The Regents of the University of California

COMMITTEE ON FINANCE
March 13-14, 2013

The Committee on Finance met on the above dates at UCSF–Mission Bay Conference Center, San Francisco.

Members present: Regents Blum, Gould, Island, Stein, and Varner; Ex officio members Lansing and Yudof; Advisory members Flores, Powell, and Schultz; Staff Advisors Barton and Smith

In attendance: Regents De La Peña, Pattiz, Reiss, Rubenstein, Ruiz, and Zettel, Regent-designate Feingold, Faculty Representative Jacob, Secretary and Chief of Staff Kelman, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Chief Compliance and Audit Officer Vacca, Provost Dorr, Executive Vice President Brostrom, Chief Financial Officer Taylor, Senior Vice Presidents Dooley and Stobo, Vice Presidents Duckett, Lenz, Mara, and Sakaki, Chancellors Birgeneau, Block, Blumenthal, Desmond-Hellmann, Drake, Katehi, Khosla, Leland, and Yang, Acting Chancellor Conoley, and Recording Secretary Johns

The meeting convened at 9:50 a.m. with Committee Chair Varner presiding.

1. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meeting of January 17, 2013 were approved.

2. **INTERIM PROGRESS REPORT ON *WORKING SMARTER*: SYSTEMWIDE ADMINISTRATIVE EFFICIENCIES AT THE UNIVERSITY OF CALIFORNIA**

[Background material was mailed to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Committee Chair Varner observed that the Working Smarter initiative is an effective response to criticisms regarding the University's operational efficiency.

Chief Financial Officer Taylor explained that this presentation was a mid-year report on the Working Smarter initiative, a five-year commitment to redirect $500 million from administrative overhead to teaching and research, an effort to streamline operations, take advantage of UC's size, enhance the quality of services, and ultimately build the foundation for a broader and better financial model for UC. Working Smarter is a high priority for the University and was recognized in the Governor's January budget proposal. Mr. Taylor anticipated that the initiative would achieve more than $400 million in positive fiscal impact by July 2013.

Chief of Staff and Director of Strategic Initiatives Maria Anguiano discussed the University's liquidity management program, which leverages UC's size and balance sheet. UC has a healthy amount of working capital, more than is needed for daily operations. The Office of the President has analyzed systemwide cash flow since 2004 in order to determine the amount to be kept in the Short Term Investment Pool (STIP), which functions somewhat like a checking account, to pay bills, meet rating agency requirements, and cover any unexpected cash flow needs. Remaining amounts not needed on a short-term basis can be moved to UC's medium-term investment vehicle, the Total Return Investment Pool (TRIP), which has a higher expected investment return. By analyzing liquidity needs systemwide rather than campus by campus, and moving to a more aggressive asset allocation, the University was able to generate $60 million for campuses over the previous two years. UC expects to transfer another $2 billion from the STIP to the TRIP at the end of the current fiscal year and to earn an additional $30 million through this move.

Chief Risk Officer Grace Crickette discussed the strategic approach of the University's Enterprise Risk Management program, identifying risks, treatment, and the effect of treatment. Enterprise Risk Management had generated over $150 million in savings over the previous two years, reduced harm, and created efficiencies. The program can be nimble and swift in deploying resources. It addresses risks in areas such as deferred maintenance and research grants. In the latter area, it has effectively reduced administrative costs and improved compliance and financial controls. Enterprise Risk Management is being embedded in the strategic decision-making of many UC projects.

Chief Procurement Officer William Cooper reported that a new e-procurement tool, Sourcing Director, enables greater collaborative purchasing across UC locations and greatly reduces redundant single-campus bidding events. The University has so far initiated 61 bidding events using Sourcing Director, with all ten campuses participating. The current pipeline had identified 144 events worth $125 million, with a forecasted savings of $6.4 million. In the first use of Sourcing Director, UCSF and UC Berkeley conducted a reverse auction on a specific group of commonly purchased chemicals. The event lasted 90 minutes, produced 50 bids from four suppliers, and resulted in 45 percent savings, or about $210,000. This lower pricing is integrated into local e-procurement systems at UCSF and UC Berkeley so that faculty and researchers who order these chemicals realize savings immediately. The lower pricing is also available to all other campuses.

Vice President Duckett discussed the family member eligibility verification program, which was deployed over an 18-month period. The program reviewed the status of over 175,000 individuals who are covered by UC health and welfare benefits. Individuals were removed from enrollment primarily due to status as an ineligible dependent or due to instances of divorce that were not properly recorded in UC's database. Amnesty was granted in cases of voluntary disenrollment. A process has also been put in place to prevent future ineligible enrollments for new hires and to verify member eligibility every four years. This program provides annual savings of approximately $35 million. Mr. Duckett praised the work of project manager Sally Philbin.

