels will continue past trends, annual investment returns going forward will average 9%, and a 5% distribution rate will continue. The results are a change from current support levels of -3% in fiscal year 2003, -10% in year 2004, -13% in year 2005, -10% in year 2006, and -3% in year 2007.

Assistant Trust Officer Hoerr commented that these percent declines in nominal levels of support from the UW System Trust Funds Endowment will not have a huge dollar impact on the UW System. However, assuming similar experiences at the foundations, and considering that total annual support from all endowments/foundations is currently about \$100 million, the dollar impacts will likely be significant.

f. Committee Business

(1) Approval of the Minutes of the June 6, 2002 Meeting

Upon the motion of Regent Jones and the second of Regent Krutsch, the minutes of the June 6, 2002, meeting of the Business and Finance Committee were approved as presented.

(2) Auxiliary Reserves Report to Joint Finance

Doug Hendrix, Associate Vice President for Financial Administration, reported that, as required by law, a letter on planned auxiliary reserves is being sent to the Joint Finance Committee. The Joint Finance Committee must approve any reserves that exceed 15% of prior year revenues for student fee funded auxiliary operations. Nine UW institutions have planned reserves that exceed this reporting threshold by a collective total of \$2.1 million. Total planned reserves for all institutions were \$43.6 million, which is \$4 million less than planned reserves for fiscal year 2002.

Regent Klauser asked what types of projects use the balances in these reserves. Associate Vice President Hendrix noted that the reserves have many uses, including housing, food service, and segregated fee operations. Three institutions that exceeded the reporting threshold have a significant immediate need for the reserves. For example, UW-River Falls is building a new residence hall and student center.

(3) Contract with Learfield Communications

Vince Sweeney, Associate Director of Athletics, UW-Madison, noted that the contract with Learfield Communications is for the exclusive multi-media rights of the UW-Madison Division of Intercollegiate Athletics. The Athletic Department has both outsourced and used in-house resources for multi-media projects in the past. The Division examined a variety of options, including: 1) Continue to move forward with its current, segmented approach; 2) Consolidate all the marketing and media rights opportunities and manage those rights internally, and; 3) Consolidate all the marketing and media rights opportunities and outsource the management of those rights. It was decided that the Division of Intercollegiate Athletics should receive bids from outside sources. Six companies submitted a bid. Three companies were asked to present their proposal, and the Committee is being asked to approve a contract

with Learfield Communications. Learfield Communications provides incremental economic benefits over the period of the contract, and a variety of advertising benefits to promote UW-Madison athletics.

Regent Krutsch asked about the Board of Regents role in these types of contracts for the Division of Intercollegiate Athletics. Vice President Durcan noted that all contracts with private profit making organizations in excess of \$500,000 require formal acceptance by the Board prior to approval. This applies to all UW organizational units, and not just the Division of Intercollegiate Athletics. This contract met that dollar threshold. Mr. Sweeney noted that all contracts for the Division of Intercollegiate Athletics go before the Athletic Board. Vice Chancellor Torphy noted that the Athletic Board reports to the UW-Madison Chancellor, who in turn reports to the President of UW System and ultimately the Board of Regents.

Regent Olivieri, noting that some projects are currently completed using in-house resources, asked whether any positions would be displaced as a result of the contract with Learfield Communications. Mr. Sweeney responded that this contract was part of an overall reorganization of their external relation function. There will be a 2.5 full-time employee reduction. However, the reduction will be accomplished through attrition, and not through layoffs.

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

Resolution I.2.f.(3)

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 Learfield Communications.

Regent Vice President Marcovich left the Business and Finance Committee meeting at this time.

(4) Report on Base Salary Adjustments to Recognize Competitive Factors

Acting Associate Vice President Harris noted that Wisconsin Statutes allow the UW System to grant salary increases to faculty and academic staff to recognize competitive factors. State statutes also provides that, no later than October 1 of each year, the Board of Regents shall report to the Joint Committee on Finance and the Departments of Administration and Employment Relations concerning the amount of such pay increases granted, and the institutions at which they are granted for the 12-month period ending on the preceding June 30.

