



THE REGENTS OF THE UNIVERSITY OF CALIFORNIA

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January 18, 2008

Mr. Ralph W. Wolff
President and Executive Director
Western Association of Schools and Colleges
987 Atlantic Avenue, Suite 100
Alameda, California 94501

Dear Mr. Wolff:

Thank you for providing us with the WASC team's final Report, which we consider to be an important contribution to our ongoing efforts to improve both management and governance within the University of California system.

This letter is a preliminary response that will provide some commentary and context to those now reading the Report. We are now actively seeking further comment and advice from members of the Board of Regents, representatives of the Academic Senate, Chancellors, and other senior administrators as we prepare a more formal response, which we expect to submit in accordance with your procedures. We have distributed a copy of this letter to those individuals, and request that this letter also be included with your report at every stage at which the report is presented.

In view of the points made in the Report, we feel that we must point out actions taken by The Regents and the University administration that are directly relevant to your Report. Many of these actions were taken prior to the visit of the review team, as part of our ongoing efforts to improve governance processes. These actions were shared with the review team, but were not included in the Report.

The Report catalogues various perceived problems and makes welcome suggestions for improvement, but does not include detail of the many relevant actions taken by the University. We will address points raised in the Report in the order in which they appear. Some we consider to be factual error, including factual errors of omission.

The Creation and Work of the Governance Committee

The report's broadest conclusion is that "there are significant, other governance issues [besides executive compensation practices] that the UC needs to address, some of which are matters of serious concern" (page 7). Brief reference is made to the creation of the Board's Governance Committee and a recommendation is made to enhance its functions (page 16). The report fails to note that the Governance Committee was both created and charged by the Board with most of the duties that the Report identifies well prior to the visit of the review team. The creation of the Governance Committee was a Board-initiated action in large part in direct response to the problems that the Report identifies "at the interface between the UC Office of the President and the Regents" (page 7).

This reform was begun a year ago. The Report fails to make this key point: That the Board itself understood that the executive compensation issue was illustrative of a broader governance problem and took action to initiate a process to review and respond to that broader problem.

Roles and Responsibilities

In general terms, the Report highlights both perceived and real confusion about the roles and responsibilities of the Regents, the President, the President's staff, and the campuses (pages 7-8). It notes also that the University has identified some of the problems in this area and has developed processes to correct them, and notes that additional audits are still underway. Further, the report notes that UC has used the services of PricewaterhouseCoopers and the Mercer Group to develop new systems and procedures.

However, the Report fails to describe or discuss the broad effort underway to address the roles and responsibilities issue systemically. The University has retained the Monitor Group to support a Provost-charged and Chancellor-chaired working group that has performed a top-to-bottom analysis of the roles and responsibilities of the President, in relation to the Regents and to the campuses. This project has been ongoing since mid-2007. Its work product was considered by the Governance Committee in early January 2008 and by the full Board of Regents at its regularly-scheduled January meeting.

Causes of the Executive Compensation Failures

The Report lists the review team's conclusions regarding the causes of the executive compensation failures (pages 9-11). We note that the Board has been in agreement regarding some of these issues since late 2006 and has taken corrective actions accordingly.

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The review team has concluded that the climate which led to Office of the President staff deciding on “a case-by-case basis which elements of compensation to report” to the Board and which not to report was caused by four deviations from WASC standards: (1) loss of institutional memory regarding policies, (2) an internal audit system that failed to track compliance with policy, (3) the absence of systematic review of materials submitted to the Regents by a person charged with ensuring compliance with policy, and (4) the absence of a central, accessible system of personnel records (pages 9-11).

The Report fails to note several specific initiatives that have been taken to address these matters.

First, the Office of the President and the Regents have been working with Mercer consultants for the last year to review and standardize compensation policies. This project, which is expected to be presented in segments at the next three Board meetings, will update all executive compensation policies. The policies, once adopted by the Board, will appear in standard format with cross-references to related policies. Work is underway to make the policies completely accessible electronically and to ensure proper indexing of the policies to ensure ease of access. The project also includes a requirement for periodic review of each policy at a pre-determined future date. The project was called for by the Regents’ task force created to respond to the executive compensation crisis.