Executive Vice President Brostrom expressed the University's intention to track and enhance the portfolio of Working Smarter projects. One example is a $225 million systemwide energy program, 525 projects throughout the state in partnership with investor-owned utilities. UC hopes to expand this program with funds provided by Proposition 39, the Income Tax Increase for Multistate Businesses, and the California Air Resources Board. UC is evaluating opportunities for systemwide digital advertising and opportunities for multicampus collaboration. Expanded collaboration with the California State University (CSU) system is another area of promise. UC has already collaborated with CSU on e-procurement. CSU Chancellor and former UC Riverside Chancellor Timothy White has indicated that he is eager to expand this collaboration to other areas to provide improved service and lower costs. Mr. Brostrom emphasized that there are many individual efforts taking place on the campuses.

Regent Gould recalled that one goal of the University's procurement program is to save $200 million annually. He asked about the magnitude and potential of these savings. Mr. Taylor responded that the University considers two types of spending: total spending and sourceable spending; in the second type, the University can drive bargains and achieve savings. Mr. Cooper explained that the University is still identifying the total amount of its sourceable spending. He estimated this amount to be around $2 billion.

Regent Gould requested more detailed information about the size of the University's sourceable spending goal at a future meeting. He praised the collaboration with CSU, but observed that UC also interacts with the community colleges; he requested a report on possible collaboration with the community colleges as well. Mr. Taylor responded that CSU, like UC, is a highly centralized system, while the administration of the community colleges is more dispersed. Besides its goal of systemwide savings, the procurement program also encourages campuses to work together at a regional level, particularly in the case of local vendors who can service only a few campuses. The opportunity to work with community college districts would be the strongest at this level, and it would require further strategizing. Mr. Taylor stated that he was encouraged by the results of campus procurement efforts over the past eight or nine months.

Regent Pattiz requested examples of the Enterprise Risk Management program applied to research grants. Ms. Crickette responded that the Research Grants Program Office at the Office of the President administers grant monies to many different entities. If these funds are not used within the required time period, they are forfeited. Enterprise Risk Management was able to identify operational, information technology, efficiency, and compliance risks in this area. Over the past year and a half, an information technology framework and process have been put in place to provide greater assurance that research grant programs are operating correctly.

Regent Pattiz asked if Ms. Crickette had any contact with the National Laboratories on this subject. Ms. Crickette responded in the affirmative. The Office of Risk Services works with Lawrence Berkeley National Laboratory. Regent Pattiz suggested that Vice President Mara discuss application of the Enterprise Risk Management program to risk areas at the National Laboratories, such as research grants, with the Office of Risk

Services. Mr. Taylor recalled that the University has been very actively pursuing laboratory safety measures and stated that the progress made in the past few months had been impressive.

Regent Zettel asked if the Enterprise Risk Management program's focus on research grants would facilitate the work of external and internal auditors reviewing research expenditures. Ms. Crickette responded in the affirmative. The data are now easily reviewed, while previously they had been recorded on Excel spreadsheets and in an obsolescent computing system. She anticipated that the new system, both its framework and information technology component, would be made available to researchers at the campus level.

Regent Zettel asked about the verification of family members on UC employees' health insurance policies. She stated that she understood the reasons for the University's action of granting amnesty, but stressed the need for a "zero tolerance" policy for activities that are fraudulent. She emphasized that the University cannot afford the cost of this fraud, and that these activities are unfair to employees who abide by the rules. She asked how many instances had occurred. Mr. Duckett responded that University policy had become stricter and that employees would be informed about the implications for their employment and eligibility for insurance if they submit improper information or fail to provide proper notification. Approximately 9,000 individuals were removed from enrollment, or about five to six percent of the population. Mr. Duckett noted that this was a much higher percentage than had been anticipated, an indication that verification programs must continue in the future.

Mr. Brostrom observed that the programs mentioned in the discussion are seeking greater efficiency in risk management, procurement, energy use, and other areas; none involve the replacement of employees.

Staff Advisor Smith stressed that UC staff are dedicated to the University's success. The success of the Working Smarter portfolio depends on a skilled and engaged workforce. Over the previous six years, non-represented employees had received only one three percent merit opportunity. This represented another kind of risk. Mr. Taylor acknowledged the importance of fair compensation for staff and recognized the essential role of staff in realizing savings in the Working Smarter initiative. Director Cathy O'Sullivan reported that the Working Smarter initiative was developing an employee recognition program that would help rank and file employees reconsider how they work and explore ways to make work more efficient. Working Smarter is interested not only in large systemwide projects, but also in making improvements in smaller units throughout the UC system.

The Committee recessed at 10:20 a.m.

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The Committee reconvened on March 14, 2013 at 9:05 a.m. with Regent Blum presiding.

