Minutes
Business and Finance Committee
Board of Regents of the University of Wisconsin System
March 10, 2005

The Business and Finance Committee met in Joint Session with the Physical Planning and Funding Committee at 1:56 p.m. in room 1920 Van Hise Hall, UW-Madison, to discuss the report on energy efficiency pilot projects. The minutes of this discussion are detailed in the minutes of the Physical Planning and Funding Committee.

The Joint Session with the Physical Planning and Funding Committee adjourned at 2:06 p.m.

The Business and Finance Committee reconvened at 2:08 p.m. in room 1920 Van Hise Hall, UW-Madison. Present were Regents Bradley, Pruitt, and Rosenzweig.

a. Approval of Minutes of the February 10, 2005 meeting of the Business and Finance Committee

Upon the motion of Regent Rosenzweig, and the second of Regent Pruitt, the minutes of the February 10, 2005, meeting of the Business and Finance Committee were approved as presented.

b. Annual Budget Decision Rules

Associate Vice President Freda Harris reported that the budget decision rules represent the start of the annual budget process which will culminate in Board action on the UW System annual budget at the July meeting. The decision rules include the principles which will be used to allocate new funding and budget reductions to the current base to the institutions once the Legislature completes budget action.

Ms. Harris stated that the decision rules are based on the Governor's recommendations for the next biennium. It is likely that the final Legislative budget will have changes, so the decision rules are only preliminary. Any changes of substance will be brought back as part of the Board's annual budget action. Items that are not funded until the second year of the biennium are not being allocated and will be brought forward in next year's decision rules.

Associate Vice President Harris noted that the distribution of the new funding items and budget reductions were discussed at a meeting of the Chief Business Officers (CBO's) of the UW System institutions. The CBO's were then asked to provide their input to the Chancellors. The Chancellors agreed to forward the decision items to the Board.

Ms. Harris remarked that there are two new funding items to be distributed this year. First, $2.5 million of funding provided for retention of high demand faculty. As previously discussed, faculty retention is an issue at all UW System institutions, so it is recommended that this funding be distributed based on each institution's share of GPR/Fee faculty full-time equivalent positions (FTE). Second, $1.5 million of funding provided for Alzheimer's research would be provided to UW-Madison.

Regent Bradley asked whether all CBO's and Chancellors agree with these decision rules. Associate Vice President Harris noted that the budget decision rules have been recommended by President Reilly in consultation and agreement with the Chancellors.

Ms. Harris commented that all of the financial aid funds will be distributed based on each institution's proportion of a three-year rolling average headcount of students of color. The funding for utilities will be distributed based on 2003-04 actual expenditures. The student technology fee funds will be distributed proportional to the 2004-05 combined academic year and summer session fee budgets, excluding the student technology fee.

Associate Vice President Harris described the distribution of the 2005-06 base reductions for the UW System. There is a $15 million administrative reduction in 2005-06, which will increase to $20 million in 2006-07. There is a $5 million ongoing procurement savings reduction which the Governor expects to be generated from new procurement contracts and initiatives. Since these contracts have not been issued, the institutions were nervous about assuming that savings would occur, especially in the first year of the biennium. As such they are treating the $5 million as a cut. Also, there are enterprise savings of $20 million targeted as a one-time asset management reduction. The asset management reduction is a way of generating additional revenues to offset increased expenditures. Again, the institutions were uncomfortable with assuming that $20 million could be generated in the 2005-06 year. The institutions suggested that $10 million of the reduction be held centrally for systemwide asset management efforts, and the other $10 million be distributed as a one time budget reduction. The $15 million administrative reduction, the $10 million of institutional asset management reduction, and the $5 million procurement reduction are all distributed based upon each institution's share of the UW System's 2004-05 GPR/Fee budget, excluding debt service, utilities, financial aid, separately budgeted academic tuition, and Extension credit programs.

Ms. Harris noted that, in addition, the administrative savings require a 200 full-time equivalent employee reduction in 2005-06. The positions are not being allocated out to institutions. The institutions will reduce positions as needed to meet the $15 million reduction requirement. The plan also says that the reductions will be managed using the following principles:

- Faculty and Instructional Academic Staff positions will not be reduced as part of the Administrative savings;
- Budget reductions should first target administrative expenses that are least related to serving students, meeting legal accountability responsibilities, achieving Plan 2008 Goals, and providing opportunities to generate (non-GPR) revenues; and,
- One-time reduction opportunities should be considered in the short term to give Provosts and Chancellors time to plan more permanent modifications including changes to program array.