Second, the Regents have hired a new Senior Vice President for Compliance and Audit as a direct report to the Board for the specific purpose of ensuring a more robust audit system and proper review of transactions for policy compliance. The individual retained to fill this role has many years of experience with both compliance and the audit functions. Her work is underway to achieve the goals outlined in the WASC team’s report. In addition, the Regents created the Chief of Staff to The Regents position to, among other things, work in coordination with the Senior Vice President and the Office of the President to address these same issues.

Third, the Office of the President has acknowledged the need to develop a central, accessible human resources information system. The Board has concurred in that assessment on a number of occasions. The President’s staff is currently assessing the cost of developing such a system and is reviewing options.

The Report concludes that one of the factors that caused violations of compensation policies was an informal Board desire to see fewer transactional issues before the Board (pages 10-11). To the extent that this assessment was at one time accurate, the Board’s many actions over the last two years can hardly be seen as reflecting that conclusion. In fact, the Board is often criticized by the campuses and others for the

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number of compensation decisions that it is currently reviewing--a direct product of the need to respond to broadly expressed concerns about administrative practices in the compensation area. In addition, the Board's personnel decisions noted above reflect a decision to shoulder greater responsibility, not less. Board members have also taken on additional time commitments to hold committee meetings off-cycle from the Board meetings to ensure greater depth of understanding in the technical areas of the Investments, Audit, Long Range Planning, and Governance Committees.

Additional Governance Findings

The Report makes four specific findings of concern in the governance area: (1) There is no consistent annual evaluation of the President. (2) There is no consistent board evaluation and no ongoing improvement program for Regents. (3) There are no consistent operating procedures for Chair and Regent decision-making. (4) There is a culture of interaction within the Board that results in unnecessarily harsh treatment of UC administrators, faculty, and staff. We will address each of these findings.

First, in 2006, the Board adopted a specific and detailed process for evaluation of the President (and other direct reports to the Board). This process was discussed in our meetings with the review team, and it is disappointing to us that the review team remained confused on this point. We are including with this letter a copy of the minutes of the Board action, as well as the materials provided in connection with this Board action. The President is required under this process to develop an annual set of goals in coordination with the four key Board members designated to evaluate his or her performance. Each direct report to the Board is assigned a pre-selected team of four Regents for his or her evaluation based on the extent of contact the employee is likely to have with Regents based on assigned duties. The President's team includes the Board Chair, the Board Vice Chair, the Chair of the Governance Committee, and the Chair of the Compensation Committee. In 2006, the President did undergo an evaluation following this process. In 2007, the evaluation process was begun with President Dynes, but midway he announced that he was stepping down. At that point, a decision was made in consultation with President Dynes that a detailed evaluation pursuant to this process was not required. Since that time, the President and the Provost have consulted with the Board collectively and also with the Chairs of the Governance and Compensation Committees at the Board's request to define their respective roles. These discussions have led to an excellent understanding of duties and to a very productive transition for both offices, for which the Board is very appreciative.

Second, we shared with the review team that work has been underway for some time on a more robust program of orientation for Regents. This effort has been led by Regent Kozberg, who was the co-chair of the task force created by the Regents to respond to concerns expressed about executive compensation. One of the central points Regent Kozberg has made is the need to involve established Regents in the

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process of orientation and mentoring for new colleagues, which by its very nature will involve established Regents in ongoing education. Regent Kozberg and Chief of Staff Griffiths are also collecting and will be reviewing various board evaluation examples from a number of sources. Both Regent Kozberg and Chief of Staff Griffiths have attended seminars at UCLA's Anderson School of Management to evaluate their director training offerings to assess whether they are adaptable to the Board's needs. UCLA has been asked to develop a proposal for review first by Regent Kozberg and later by the Governance Committee for a multi-session orientation program. Part of the specific reasoning that led Regent Kozberg to consider UCLA was their particular expertise in Sarbanes-Oxley principles. In addition, it is also worth noting that our new Senior Vice President for Compliance and Audit was hired in part because of her knowledge and experience with Sarbanes-Oxley principles. She made her first presentation on this subject to the Audit Committee last month. Please note that all of these efforts have been Board-initiated.

