The Regents of the University of California

COMMITTEE ON FINANCE
May 14, 1998

The Committee on Finance met on the above date at Covel Commons, Los Angeles campus.

Members present: Regents Atkinson, Connerly, Johnson, Khachigian, Lee, Levin, McClymond, and Sayles; Advisory members Espinoza, Miura, and Willmon

In attendance: Regents Chandler, Clark, Davies, Leach, Montoya, Nakashima, Ochoa, Parsky, and Soderquist, Faculty Representatives Dorr and Weiss, Secretary Trivette, General Counsel Holst, Treasurer Small, Provost King, Senior Vice President Kennedy, Vice Presidents Broome, Darling, Hershman, and Hopper, Chancellors Berdahl, Carnesale, Dynes, Greenwood, Orbach, Vanderhoef, Wilkening, and Yang, Vice Chancellor Bainton representing Chancellor Debas, Laboratory Directors Browne and Tarter, and Recording Secretary Bryan

The meeting convened at 3:50 p.m. with Committee Chair Johnson presiding.

1. **REMARKS OF VICE PRESIDENT HERSHMAN CONCERNING THE BUDGET**

Vice President Hershman thanked Governor Wilson for submitting to the Legislature a State budget that is generous to higher education. He noted that part of a recently announced $4.2 billion federal surplus will be directed to education and that, because of California's unexpected surplus, the University expects to be able fully to fund enrollment, to enhance technology, and to purchase additional library materials. It is expected also that additional money will be available for research and for health benefits.

2. **CONSENT AGENDA**

A. ***Amendment of the Budget for Capital Improvements and the Capital Improvement Program***

The President recommended that the Committee concur with the recommendation of the Committee on Grounds and Buildings that the 1997-98 Budget for Capital Improvements and the 1997-2000 Capital Improvement Program be amended to include the following projects: Davis: C. UC

Davis Center for the Arts: Performance Hall and D. South Campus Development: Parking and Roadway Improvements.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board.

3. **ESTABLISHMENT OF UNDERGRADUATE ATHLETICS FEE, RIVERSIDE CAMPUS**

The President recommended that, effective one year before the Riverside campus begins competition at the Division I level in the National Collegiate Athletic Association but no earlier than fall quarter 1999, an Undergraduate Athletics Fee of $35 per undergraduate student per quarter be established.

It was recalled that Riverside campus student athletes currently compete at the Division II level of intercollegiate athletics within the National Collegiate Athletic Association (NCAA). Participation at the Division I level would increase the reputation and visibility of the campus, expand entertainment opportunities for the entire campus community, and provide student athletes with a more comprehensive athletic experience.

Before completing its transition from the Division II to the Division I level, the campus needs to increase the number of athletic scholarships, develop one additional women's sport (soccer) and two additional men's sports (soccer and golf), and secure a commitment for membership in a Division I athletic conference. These actions will require an increase of at least $1 million in the athletic budget of the campus. The Undergraduate Athletics Fee is intended to provide 90 percent or more of the minimum funding required; additional funding will come from individual and corporate donations and sponsorships, increased ticket sales for athletic events, and related revenue associated with Division I status.

The campus must formally declare its intent to change from Division II to Division I status at least two years and three months prior to the September in which it will achieve Division I status. If that status is approved by the NCAA, all undergraduate students will be charged an Undergraduate Athletics Fee of $35 per student per quarter, starting with the fall quarter of the year before Division I competition begins. The campus anticipates that Division I competition would begin no earlier than fall 2000, in which case collection of the new fee would be effective for fall 1999.

On April 14 and 15, 1998, the Associated Students (ASUCR) held a referendum among undergraduate students on the Undergraduate Athletics Fee in connection with their election of student senators for 1998-99. In accordance with University policy regarding student fee referendum requirements, the Chancellor required that at least 20 percent of the undergraduates cast a ballot in the election overall, and that the majority of those voting on the measure vote in favor of passage. Of the 7,951 eligible undergraduate student voters, 1,777 (22.3 percent) cast ballots with 992 (55.8 percent) voting in favor of the fee. The election results were certified by the ASUCR Senate on April 21, 1998.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board.