Members present: Regents Blum, Gould, Island, Mendelson, and Stein; Ex officio members Lansing and Yudof; Advisory members Flores, Powell, and Schultz; Staff Advisors Barton and Smith

In attendance: Regents De La Peña, Kieffer, Pattiz, Reiss, Rubenstein, Ruiz, and Zettel, Regent-designate Feingold, Faculty Representative Jacob, Secretary and Chief of Staff Kelman, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Chief Compliance and Audit Officer Vacca, Provost Dorr, Executive Vice President Brostrom, Chief Financial Officer Taylor, Senior Vice Presidents Dooley and Stobo, Vice Presidents Duckett, Mara, and Sakaki, Chancellors Block, Desmond-Hellmann, Drake, and Yang, Acting Chancellor Conoley, and Recording Secretary Johns

3. CONTINUATION OF TUITION SURCHARGE

The President recommended that the Regents approve continuation of the $60 temporary tuition surcharge (the Surcharge) currently being charged annually to all enrolled students until such time that all costs associated with the *Kashmiri v. Regents* and *Luquetta v. Regents* judgments are recovered. An amount equivalent to 33 percent of the Surcharge revenue generated from undergraduate students and graduate professional students, and 50 percent of the Surcharge revenue generated from graduate academic students, will be set aside for financial aid.

[Background material was mailed to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Regent Blum briefly introduced the item. Executive Vice President Brostrom explained that the temporary tuition surcharge was made necessary by the *Kashmiri v. Regents* and *Luquetta v. Regents* lawsuits and would continue until 2017-18.

Regent Stein expressed opposition to the proposed action and disappointment on behalf of the student leadership, whose view is that the University lost a lawsuit against students and made students pay for it. While this is an oversimplification, this is how the situation appears to the student body. He stated that the situation had an unseemly quality; it had been handled poorly and could have been addressed differently.

Regent Blum asked about the annual costs associated with these lawsuits, and for how many years the University would be required to pay them. Mr. Brostrom responded that the original settlement for both lawsuits was for approximately $49 million. The cost was being spread out over ten years to mitigate the impact on any cohort of students.

Regent Island asked about the rationale for a charge to students. He stated his view that the cost of a lawsuit lost by the management of the University should not be imposed on students.

President Yudof stated that the proposed action was an extension of an existing fee already approved by the Regents, and that the University did not have independent wealth to address this cost. The cost could be paid for from tuition, from State appropriations, or from a surcharge. He stated his view that students as a whole had received the benefit of a tuition reduction when this was ordered by the court. He stated that students would suffer by degrees because the University in effect has one bank account.

Regent Island objected that those students who received the benefit of lower tuition were not the ones who would pay the surcharge. Students were being asked to bear the cost of the lawsuit through no fault of their own. President Yudof responded that this was true of all settlements. Regent Island countered that the University does not usually separate the cost of lawsuit losses as a specific charge to students; these costs are funded through UC's management of costs sytemwide. He stated that the University's approach to this matter would needlessly provoke bad feeling among students. Mr. Brostrom responded that the University was taking this approach in the interests of transparency. This cost could have been added to tuition or covered with investment earnings or Short Term Investment Pool funds. This was a temporary charge that would dissipate when the costs were paid. This practice is common in municipal and state governments, when a city or state is charged with a judgment bond and the charge is levied on property tax or sales tax. He stated his view that it was preferable as a matter of transparency to make this charge explicit rather than fold it into tuition.

Regent Reiss asked if the annual cost would be about $5 million, given that the total cost of $49 million would be spread over ten years. Mr. Brostrom responded in the affirmative and added that there are small interest costs as well. President Yudof observed that the University had already been paying on the prior lawsuit and that it was not raising tuition. If the Regents decided against taking this action, another source would have to be found: indirect cost recovery, existing tuition charges, or State appropriations. President Yudof reiterated that this was an existing charge and asked how much of the total cost the University had paid so far. Mr. Brostrom responded that UC had been paying this cost for five years and had paid about $30 million. President Yudof observed that the cost could be paid from campus funds, in which case it would take away from other activities, instructional programs or student services.

Regent Reiss asked Regent Stein about a source of payment for this cost, if it were not drawn from the proposed surcharge. Regent Stein expressed students' frustration at the fact that the University finds the means to cover certain costs of this magnitude internally rather than resorting to a charge to students. Mr. Brostrom responded that the University could have drawn on its investment earnings or another fund. He recalled that UC does not possess large amounts of unrestricted funds. The cost of these lawsuits ultimately affects the University. Mr. Brostrom stressed the transparency of the proposed action.

Regent Stein observed that the University was paying the cost of its settlement following the pepper spraying incident at UC Davis, but was not passing this charge on to students. Mr. Brostrom responded that some of the Davis settlement costs were covered by insurance. Many of the University's judgments and settlements are covered by insurance policies. There is no insurance policy in the case of a tuition error.

