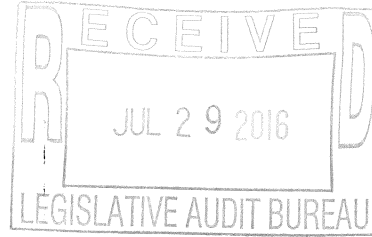




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July 29, 2016

Senator Robert Cowles
Representative Samantha Kerkman
Co-Chairs, Joint Audit Committee

Dear Senator Cowles and Representative Kerkman:

Thank you for this opportunity to update the Joint Audit Committee on progress made by the University of Wisconsin (UW) System to address issues noted in audit report 16-3, our annual financial audit. In that report, the Legislative Audit Bureau provided one recommendation related to the UW System's program revenue balances report and five recommendations related to investment management. This letter serves as the status report of those recommendations.

Program Revenue Balances Report

In October 2014, the UW System Board of Regents approved the first program revenue balances report. This fiscal year 2013-14 report provided detailed commitments made against year-end balances. Enhancements were made as the fiscal year 2014-15 report was subsequently prepared.

The Legislative Audit Bureau reviewed the 2014-15 report and recommended that the UW System *review institutional reserve policies to ensure the policies are complete and consistently in compliance with Board of Regents' policies and UW System Administration guidance.*

At the time of LAB's review, two UW institutional reserve policies were in draft form. These two institutions have since finalized and implemented their reserve policies. In addition, four other institutional reserve policies provided a definition of reserves that was perceived to conflict with the UW System guidance. UW System Administration has clarified guidance regarding the potential use of reserve balances. The revised guidance has been communicated in multiple forums with institutional staff. The four institutions have also revised their reserve policies to align with the definition and System guidance.

Investment Management

As of June 30, 2015, the UW System held \$523.4 million in investments of gifts and bequests made to the UW System, the majority of which was invested by external managers. The audit recommendations are provided in italics below, followed by the related UW actions.

Review the asset allocation plans to determine if changes should be made, report to the Board of Regents on the results of the review, and seek approval of any revisions

The Board of Regents reviews the UW System's Investment Policy Statement on an annual basis. In accordance with the Investment Policy Statement approved in December 2015, given the focus on long-term capital market assumptions, "in-depth asset allocation reviews need not be conducted on a set schedule. However, it is anticipated that in-depth reviews will be made at least once every three years."

The last detailed internal asset allocation analysis was conducted in late 2014. UW System Administration intends to conduct a robust asset allocation analysis for UW trust funds and present its findings and recommendations to the Board at its December 2016 meeting.

Make improvements to the UW System's current processes to ensure that ongoing due diligence is being completed and documented, and provide an annual due diligence report for each external investment manager

Of the six external investment managers currently employed, due diligence meetings for 2016 have been conducted with three. Due diligence reports for these managers will be provided to the Board of Regents' Business and Finance Committee in August. Meetings with the three remaining managers have been scheduled and due diligence reports will be completed by the end of the calendar year.

Request from each external investment manager, on at least an annual basis, information on the actual investment management fees charged against investment earnings. Compare the amount of investment fees charged against earnings to the terms of the contracts to ensure the UW System is payment the correct amount of fees

The UW System invests 85% of its trust funds in separately managed accounts, which have a contract or investment management agreement in place. For these accounts, management fees are directly billed to UW System Administration, instead of being charged against investment earnings. In these cases, all management bills are reviewed and checked for accuracy to ensure agreement with contractual fee arrangements.

The remaining 15% of trust funds are invested in mutual funds and exchange-traded index funds. For these funds, management fees or expense ratios are outlined in their prospectuses and other regulatory filings, and are charged against fund earnings. UW System Administration has contacted the State of Wisconsin Investment Board (SWIB) to determine how it monitors similar management fees. If SWIB has such a process in place, UW System Administration will attempt to replicate it to the greatest degree possible. UW System Administration will also be working with the fund managers to investigate how it can obtain independent verification that fees charged are as reported.

Review the benchmarks used to assess and report on investment performance of the Intermediate Term Fund and determine if an alternative benchmark should be used

UW System Administration reviewed the Intermediate Term Fund's benchmarks and began reporting on the performance and risk characteristics of its Policy Portfolio Benchmark beginning with the second quarter of fiscal year 2014-15. As described in the Investment Policy Statement, the Policy Portfolio Benchmarks are designed to closely mirror the target strategic asset allocations of a fund, using an appropriate mix of passive indexes for each asset class or strategy. As of the March 31, 2016 quarterly investment review, the Intermediate Term Fund has outperformed this additional benchmark for the three-month and one-, three-, five-, and ten-year periods.

Ensure information is available on the UW System website in a timely manner, provide external investment manager performance information in the Board of Regents meeting materials, and provide a comparison between actual asset allocations to the approved target allocations and ranges in the Board meeting materials.

The detailed quarterly investment review through March 31, 2016 has been posted to the UW System website. Going forward, the goal will be to ensure the completion and availability of these quarterly

reports within eight weeks of quarter-end. Asset allocations of each fund versus approved target allocations and ranges continue to be provided within the detailed quarterly investment reviews.

I want to thank the Legislative Audit Bureau for their work. If you have any questions regarding these issues, please do not hesitate to contact me or Interim Vice President Julie Gordon.

Sincerely,



Ray Cross
President

cc: Chancellors
State Auditor Joe Chrisman
Vice President David Miller
Interim Vice President Julie Gordon
Trust Funds Director Doug Hoerr
Chief Audit Executive Lori Stortz