4. REPORT ON UC CONTROLLERSHIP FUNCTION

Senior Vice President Kennedy reported that, working from an assessment undertaken by his division and embracing recommendations of the University's external and internal auditors and campus personnel, Vice President–Financial Management Broome has instituted new programs, hired or deployed new staff, and established new financial accountability and control standards for the University in order to strengthen financial controls. A control assessment team has fashioned a new management framework, based on a private sector model, designed to manage risk at acceptable levels across a campus environment. He believed that the new initiatives will help campuses formulate individual assessment plans by using the training standards and professional concepts developed in pilot studies at the San Diego and Santa Cruz campuses.

Vice President Broome reported that a director of financial control and accountability position has been established at each campus and in the Office of the President. On campus, the position reports to the Vice Chancellor for Business and Administration. At the Office of the President, it reports to the position of Vice President–Financial Management. In addition, the position at the campus has a dotted-line reporting relationship to the Vice President–Financial Management. This relationship helps ensure consistency, the sharing of ideas, and developing and implementing the control initiatives systemwide. The role of this position is to establish, support, and maintain an effective control environment by ensuring that adequate internal and financial controls are in effect and are being monitored appropriately. At most campuses this position has been combined with that of financial accounting officer.

Ms. Broome noted that the first step in developing and supporting an adequate control system is to assess the current control environment. The risk management division of Deloitte and Touche will assist in developing assessment programs. Self-assessment pilots are under way at the Santa Cruz and San Diego campuses. Each is following a conceptual framework that provides for both faculty and staff involvement in the program. The framework introduces the concept of managing risk to acceptable levels across higher level strategic and business objectives as well as lower level processing compliance objectives. At Santa Cruz, senior leadership initiated the control assessment by reviewing the objectives and strategies of the campus and identifying risks that might prevent the campus from realizing its goals and objectives. These risk factors were identified through a series of interviews and a survey questionnaire and were validated at an all-campus conference. There, the participants developed initiatives to address their highest risks and outlined processes they would put in place to minimize these risks. The campus is now involved in the second phase of its assessment, a detailed look at various business processes on the campus to determine what risks are apparent in the processes and what control procedures can be instituted to minimize these risks. This linking of the higher and lower levels of control creates campuswide understanding of the management of risk. San Diego's approach to implementing the control self-assessment includes using the same conceptional framework for risk and control, but it is tailored to meet the needs of a larger, multiple-mission campus. San Diego has formed a chancellor's committee on controls and accountability to help develop the program, provide input, and engage campus leadership. The committee includes faculty, Academic Senate leaders, and financial officers.

Ms. Broome noted that the techniques and models developed in these two pilot programs will form the basis of programs to be initiated at other campuses and the Office of the President, including the Division of Agricultural and Natural Resources and the Offices of The Regents. The initial control assessment is expected to be accomplished over various time frames depending upon the size of the campus. It is expected that the San Diego campus will complete its assessment within five years. A continuous monitoring process will be established based on the results of the initial assessments. Campuses will communicate regularly through monthly control directors' meetings and will share implementation strategies as well as develop a database of best business practices.