Third, regarding operating procedures for Board decisions, the presentation to the Governance Committee this month of the analysis of the Monitor-facilitated working group on the roles of the Regents, the President, and the campuses will be foundational to our ongoing efforts to address this issue. Regarding the team's criticism of Chairman Blum's letter, we note that neither Regent Blum nor his colleagues on the Board were confused about whether the views he expressed were his own. As we reported to the team, the letter was drafted with the express intent by Regent Blum to share his views with his colleagues to prompt dialogue on the subjects discussed.

Regarding the team's expression of concern that a formal appointment of the chief operating officer by the Board did not occur, we note that the University's General Counsel was consulted in advance of Provost Hume being given operating officer duties. He advised that the President was authorized to delegate operating officer duties to Provost Hume without Board action. The important point is that legal advice was sought and actions taken by the President in accordance with that advice. Regarding the boundaries between the Regents and the President, we will not repeat here what we said above regarding the Monitor-facilitated working group, except to note that this work was in process prior to the review team's visit.

Fourth, regarding the interaction between Regents and University officials and staff, we anticipate that this issue will be discussed at the Board retreat now in development. The last Board retreat was in 2004, at which time it was recommended that retreats occur periodically on a three-year cycle.

Report Recommendations

The review team has offered six recommendations in its Report. They are: (1) Comprehensive processes to assure that policies are preserved and understood as well as

readily available internally and to the public. (2) Increased effectiveness of the Governance and Audit Committees, as well as development of a comprehensive system for verifying regulatory compliance. (3) Procedures to allow for timely appointment of senior officers consistent with the competitive marketplace. (4) A clear document outlining the respective roles of the President and the Regents. (5) Presidential protocols to support the campuses and a central system for common functions for the campuses. (6) WASC accreditation criteria to include explicit standards for system presidencies and boards. (Pages 15-19) We comment as follows, noting again that this is a preliminary response to provide context to those who read the Report.

First, as noted above, the Office of the President and Regents have been working over the last year on a comprehensive review of compensation policies, which will include standardizing the format and cross-references to other authorities as well as a robust system of indexing the policies and accessing them electronically. It is anticipated that this work, done in conjunction with the Mercer consultants, will be presented in segments to the Board at the next several Board meetings. The proposal specifically includes a system of periodic, required review of polices on a regular cycle.

Second, also noted above, almost all of the details of the recommendation to enhance the duties of the Governance and Audit Committees have been under way for some time. The hiring of the Senior Vice President for Compliance and Audit and the Chief of Staff to the Regents are part of this effort, as is the Monitor-supported working group efforts to look at the respective roles of the President, the Regents and the campuses. The efforts to develop a comprehensive orientation and mentoring program, including Board evaluation, have also been in progress for quite some time. Please refer to earlier portions of this letter for more detail. Attendance at AGB seminars has been offered to Regents in the past when consistent with budgetary limits. We will continue to offer participation to our Regents consistent with the budgetary restrictions our state currently faces. Regarding presentation of Sarbanes-Oxley principles to the Board, we have already detailed that this will be a significant portion of the orientation program we are developing and also noted that the Audit Committee heard a presentation on these principles last month.

Third, regarding procedures for appointment of senior officers, the Office of the President and Regents have been working with Mercer consultants on this issue for much of the last year. The goal is to achieve a more streamlined system of approval but at the same time to ensure that compliance and transparency protections are very strong. We had anticipated that this proposal would come before the Board in January, but in view of the need for further refinements the presentation has rescheduled for our March meeting.