President Reilly reported that, in the past, Regents have raised the question of why the base reallocations are distributed across the board rather than using a more targeted methodology. Allocation methodologies for items that are new initiatives may be modified in 2006-07 if a year's experience provides more appropriate criteria; however, funding for 2005-06 will be allocated in the same manner as in prior years.

President Reilly indicated that there are two efforts under way that could influence allocations in the future: 1) the Integrated Planning Working Group will be looking at alternative institutional funding models; and, 2) a group of Chief Business Officers and Provosts are reviewing administrative functions, including those that are performed by System Administration and those performed by the campuses. These groups will report back on their findings later this year, and these findings will be presented to the Board with the expectation that changes to the allocation method will take place in the second year of the biennium. Therefore, the decision rules that the Board is approving are effective for the first year of the biennium only.

Regent Pruitt asked about the faculty retention funding formula, and whether other funding models were considered for the doctoral and comprehensive institutions to facilitate more systemwide competitiveness. Associate Vice President Harris noted that the CBO's discussed various funding models at length; however, $2.5 million will not go a long way towards faculty retention. The CBO's recommended using the GPR/Fees faculty (FTE) funding method since it captures the potential number of people that each campus needs to retain.

Regent Bradley asked for examples of asset management saving initiatives. Ms. Harris commented that an example would be an item that could be sold or leased that generates revenue streams such as parking lots or power plants. Institutions could also hold current position vacancies open to meet the one-time reduction.

Regent Rosenzweig asked whether the Governor's budget encouraged the institutions to develop more creative saving initiatives. Associate Vice President Harris stated that the institutions are identifying areas where they can cut back; however, differences among the institutions provide opportunities in different areas. For example, differences in campus property give some institutions more opportunities to target savings through parking initiatives. Institutions are being very proactive in targeting areas for savings.

Regent Rosenzweig asked whether the UW System will continue to have a utilities shortfall in the future. Vice President Durcan stated that the Governor's budget should sufficiently address the utilities funding going forward, but does not include funding for the current year's shortfall. Although it is difficult to predict, once the UW System gets through this year, there is not expected to be a continuing problem in the future.

Upon the motion of Regent Pruitt, and the second of Regent Rosenzweig, the Committee approved Resolution I.2.b.

Resolution I.2.b.

That, upon recommendation of the President of the University of Wisconsin System, the Board of Regents approves the 2005-06 annual budget allocation decision rules. If subsequent legislative action modifies either the first year funding increases or reductions noted in the rules, the UW System would distribute the changes according to the principles set forth in Sections I and III.

c. Business of the Committee

(1) UW-Madison: Consideration of a proposed sponsorship agreement with adidas Promotional Retail Operations, Inc.

UW-Madison Vice Chancellor Darrell Bazzell stated that UW-Madison seeks to enter into a new agreement with adidas for the purpose of securing apparel and equipment for its intercollegiate athletic teams. Since June, 2001, UW-Madison has had a similar agreement with adidas. The term of the proposed agreement would be six years. The first year of the proposed agreement would replace the last year of the current agreement, with an additional five years to follow.

Mr. Bazzell reported on some of the details of the agreement. In the proposed agreement, the amount of the annual compensation begins at $900,000 and increases incrementally to $950,000 in the sixth year. In addition, the UW-Madison Division of Intercollegiate Athletics would be eligible to receive annual bonus compensation based on the overall performance of the university's athletic teams that amounts to $275,000 in the first year, and increases incrementally to $400,000 in the sixth year.

Vice Chancellor Bazzell remarked that, if requested to do so by adidas, UW-Madison Division of Intercollegiate Athletics coaches would continue to make a limited number of appearances in connection with the advertisement, promotion, and sale of adidas products. Also, UW-Madison would continue to provide to adidas certain specified tickets, parking passes, sponsorship opportunities, and support for special events. The annual direct cost associated with this is approximately $65,000.