Regent Lee asked about the reporting lines for the control function. Ms. Broome explained that for policy issues and consistency, the business vice chancellor at each campus has a dotted line reporting responsibility to her as Vice President–Financial Management. In an effort to ensure that the individuals had comparable qualifications, she and Senior Vice President Kennedy had input as to who would hold each campus position. The campuses will evaluate the performance and provide the salary review for these positions. Regent Lee suggested that consideration be given to making the reporting relationship a solid line in order to ensure that issues that arise on the campuses will be brought to Vice President Broome's attention without delay. In response to a question by Regent Clark, Ms. Broome explained that most of the campus controllers had been the chief accounting officers. The initiative was put into place by making those persons controllers if they were qualified CPAs, certified internal auditors, or certified management auditors. Regent Clark suggested that campuses need chief financial officers. Ms. Broome noted, however, that many of the responsibilities usually assumed by chief financial officers are assumed by business vice chancellors in the UC system. At two campuses, where there were financial officers in place who were knowledgeable but were not CPAs, directors were hired who are CPAs and who will do all the control work. She explained that in the two pilot programs, internal audit will assist the controller in the control self-assessment, but she emphasized that the initiative is a management responsibility and not the responsibility of the internal audit. Internal audit has experience with risk assessment and valuation and many times will be used as support staff to help the controller function. Internal audit does not report to the controller, however. Its role is to evaluate independently the effectiveness of the control program. She noted that the model is based on that used by most large companies.

The Regents acknowledged the campus controllers, who were all present, and Regent Leach observed that the work they do and their commitment to it are very important to the University.

5. **CHANCELLORS' COMPENSATION STUDY**

It was recalled that the 1997 Chancellors' Compensation Study was done by the consulting firm of William M. Mercer, Inc. The Mercer study identifies a significant competitive market lag in salaries for Chancellors at University of California campuses.

The University historically has employed a market-based analysis in establishing senior management compensation levels, using survey methodologies similar to those used for faculty and staff salaries. Effective December 10, 1992, The Regents adopted a market assessment methodology which surveyed a full comparison group of 26 public and private comparable universities, using the position of Chancellor as the benchmark. The University goal for the average total cash compensation of Chancellors is the mean of the full comparison group, with internal salary relationships to be established on the basis of the scope, size, and complexity of each UC campus; performance and experience of each Chancellor; and recruitment and retention factors. Adoption of the market methodology was endorsed by the California Postsecondary Education Commission.

Chancellors' Salaries in Comparison to the Market

The Mercer report indicates that as of July 1, 1997, the average salary for Chancellors in the full comparison group was $257,791; UC Chancellors' average salary was $204,978 and lagged behind the market by 25.8 percent. When the UCSF Chancellor's salary is excluded from the comparison as a unique health sciences campus, the lag increases to 29.3 percent.

Broken down by campus, the salary for each UC Chancellor lags the full comparison group average salary as follows: Berkeley 15.8 percent, Davis 31.3 percent, Irvine 31.3 percent, Los Angeles 15.8 percent, Riverside 38.6 percent, San Diego

31.3 percent, San Francisco 3.3 percent, Santa Barbara 33.6 percent, and Santa Cruz 41.6 percent.

Chancellors' salary data also were gathered for the comparison eight institutions that are surveyed in determining faculty salaries. As of July 1, 1997, the average salary for Chancellors of institutions in this group was $275,654. UC Chancellors' average salary of $204,978 lags this group by 34.5 percent. With the exclusion of the UCSF Chancellor's salary from the UC average, the lag increases to 38.2 percent.

Recent Salary History for UC Chancellors

From 1992 to 1997, the average salary for the full comparison group increased 40.4 percent, while the average salary for UC Chancellors increased 24.2 percent. The gap in salary growth was due to the fact that from 1990 to 1994, UC Chancellors received no market or merit-based salary adjustments. In 1995, Chancellors received an average 3.5 percent salary increase, the same afforded to staff. In 1996, the Board of Regents approved market-based equity adjustments averaging 1.5 percent for chancellors, effective October 1, 1995, to begin to address the lag to market; however, the July 1, 1997 lag of 25.8 percent is the greatest lag to market during the six-year trend analysis period.

Effective November 1, 1997, Chancellors received merit increases averaging 4.0 percent, the same percentage established for other University staff in performance-based programs. The November 1 salary adjustments increased the UC average salary for Chancellors to $213,044 and reduced the lag to the market full comparison group from 25.8 percent to 21 percent and the lag to the comparison eight institutions from 34.5 percent to 29.4 percent. These comparisons, however, do not reflect market change among the comparison institutions after July 1, 1997.