Ms. Harris stated that a total of 511 individuals at 10 institutions received \$1,354,886 for normal equity and retention issues in 2001-02. By comparison, there were a total of 93 individuals at 7 institutions receiving \$762,336 in 2000-01. The large increase in the number of individuals receiving adjustments this year was due largely to Phase III of UW Colleges' Salary Improvement Plan. This plan addresses long-term salary compression and market issues through a phased-in compensation plan that will affect many individuals employed by Colleges. It increases the salaries of those Colleges' employees who are currently being paid below their market peers, in an effort to pay them a more comparable market rate over the course of a number of years.

Regent Krutsch asked which peers were used to compare salaries for the UW Colleges. Steve Wildeck, Assistant Chancellor of the UW Colleges, noted that the plan was established and implemented by the Senate Budget Committee, comprised of senators from UW Colleges' faculty and academic staff, after a study was completed comparing UW Colleges salaries to the average salaries at the comprehensive institutions. The goal was to make up 50% of the difference over a four-step process. This was dependant upon enrollment at UW Colleges, and if enrollment requirements are not met, the salary adjustments are not made. Regent Krutsch noted that she was unaware of other state university systems' comparing four-year and two-year campuses for salary considerations. Associate Vice President for Human Resources George Brooks commented that the UW Colleges are unique, and have no peers for salary comparison. The UW

Colleges are not a community or technical college, and should not be compared against them. UW Colleges analyzed salaries in light of internal equity within the UW System. Assistant Chancellor Wildeck noted that UW Colleges has no plans to make up the whole difference between UW Colleges and the comprehensive institutions' salaries, and the plan is only to make up 50% of the gap phased in over the course of four installments.

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

Resolution I.2.f.(4)

That, upon the recommendation of the President of the University of Wisconsin System, the Report on 2001-02 Base Salary Adjustments to Recognize Competitive Factors Required by Section 36.09(1)(j), Wisconsin Statutes, be accepted for transmittal to State Officials.

(5) 4th Quarter Gifts, Grants and Contracts

Vice President Durcan gave a brief summary of gifts, grants and contracts awarded to the institutions of the UW System for the twelve-month period ended June 30, 2002. Total gifts, grants and contracts for this period were \$920.5 million, an increase of \$53.1 million from the comparable period of the previous fiscal year. Federal awards increased \$75.7 million while non-Federal awards decreased \$22.6 million. Compared to the previous fiscal year, Federal awards increased significantly in Research (\$55.4 million), Student Aid (\$13.7 million), Instruction (\$6.0 million) and Miscellaneous (\$2.1 million). The one category with a significant decrease was Physical Plant (\$2.1 million).

g. Trust Funds Issues

(1) Asset Allocation and Spending Plan Review

Assistant Trust Officer Hoerr noted that the single most significant decision in the investment process is that of asset allocation; that is, deciding how assets are to be allocated among the major investment categories (or asset classes). Studies indicate that well over 90 percent of a portfolio's return can be explained simply by its asset allocation.

Mr. Hoerr stated that forward-looking capital market assumptions are essential in determining what portfolios will exhibit desirable risk/return profiles. These assumptions are also the key inputs to "mean-variance optimization." The assumptions are: (1) expected returns; (2) standard deviations, and; (3) correlations.

Assistant Trust Officer Hoerr noted that, in addition to looking at purely quantitative or probabilistic measures of risk, UW System Trust Funds must also look at more qualitative indicators of risk tolerance. For the Principal Long-Term Fund, the indicators that need to be considered when conducting an asset allocation study include investment horizon, fund size, dependence on distributions, and exposure to variability.

Mr. Hoerr presented an analysis of the UW System Trust Funds asset allocation. Six asset class allocation scenarios were given, and risk and return estimates were provided for each scenario. He stated that the asset allocation analyses indicate that a reasonable target rate of return for the Long-Term Fund, using some additional asset classes, while keeping risk at currently reasonable levels, would be 9.5 percent. Providing a residual net real return of 1.0 percent, our previous target, would suggest a spending rate of 4.6%. The spending rate is now at 5.0 percent. Although the National Association of College and University Business Officers' (NACUBO) most recent Endowment Study indicated that the average annual spending rate for all institutions was 5.0 percent as of June 30, 2001, it noted that larger endowments have smaller spending rates. For those with assets between \$100-\$500 million, the average was 4.8 percent; for

those between \$501 million-\$1.0 billion, it was 4.75 percent, and; for those greater than \$1.0 billion, it was 4.0 percent (the UW-Madison Foundation reports that they currently use 4.75 percent).