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Fourth, as noted above, the Regents and other University officials have all recognized the need to more clearly define the roles of the President, the Regents, and the campuses. Substantial amounts of time, attention, and resources have been devoted to this work.

Conclusion

As leaders of the University of California, we make every effort to enhance and build the University's reputation as the finest system of public higher education in the nation. Our actions in the past two years to deal effectively with serious concerns and procedural deficiencies related to executive compensation practices is only one aspect of our commitment to serving that goal. We have adjusted our organizational structure, personnel decisions, resource allocation, and committee structure and schedules to deal with the governance issues that the compensation issues made apparent.

We are grateful for the efforts and dedication of the review team and others involved in preparing the Report and look forward to further productive interactions with WASC as we work to further improve our policies, practices and procedures.

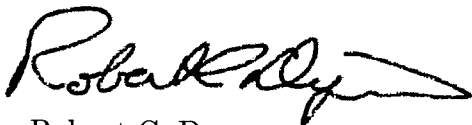
Sincerely,



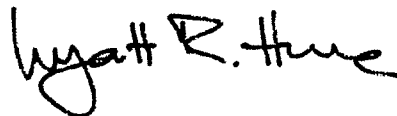
Sherry L. Lansing
Chair, Committee on Governance



Russell Gould
Vice Chair, Committee on Governance



Robert C. Dynes
President



Wyatt R. Hume
Provost

Enclosures: (1) Minutes of Committee on Compensation, March 16, 2006; and
(2) *Process and Timetable for Annual Performance Review of Officers Reporting Directly to The Regents* (Mercer Human Resource Consulting, March 16, 2006)

cc: Chancellors
Academic Council Chair Brown
Secretary and Chief of Staff Griffiths

The Regents of the University of California

SPECIAL COMMITTEE ON COMPENSATION

March 16, 2006

The Special Committee on Compensation met on the above date at Covell Commons, Los Angeles campus.

Members present: Regents Dynes, Hopkinson, Juline, Marcus, Moores, Parsky, Pattiz, Schilling, and Wachter; Advisory members Coombs and Oakley

In attendance: Regents Gould, Island, Johnson, Kozberg, Lansing, Lozano, Preuss, Rominger, Rosenthal, and Ruiz, Regents-designate Ledesma and Schreiner, Faculty Representative Brown, Secretary Trivette, General Counsel Holst, Interim Treasurer Berggren, Acting Provost Hume, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Foley, Gurtner, and Hershman, Chancellors Birgeneau, Bishop, Carnesale, Córdova, Denton, Drake, Fox, Tomlinson-Keasey, Vanderhoef, and Yang, Laboratory Director Anastasio, Acting Laboratory Director Kuckuck, University Auditor Reed, Financial Expert Advisor Vining, and Recording Secretary Bryan

The meeting convened at 10:15 a.m. with Committee Chair Hopkinson presiding.

12. **PROCESS AND TIMETABLE FOR ANNUAL PERFORMANCE REVIEW OF OFFICERS REPORTING DIRECTLY TO THE REGENTS**

Committee Chair Hopkinson recommended that The Regents approve the process and timetable for annual performance reviews of the Officers reporting directly to The Regents.

The Regents have an obligation to provide a performance management program for UC positions that report directly to The Regents: the President, General Counsel, Treasurer, and Secretary of The Regents. Objectives for this proposal include aligning incumbent performance with The Regents' top priorities, promoting incumbent development, and determining possible impact on compensation.

As part of the proposed performance management process, each incumbent will be asked to provide a self-assessment of his or her prior year's performance in three areas: goal progress and achievement, ongoing responsibilities, and leadership competencies. Specific Regental responsibilities and time frames are defined in the proposal.

Mr. Bob Miller, of Mercer Consulting, reported that the objectives of the program are to make sure there is the right focus on priorities, that the individuals receive input from a select group of Regents on their performance in meeting their goals and priorities, and to set the stage for performance management across the UC system. He noted that the Office of the Treasurer has a separate performance management process that focuses on investment performance and is tied to incentive compensation.