Cash Compensation for Chancellors

In 1988, The Regents approved deferred compensation in the form of Non-Qualified Deferred Income Plans (NDIPs) for the President, Vice Presidents, Chancellors, Laboratory Directors, Principal Officers of The Regents, and the Associate Treasurer of The Regents. The NDIPs were used to address salary deficiencies identified in market surveys and during recruitment and provided a temporary replacement for the IRC Section 403(b) supplemental retirement plan, eliminated by the Tax Reform Act of 1986. NDIPs were common in both the public and private sectors in nonqualified deferred compensation programs. Other universities that offered similar deferred compensation programs included Yale, Stanford, Johns Hopkins, MIT, Columbia, and the University of Pennsylvania.

Each NDIP agreement was drawn for a term of five years or until the date of retirement, whichever was earlier, and specified the annual amount of deferred compensation as a percentage of the recipients' approved base salary (5 percent on average for Chancellors). Payment of the deferred income upon expiration of the agreement was contingent on satisfying the terms and conditions of the contract. NDIPs were favored by some employers because the payment obligation was deferred until expiration of the agreement, and because the "at risk" nature of the compensation was an effective means of executive retention.

The NDIP concept was not easily understood by many people and was viewed by some as an inappropriate form of compensation. Consequently, The Regents terminated NDIPs as of December 31, 1993, and enacted a salary conversion plan whereby the NDIP face value was added to the Officers' base salary. The elimination of NDIPs as deferred compensation and their conversion to base salary resulted in an average 13.8 percent upward adjustment in 1993, as is reflected in the Chancellors' Compensation Study; however, this conversion to base salary did not increase overall compensation.

From 1993 through 1996, new Chancellors were appointed at UC Davis, UC Irvine, UC San Francisco, UC Santa Barbara, UC San Diego, and UC Santa Cruz at lower compensation levels than their predecessors. The salaries for the Chancellors at the Berkeley and UCLA campuses who were appointed effective July 1, 1997 were identical to those of their predecessors.

Benefits for Senior Managers

On October 5, 1992 and December 10, 1992, The Regents also significantly reduced benefits for senior administrators as summarized below:

- Suspension of the special 5 percent augmentation to the severance pay plan for Associate of the President and Chancellors;

- Reduction in coverage of the Executive Life Insurance Program from three times salary to two times salary;

- Elimination of supplemental vacation;

- Discontinuance of the Executive Tax and Financial Planning Program; and

- Suspension of the supplemental retirement benefit and elimination of the ability to restore benefits earned under UCRS but limited by the Internal Revenue Code.

Elimination of supplemental retirement benefits is an especially serious obstacle to the recruitment and retention of Chancellors and other senior administrators.

Benefits that supplement those earned under a qualified retirement plan enable universities to recruit key executives who otherwise would sustain a large pension benefit loss as a result of changing employers in mid-to-late career.

There are other obstacles to building an adequate income-replacement retirement benefit. The Internal Revenue Code [Section 401(a)(17)] limits the amount of salary on which a pension can be calculated. The current limit which applies to employees hired after July 1, 1994 is $160,000. The Internal Revenue Code (Section 415) also restricts the amount that can be paid from a qualified pension plan, once the pension is calculated. The current maximum annual pension the UC Retirement Plan can pay to an employee hired after 1990 is $130,000; therefore, UC's competitive disadvantage resulting from the market lag in Chancellors' salaries is compounded by severe limits on the amount of retirement benefits that can be paid. These limits on pension benefit payments also confront faculty and other senior administrators and present a serious impediment to recruitment and retention.

The Mercer firm's 1997 Chancellors' Compensation Study reports that 33 percent of survey participants offer some form of deferred compensation; 32 percent offer an employment contract, which frequently is used to remedy salary deficits and pension benefit losses arising from acceptance of a position with another employer; and 16 percent offer supplemental retirement plans. The number of participants offering non-cash benefits continues to increase, with 36 percent providing a driver and education aid, and 24 percent providing physical examinations.