Regent Rosenzweig asked how this contract compares with sponsorship agreements of other institutions. Vice Chancellor Bazzell noted that four other institutions have contracts with adidas: the Universities of Tennessee, Nebraska, California-Los Angeles, and Notre Dame; however, the contract value is difficult to compare to other institutions. It would be valued below sponsorship agreements of the University of Michigan and The Ohio State University, and be positioned in the same tier as Pennsylvania State University.

Regent Pruitt asked why other vendors, such as Reebok or other competing shoe companies were not chosen. Mr. Bazzell noted that in 1996, UW-Madison had a favorable contract with Reebok; however, during the term of the contract, the Division of Intercollegiate Athletics experienced problems with their quality and responsiveness to UW-Madison's needs. In addition, Reebok is currently focusing on professional athletics. Finally, Nike could not meet UW-Madison's agreement requirements, especially concerning facilities disclosure.

Regent Bradley stated that the contract should explicitly state that the UW-Madison has the right to terminate the contract if adidas refuses to adhere to the university's code of conduct, refuses UW-Madison's request to inspect adidas' records, or engages in violations of human rights. Casey Nagy, Executive Assistant to UW-Madison Chancellor John Wiley, noted that there is a mutual cooperation clause in the contract, which allows the parties to seek amicable solutions to any disagreements arising between the two parties. Either party can terminate the agreement if there is a material breach of the contract. Also, there is a clause stating that the understanding between the parties includes the Collegiate Licensing Company (CLC) Special Agreement Regarding Labor Codes of Conduct. Any violation of the CLC agreement would result in a material breach of the contract.

Liana Dalton, University of Wisconsin Labor and Licensing Policy Committee (LLPC) member and a UW-Madison junior, expressed her concern that, as an institution of intellectual and moral integrity, the University of Wisconsin (UW) has a commitment to ensuring that UW apparel is not made in sweatshops. However, the reality is that workers' fundamental human rights are systematically violated on a daily basis in the name of this institution. The LLPC is deeply disturbed that the negotiations with adidas have seemingly taken place without consideration for labor rights. The contract should only be renewed after this issue is made a pivotal element of the discussion.

Ms. Dalton commented that UW-Madison requires all licensees to disclose the wages of their factories' laborers in hopes of monitoring working conditions. The LLPC works with the independent monitoring organization, the Workers' Rights Consortium, to ensure that the university's code of conduct is being enforced. adidas should be reporting wage data; however, adidas has not cooperated with all open records requests. This has not come to the level of dropping the agreement with adidas, but the university has an obligation to ensure that companies are not putting profits over people.

Ms. Dalton reported that an adidas factory in Indonesia recently shut down and moved to China, a country that does not legally protect the freedom of association. Freedom of association is a human right as declared by the United Nations declaration of human rights, and is an integral part of the university's code of conduct. Moving a factory to a country such as this prevents any meaningful enforcement of the university's code of conduct. As a result of the move, 1,000 Indonesian workers lost their jobs. It was only through student and university action that adidas settled with workers for slightly higher than the legally mandated severance.

Ms. Dalton pointed out that a clause in the contract affirms that adidas will keep the university continually informed of all facilities involved in the production of goods for the university, whether the involved facilities work directly with university logos and marks or with blank materials intended for future application of university logos and marks. The wording does not state that one specific individual; rather the university will be informed, meaning that this information should be made public, since UW-Madison is a public institution.

Ms. Dalton remarked that it is not sufficient to rely on adidas to be their own enforcement mechanism. The university should have clear enforcement mechanisms in place to put pressure on corporations to be more transparent. UW-Madison owes this to the workers who produce UW clothing.

Regent Bradley, noting that companies need a certain level of confidentiality, asked whether wage rates are included in the university's access to inspection and monitoring reports for all facilities producing goods for the university. Mr. Nagy stated that adidas agreed to give complete and unfettered access to their records, including wage rates, to a designated university official. This is an extraordinary level of access and compliance with university requests.

Regent Bradley asked that any violation of the UW-Madison's code of conduct be brought to the attention of the Committee. Vice Chancellor Darrell Bazzell reported that the Business and Finance Committee would be notified of any ongoing concerns throughout the term of the contract, especially any violations of the university's code of conduct.