Mr. Miller reported that, based on priorities communicated by The Regents, the individuals would develop goals for the coming year in April or May and provide them for Regental review, and in July or September the Regents would respond with input on the prior year's performance and would propose compensation in October or November. There are three major components: four or five annual goals, ongoing responsibilities that might not be included in a specific goal for the year, and leadership competencies.

Committee Chair Hopkinson believed that the proposal was overdue. She indicated that the Chairman would name the lead Regent for each of the positions. Chairman Parsky suggested the following: with respect to the President, the Chairman would take the lead responsibility; for the General Counsel it would be the Chair of the Committee on Finance; for the Treasurer, the Chair of the Committee on Investments; and for the Secretary, the Vice Chairman of the Board. He commented that as part of establishing best practices, this kind of review for these positions is appropriate.

Regent Marcus expressed concern that there is consistency and uniformity among the activities that the Regents are engaged in. He believed that would be difficult under the current structure. He noted that it is common for boards to have a personnel committee or other committee that operates consistently on these matters. Chairman Parsky indicated that over the course of the coming year it may be appropriate to shift the duties solely to the Committee on Compensation.

Regent Moores noted that the proposal was very process-laden and possibly too detailed. On most boards, most members would be very familiar with what their direct reports are going to do. Chairman Parsky responded that the Regents have a responsibility to oversee the performance of their direct reports. The proposal is only a suggestion of how the reviews might take place.