Compensation for Certain Vice Chancellor Positions

Recent market survey data for the positions of Executive or Academic Vice Chancellor and Vice Chancellor for Business and Administrative Services indicate that salaries for the positions also significantly lag the market. As of November 1, 1997, the $162,800 average salary for UC Executive or Academic Vice Chancellors lagged the $197,092 average salary reported in the full comparison group by 19.6 percent and lagged the $216,269 average salary of the comparison eight institutions by 31.2 percent. The $149,420 average salary for UC Vice Chancellors for Business and Administrative Services lagged the $188,024 average salary in the full comparison group by 25.8 percent and lagged the $196,842 average salary for comparison eight institutions by 31.7 percent.

In addition to surveying prevailing salary rates for comparable Chancellor and Vice Chancellor positions in the labor market, the University reviews internal relationships, coupled with the performance and experience of the individuals, and recruitment and retention factors to determine compensation for other senior managers. These measures are supplemented by specialized surveys for positions not adequately represented in the full comparison group and in comparison eight institutions.

Conclusion

It is clear from the Mercer analysis that salaries paid to UC Chancellors significantly lag those at comparable institutions. The comparison of salary data for July 1, 1997 indicates that UC Chancellors' salaries lag by 25.8 percent the market average salary for Chancellors in the full comparison group and lag by 34.5 percent the market average salary for Chancellors in the comparison eight group. The lag in salaries, and the loss of deferred compensation and certain ancillary benefits leaves the University at a competitive disadvantage in recruiting Chancellors from outside the University and in retention efforts. In addition, the inability to address the impact of limitations on retirement benefits is particularly detrimental to efforts to recruit and retain key executives. To address this serious issue, the President will submit to The Regents in September 1998 a recommendation for incremental equity adjustments to increase Chancellors' salaries to the mean of the full comparison group salaries over a two- to three-year period.

Vice President Kennedy emphasized that the fact that the University's salaries are seriously deficient and that the chancellors' salaries in particular are lagging far behind the market, combined with the elimination of deferred compensation and certain additional benefits, leaves the University at a competitive disadvantage both in recruiting Chancellors from outside the University and in retaining chief executives and other key administrators. Associate Vice President for Human Resources and Benefits Boyette presented the key findings of the Mercer study.

Ms. Boyette reiterated that beginning in 1992 The Regents, in agreement with the California Postsecondary Education Commission, approved a comparison set of 26 positions in 21 research universities to be used as a benchmark for Chancellors' salaries. This included 12 private and 14 public institutions. Also compared annually are salaries within the comparison eight group, a subset of the 26 positions. The subset is used to assess faculty salaries. In December 1997, Mercer compiled its annual third-party survey of compensation. This data, as well as the data on the subset group, was based on July 1, 1997 salaries. The market average base salary for positions comparable to chancellor within the full comparison group was reported as $257,791. The UC Chancellors' average July 1, 1997 salary was $204,978, a 25.8 percent lag and a 34.5 percent lag behind comparison 8 institutions. When the salary of the UCSF Chancellor is excluded from the UC average, the lag to the full comparison set increases to 29.3 percent and to the comparison 8 increases to 38.2 percent. Effective November 1, 1997, UC Chancellors received merit increases averaging 4 percent. Ms. Boyette noted, however, that recent recruitments in the full comparison group showed increases in pay for new hires of 15 to 20 percent. Since 1992, the UC Chancellors' total compensation has consistently lagged the market by from 2.9 to 25.8 percent. The 1997-98 fiscal-year lag of 25.8 percent is the greatest in seven years. From 1992-1997 the market-averaged total cash compensation for comparable positions to

Chancellors increased 40.4 percent, while UC's average increased by only 24.2 percent. UC's senior managers' and Chancellors' salaries have been frozen or limited since January 1991 due to budget constraints, and no market or merit-based adjustments were provided to UC Chancellors between 1990 and 1994. She attributed the significant change in data from 1996-97 to 1997-98 to several factors. First, in the 1996-97 survey, not all of the comparison institutions provided data. The consultant indicated that three institutions that did not respond are also among the three highest paying in the group. In the 1997-98 data, because UC has had increasing problems with recruitment and retention, Mercer was asked to make a special effort to get information and responses from all of the comparison institutions, so the 1997-98 data is accurate and includes them all. Also, the increase in the lag is a reflection of the general market increase for salaries of high level executives. The consultant indicated that the pool of people who would be qualified to lead institutions like the UC campuses would number perhaps 50 to 100 people nationwide.