Upon the motion of Regent Rosenzweig, and the second of Regent Pruitt, the Committee approved Resolution I.2.c.(1).

Resolution I.2.c.(1)

Chancellor of the University of Wisconsin-Madison, the Board of Regents accepts the Sponsorship Agreement with adidas Promotional Retail Operations, Inc. which will provide, among other things, shoes, equipment, and apparel to the University of Wisconsin-Madison intercollegiate athletic teams, certain cash compensation, and enhanced licensing opportunities.

d. Trust Funds

The Committee agreed to revise the order of the agenda items.

(3) Socially Responsible Aspects of Timber Investing – Conference Call at 2:30 with Grantham, Mayo, Van Ottorloo & Co. LLC (GMO)

Regent Bradley commented that last month, Assistant Trust Officer Doug Hoerr briefed the Committee on timber as a potential new asset class for allocation. The Committee expressed concerns that timber investments could be sold to companies that would harvest the timber in an environmentally unsound way. The Committee would need to be assured that companies apply due diligence to prevent this from occurring if UW System Trust Funds were to invest in timber.

Eva Greger, Managing Partner of GMO's Renewable Resources Group, reported that managed timber has historically provided a real annual rate of return of about 8% over a seven year typical holding period. Timber must provide a real return because it is an illiquid asset class. Due to Generally Accepted Accounting Principles (GAAP), it is not possible to record an increase in value until the timber is cut. Therefore, investing in younger timber forests do not regularly contribute to quarterly income. The major reason that institutions invest in timber is to diversify their portfolio. Occasionally, GMO will sell the timber and land, and the value per unit increases rapidly as the diameter of the trees increases.

Regent Bradley asked if GMO oversees the harvesting decisions, and asked about GMO's policy on reseeding or replanting after harvesting. Ms. Greger noted that in almost all cases, GMO replants, which is good forestry practice, and also in accordance with most timber locations' laws. For the most part, GMO's strategy is to hold and grow timberland investments, and sell the land and timber together.

Ms. Greger commented on timberland investment risks. Risk of fire, ice and pests is relatively low because most timber investments are young trees and properties are closely managed; physical losses average less than one half of one percent loss, and are rare in good growing regions. The real risk is up front at the point of acquisition. High quality information is essential, and overbidding to invest quickly generally reduces returns.

Ms. Greger remarked on state regulations, noting that their timber funds operate in seventeen states and three foreign countries, with differing levels of environmental regulation. For example, the State of Washington has regulations regarding harvesting permits, reforestation rules, and limitations on clearcuts, whereas the State of Texas has very limited regulations.

Ms. Greger noted that GMO often partner with conservation groups, where these groups participate in the timberland purchase either through an allocation of acres or land rights such as environmental easements. Two examples of these are the Cumberland Plateau in the State of Tennessee, and the Tug Hill Plateau in New York. Environmental easements are a permanent restriction on land use. They typically limit the building of subdivisions and limit uses of the land for purposes other than forestry. Easements may include forest management standards, and are meant to ensure protection beyond the life of the fund.

Ray Guries, Chair of the Department of Forest Ecology at UW-Madison, asked why GMO does not pursue certification of timberland investments. Ms. Greger noted that there is little premium in certified versus non-certified timber. There are times when GMO pursues certification; however, the cost associated with certification is the main reason why GMO does not always pursue it, especially where risks are low. Professor Guries offered a caution to the Committee that certification could satisfy questions about the Board of Regents' fiduciary responsibility, as well as environmental stewardship regarding timberland investments.

(1) Annual Trust Funds Proxy Season Report

Assistant Trust Officer Hoerr reported that most of the non-routine shareholder proposals that will be up for voting at the 2005 annual meetings of companies that the UW System holds stock involve issues of social responsibility. The Trust Funds Office is asking for approval to vote in the affirmative for those 2005 proposals related to the 20 issues previously reviewed with the Committee. The Office is also asking for approval to vote in the affirmative on one new issue: Report on Animal Welfare Standards. Specifically, the

Office recommends voting in the affirmative for proposals asking companies to review or report on animal treatment practices, including slaughter methods. However, the Office does not recommend automatically voting for proposals asking companies, such as pharmaceutical companies, to cease animal testing, but rather to consider these on a case-by-case basis.