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

MERCER

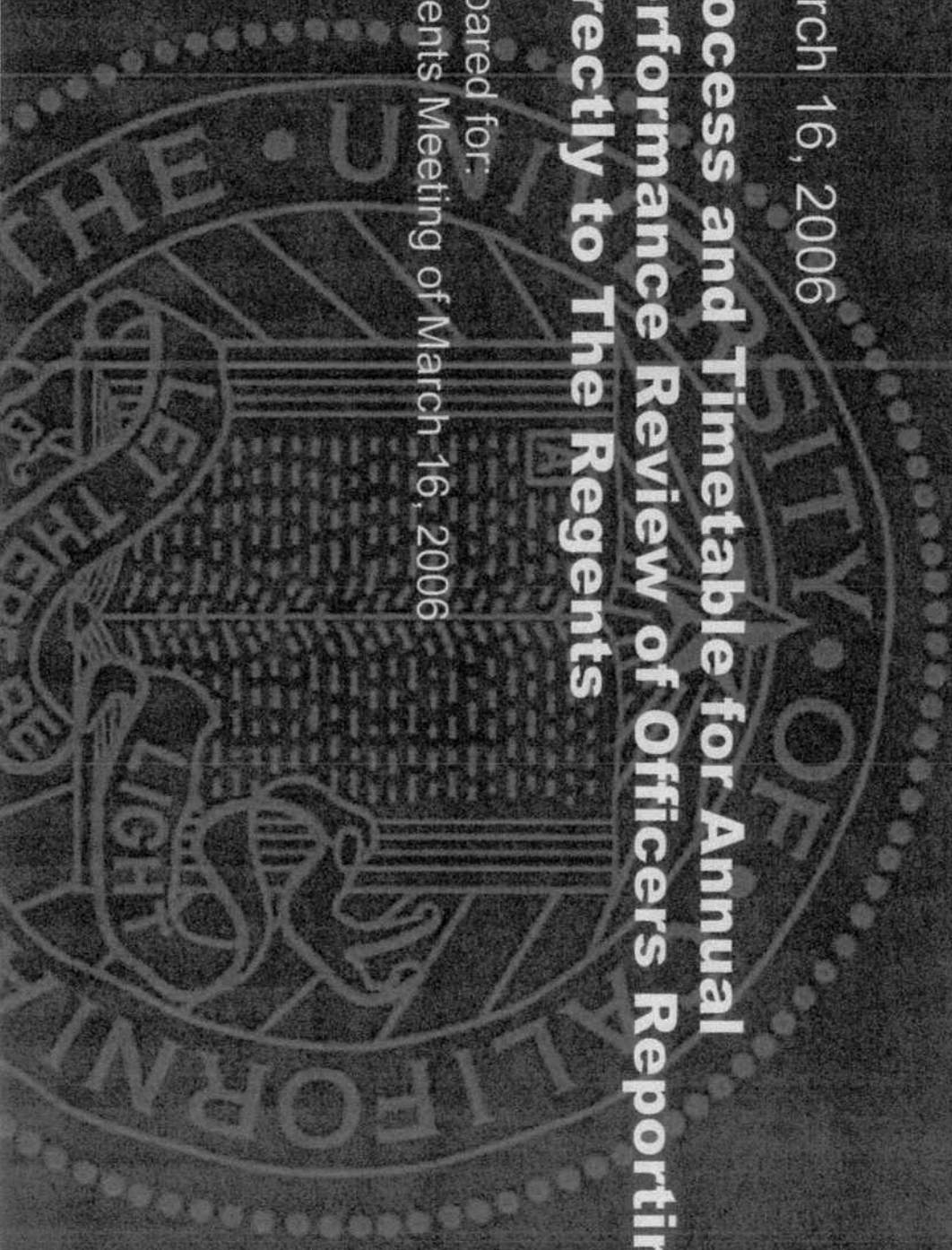
Human Resource Consulting

March 16, 2006

Process and Timetable for Annual Performance Review of Officers Reporting Directly to The Regents

Prepared for:

Regents Meeting of March 16, 2006



Performance Management Proposal

Definition

- Performance management is a process used by organizations to ensure executives and employees focus on the right values, strategies and priorities. It typically involves goal setting, ongoing performance, behavioral (competency) expectations, input on strengths and development opportunities.

Proposal

- The Regents have an obligation to provide a performance management program for UC positions where they have direct oversight.

Performance Management Program

Objectives

Objectives

1. Align incumbent performance with the Regent's strategic direction and priorities
2. Through collaboration with the President, ensure Chancellors and managers focus on top priorities
3. Promote incumbent development through Regent input and review
4. Assist the Regents in evaluating incumbent performance and determining possible impact on pay
5. Reinforce the importance of strong performance management practices across the UC system

Performance Management Program

Positions Included

- **President (Bob Dynes)**
- **General Counsel (James Holst)**
- **Treasurer (Interim: Marie Berggren) ***
- **Secretary of The Regents (Leigh Trivette)**

* This program is complementary to and would not impact the Treasurer's investment performance metrics or incentive opportunity.

Performance Management Cycle

**Regents Communicate
Top Priorities**

**Develop Goals for Coming Year
(April - May)**



**Determine
Compensation Impact
(Oct - Nov)**

**Review Prior Year's
Performance and Approve
New Goals
(July - Sept)**

Performance Management Responsibilities

Selected Regents* Responsibilities

- Approve incumbent's annual goals
- Meet with incumbent to review annual performance
- Determine need for pay increase recommendation