Ms. Boyette commented that all the individual salaries of the UC Chancellors, including that of the UCSF Chancellor, lag the full comparison group market average. The salary lags range from 3.3 percent at San Francisco to 41.6 percent at Santa Cruz. All the UC Chancellors also lag the comparison eight by even greater amounts, ranging from 10.5 percent at UCSF to 51.5 percent at Santa Cruz. Although the Chancellors' perquisites that were discontinued in 1992 are in line with 50 percent of the comparison group, they cannot make up for a significant lag in cash compensation.

Regent Clark asked why the recommendation is being delayed until September. Vice President Kennedy explained that a September recommendation will be in conjunction with the new fiscal year salary structure. Salaries for people in senior management are usually effective on October 1, with the State budget.

In response to a question by Regent Montoya, Ms. Boyette stated that the presentation to support the President's individual salary recommendations will make clear the distinctions among the size and scope of the Chancellors' campuses and their responsibilities. Regent Lee advised that in setting the new salaries the total amount of compensation, including retirement benefits, should be considered. Regent Nakashima believed that the University's salaries are significantly below the comparison average only for certain Chancellors. Ms. Boyette pointed out that the market methodology on which the survey was based was agreed upon by The Regents and CPEC. Regents Chandler and Ochoa also voiced the opinion that all perquisites and benefits should be taken into account when determining salary increases for the Chancellors. Regent Ochoa noted that deans shoulder a lot of the responsibility for running the medical schools, a fact that could affect the salaries of the Chancellors of those campuses. Mr. Kennedy observed, however, that notwithstanding that arrangement, the reality of market considerations must dictate the salaries of Chancellors who have medical schools on their campuses. Because UC salaries are not competitive, recruiting outside people has become extremely difficult. Ms. Boyette noted that the next comparison survey will be expanded in an attempt to provide additional information on the perquisites offered by the comparison institutions.

Regent-designate Willmon and Regent Parsky stated that they found the survey to be very helpful. Regent Parsky reported that his service on a search committee for a new Chancellor made him acutely aware of the salary differences among universities. He believed that when the President comes forward with specific recommendations that are supported by full disclosures concerning the various levels of responsibility Chancellors have and the perquisites that they enjoy, making decisions concerning new salary levels will not be unduly difficult. President Atkinson encouraged those Regents with a particular interest to study the Mercer report and seek answers from the administration to any questions they may have. The President noted that he will be considering how best to present the issue from the perspective of public opinion and whether raises should be implemented over a one- or two-year period.

Faculty Representative Dorr noted that the faculty support the method used in the study. She asked whether raising chancellors' salaries will automatically raise salaries for those in lower ranks. Mr. Kennedy explained that each September, salary recommendations are made to the Regents for senior managers whose salaries require Regental approval. He believed that over time, the President will wish to increase those salaries in order to decompress the overall salary structure of the University.

Regent Davies commented that he would not be willing to support monetary enhancements for the Chancellors that were in a form other than salary increases. He believed that any perquisites should remain as they are currently. President Atkinson agreed to structure his recommendation in that way.

6. **REPORT OF THE GENERAL COUNSEL**

The General Counsel presented his routine **Report of New Litigation**. By this reference, the report is made an official part of the meeting record.

[The **Report of New Litigation** was mailed to all Regents in advance of the meeting, and a copy is on file in the Office of the Secretary.]

The meeting adjourned at 5:15 p.m.

Attest:

Secretary