Regent Blum concurred that the University had made errors in this case and that the tuition surcharge was not a perfect solution.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board, Regents Island and Stein (2) voting "no."

4. **CHIEF FINANCIAL OFFICER DIVISION INTERNAL BENCHMARKING REPORT ON FINANCE METRICS**

[Background material was mailed to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Financial Officer Taylor observed that this internal benchmarking report was a work in progress, with regular input from the campuses about how and which finance data to analyze.

Mr. Taylor called attention to a chart showing the percentage of employees receiving their pay by electronic direct deposit, which yields significant savings to the University. He noted that the issuing of paper checks is expensive, requiring staff time, postage, and special paper. The University has a goal of having 90 percent of its employees enrolled in direct deposit. Mr. Taylor then discussed a chart showing percentages of invoices by payment method. In this area, the University is trying to increase electronic payment of vendors. Monies saved through this effort are often unrestricted and can be returned to UC teaching and research.

Chief of Staff and Director of Strategic Initiatives Maria Anguiano commented on a chart showing the percentage of full time equivalent (FTE) employees eligible for retirement, observing that this was a quality risk that the University had been able to quantify. There is a real risk of losing institutional knowledge in the near term. The chart displayed this information by campus and medical center, but Ms. Anguiano noted that the University has the information in more detail, by department, as well. This information allows UC to identify where this risk is present and which departments have a greater need for succession planning.

Regent Gould asked about capital markets, the implications of the Governor's proposed budget, and how the University would calibrate its long-term debt capacity. Mr. Taylor responded that addressing UC debt capacity is a challenging task because rating agencies make changes to their standards or methods of calculating. Systemwide, the University has a fair amount of debt capacity. The Office of the President has regular discussions with individual campuses to ensure that one campus is not carrying another's debt and that each campus understands its own debt capacity, allowing it to prioritize projects. Every campus now uses a standard debt affordability model. Mr. Taylor described debt capacity as a moving target for the University in the context of changes in the industry and rising interest rates. The University's credit ratings are under pressure. The previous week, Moody's placed the University's rating on a status of "negative outlook." Moody's found that the pressure from pension and retiree health costs is causing the University to spend more; operating expenses are higher than operating revenue, and this has been the case for a number of years. Mr. Taylor anticipated that there would be change in this area, but the direction of that change could not be predicted.

Regent Rubenstein referred to the various charts in the report showing efficiencies or savings by campus and noted that the performance of some campuses is consistently poorer than others. He asked about the reasons for this inconsistency. Mr. Taylor responded that the report allows the University to target resources to the campuses that need them. Some campuses have underinvested in certain administrative systems. The Office of the President is attempting to ensure that appropriate personnel and processes will be put in place on the campuses.

In response to another question by Regent Rubenstein, Mr. Taylor affirmed that if a campus is consistently low in any particular category, an effort is being made to improve performance and make the campus more efficient. The Office of the President has discussions with administrative vice chancellors, campus controllers, and vice chancellors for planning and budget about resources and expertise that can be provided to campuses to bring about improvement. In some areas a change in leadership may be required.

Staff Advisor Smith referred to the percentage of employees still receiving paper checks. He noted that there are direct and indirect costs associated with issuing paper checks. He asked how UCPath, the new payroll system, would affect the paper check process at the campus level. Mr. Taylor anticipated that the implementation of UCPath would lead to progress in moving employees to electronic direct deposit. With the centralization of this function at the UCPath center, it would no longer be possible for every campus to hand-deliver checks. Employees would need a special reason for not moving to direct deposit. Depending on the campus, the cost to UC of issuing a paper check is $35 to $60 per check; the University cannot afford this expense. Mr. Taylor recalled that UC had significantly increased the number of employees receiving an electronic W-2 form by simply providing a reminder when an employee checks his or her pay stub online. The University would continue using such measures to encourage employees to move to electronic direct deposit.

Mr. Smith referred to information provided for the Connexxus travel program and asked why percentages of airline purchases made through Connexxus ranged around 40 percent and were not closer to the 80 percent goal. Mr. Taylor responded that progress had been made in the past year. The Connexxus website was initially awkward and difficult to use.

Mr. Smith then discussed the chart showing the percentage of FTE employees eligible for retirement. He asked if the chart included both faculty and staff; if so, he suggested that two charts be included in a future report to show percentages separately for faculty employees and staff employees. The footnote to the chart defined retirement eligibility as a minimum of 50 years of age and five years of service as of October 31, 2012. He suggested that it would be more helpful to consider percentages of employees who are older and have more years of service credit, and who are more likely to retire. Mr. Taylor responded that this information, useful to the Regents and others, could be provided in the future.

The meeting adjourned at 9:30 a.m.

Attest:

Secretary and Chief of Staff