Assistant Trust Officer Hoerr stated the following recommendations and action steps:

- No immediate change to the current asset allocation, but further analysis will be conducted on potential new asset classes.
- A reduction in the spending rate from 5.0 percent to 4.75 percent is recommended at this time, with eventual consideration of a further reduction to 4.5 percent at the time of the final asset allocation review or next year.

Mr. Hoerr noted that the preparation stages of the investment manager search process for all current manager mandates will begin this fall. It is expected that this process will also involve searches for managers in approved new asset classes as well. As discussed with the Committee previously, all current manager contracts expire on October 31, 2002. It is anticipated that the Committee will be asked for approval to extend these contracts through June 30, 2003. New contracts would then begin July 1, 2003 and be open-ended. All major asset class and manager allocation shifts would be completed on or about July 1, 2003.

Regent Olivieri noted that it would be preferable to revisit the spending policy after the Committee makes a final recommendation on asset allocation. An adjustment to the spending policy may be prudent, but the Committee should make that decision after further discussions on asset allocation and achievable returns are held at the December meeting.

Upon the recommendation of Regent Olivieri, and the consensus of the Committee, Resolution I.2.g.(1), reducing the spending rate from 5.0 percent to 4.75 percent, was deferred to the December meeting, when the Committee will also review the UW System Trust Funds final asset allocation recommendations.

h. Report of the Vice President

Vice President Durcan asked Director Yates to update the Committee on the types of audits currently being conducted at the institutions that relate to ensuring fiscal integrity. The UW System and the institutions identified six "core audit areas." The institution auditors decide the frequency and scope of audits in these areas. The areas are: cash handling, payroll/personnel, property control, auxiliary operations, tuition and segregated fees, and major systems. Director Yates noted that 70% of reported audit activity at the UW institutions was in these core audit areas. The remaining 30% of audit activity was in other areas, such as conducting various monitoring activities, reviewing complaints, or conducting training.

Regent Krutsch asked what other state bodies perform audits, and whether those organizations could provide audit services for the UW System. Director Yates responded that the Legislative Audit Bureau (LAB) performs financial and federal compliance audits of the UW System. Also, LAB has just begun an audit of state agency procurement card usage that will include the UW System. Regent Olivieri asked about the UW System audit, and whether there are policies and standards for the institutions to follow regarding these audits. Director Yates responded that LAB audits the UW System annually. LAB does not verify each individual campus's financial figures by going to each campus, but looks at the UW System as a whole in its audit.

Vice President Durcan noted that the UW System assessment of the statewide Shared Human Resources System (SHRS) dropped by 50%. SHRS is the on-line job application and testing system. The assessment, based upon the number of classified employees that the UW System has (22.53% of the statewide total), fell from \$153,000 to \$76,000. She then alerted the Committee to the significant increase in property insurance premiums that UW System institutions will be facing. Premiums will increase from \$600,000 to \$1.9 million in fiscal year 2004. This increase has gone into effect for fiscal year 2003, but DOA is spending down reserves to delay the impact on State agencies. There are several challenging

contractual issues related to our insurance coverage, and Senior Vice President David Olien plans to review this with the Committee in closed session next month.

Senior Vice President Olien updated the Committee on the potential hazard of employee and student driven 15 passenger vans. He noted the policy changes that were immediately put into place, including a ban on drivers under the age of 25. Exceptions to this policy must be submitted in writing by the institution's Chancellor. Senior Vice President Olien noted that safety is a paramount concern for University students and employees.

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

No additional items were presented to the Committee.

j. 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 Jones, the Business and Finance Committee adjourned to Closed Session at 3:36 p.m. Present were Regents Klauser, Olivieri, Jones, and Krutsch.

The Business and Finance Committee adjourned at 4:04 p.m.


Eric Engbloom, Recording Secretary