Upon the motion of Regent Pruitt, and the second of Regent Bradley, the Committee approved Resolution I.2.d.(1).

Resolution I.2.d.(1)

That, upon recommendation of the President of the University of Wisconsin System, the non-routine shareholder proxy proposals for UW System Trust Funds, as presented in the attachment, is voted in the affirmative.

(2) Annual Endowment Benchmarking Report

Assistant Trust Officer Doug Hoerr reported on the annual endowment benchmarking report prepared by the National Association of College and University Business Officers (NACUBO). Mr. Hoerr noted that some university systems combine their foundation and university-controlled endowments for reporting purposes, where there are both, and others report them separately. UW System Trust Funds are reported on a stand-alone basis. UW System Trust Funds' true endowment, the Long Term Fund only, was valued at $276 million as of June 30, 2004.

Mr. Hoerr commented on key findings that have been consistent over the past few years. UW System Trust Funds returns were above the NACUBO peer average in 2004 and equaled the Big 10 institutions' average. Over longer periods of time, returns are in line with peer averages, to slightly below, and differences are most likely due to differing asset allocations. The biggest difference in asset allocation is the UW System endowment's underweight to alternative asset classes. For endowments with total assets of $100-500 million, the alternative asset class represented 17.2%, and for endowments greater the $1 billion, it represented 35.2%; the largest single alternative asset class was hedge funds, which represented 10.0% and 20.2%, respectively. The UW System currently has only 1% in alternatives, but more is being targeted.

(4) Introduction to Real Asset Classes: Commodities and Real Estate

Assistant Trust Officer Hoerr led a brief introductory discussion on commodities with the Committee, and noted that an upcoming asset allocation study may recommend that a small portion of the Long Term Fund be invested in this asset class. A passive investment in an index of commodity futures is a viable means to gain exposure to commodities as a broad asset class. If an index were the means of investing in this asset class, it could be done in-house or possibly through the Applied Securities and Analysis Program (ASAP) at the UW-Madison Graduate School of Business.

e. Report of the Vice President

Vice President Debbie Durcan reported that the Provosts and Chief Business Officers met jointly last month to develop guiding principles and identify major areas for further study in leading to a systemwide administrative cost reduction plan.

Ms. Durcan remarked that the group brainstormed specific ideas for cost reductions ranging from adopting a common academic calendar to regionalizing the internal audit function to centralizing admissions. Seven work groups, including both System Administration and campus staff, are being formed to further develop cost saving proposals in targeted areas. Work groups will be established for each of these seven areas:

- Regulatory Flexibility;

- Staffing and Hiring Practices;
- Academic Programming;
- Regional Consolidation;
- Operational Efficiencies and Outsourcing;
- System Consolidation; and,
- Technological Efficiencies.

Ms. Durcan noted that she is on the System Consolidation group, which will be looking at all of the administrative functions performed at the system and campus level. The groups will begin their work later in the spring and conclude by early fall. After they have been vetted with the Chancellors, the recommendations will be reported by President Reilly to the Board.

Vice President Durcan remarked that at the end of February, the Legislative Audit Bureau (LAB) issued a limited scope review of cell phone contracts and usage by state and university employees. Two-thirds of employees had cell phone usage of less than $20 per month. However, LAB found 386 persons with monthly bills greater than $100 per month, and over 200 of these were university employees. Five persons had bills greater than $500 per month, and four of those were UW employees. As to the four, two users had inappropriate usage and campuses have been or will be reimbursed. The other two were seemingly on the wrong cell phone plan and they are changing to more appropriate plans.

Ms. Durcan reported that the UW System agrees with all of the LAB findings in the letter report, and the Office of Operations Review and Audit will shortly be releasing a draft report entitled "Review of UW Cellular Phones," which will be brought before the Committee for review later in the spring.

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.*

The Committee did not meet in closed session since there were no additional trust fund items to discuss.

Upon the motion of Regent Rosenzweig, and the second of Regent Bradley, the Business and Finance Committee adjourned at 3:59 p.m.

Eric Engbloom

Eric Engbloom, Recording Secretary