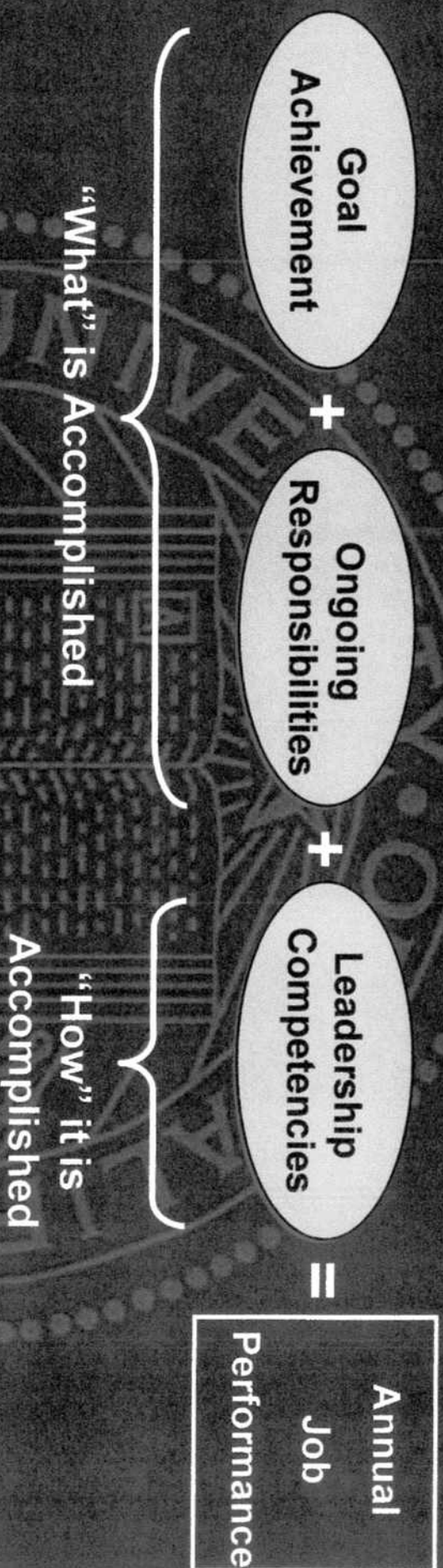
Incumbent Responsibilities

- Draft annual goals for Regent's review
- Provide progress report and/or goal adjustments (as necessary)
- Complete annual self-assessment
- Meet with Selected Regents* to review annual performance

* See page 9 for specific Regent responsibilities

Performance Management Areas

Three Components



Examples of Performance Areas

- Performance areas may include initiatives beyond the incumbent's full control
- In these instances, level of effort should be considered in the assessment

President	General Counsel	Treasurer	Secretary of The Regents
Examples of Annual Goals ▼			
<ul style="list-style-type: none"> ▪ Hire new Chancellor 	<ul style="list-style-type: none"> ▪ Introduce new process for measuring client satisfaction 	<ul style="list-style-type: none"> ▪ Assess need for new investment partners 	<ul style="list-style-type: none"> ▪ Develop new Regent on-boarding process
Examples of Ongoing Responsibilities ▼			
<ul style="list-style-type: none"> ▪ UC funding 	<ul style="list-style-type: none"> ▪ Outside counsel oversight 	<ul style="list-style-type: none"> ▪ Investment performance 	<ul style="list-style-type: none"> ▪ Regent meeting support
Examples of Leadership Competencies ▼			
<ul style="list-style-type: none"> ▪ Strategic Vision 	<ul style="list-style-type: none"> ▪ Collaboration 	<ul style="list-style-type: none"> ▪ Leading Teams 	<ul style="list-style-type: none"> ▪ Knowledge of Governance Practices

Performance Management Schedule and Timing

Schedule ▼	Timing	Position Incumbent	Selected Regents* Responsible	All Regents
1. Incumbent submits annual goals for coming year to Selected Regents*	April 1	Draft		
2. Selected Regents* provide input and approve final goals	May 1		Input & Approve	
3. Regents receive final goals	May Regents Meeting			Informed
4. Incumbent submits self-assessment for prior year to Selected Regents*	July 31	Draft		
5. Selected Regents* review self-assessment and provide assessment	August 31		Input & Review	
6. Incumbent and Selected Regents* meet to discuss prior year's performance	September	Input	Input & Approve	
7. Regents receive summary of incumbent's prior year's performance	September Regents Meeting			Informed
8. Compensation Committee recommends compensation impact for Regents' ratification, contingent on legislative budget action (see note)	October Regents Meeting		Compensation Committee Approval	Approval

* See page 9 for specific Regent responsibilities

Note: Committee on Investments would also recommend and approve the Treasurer's incentive award

Regents Responsible for Providing Performance Input and Review

✓ = Primary Responsibility

	Incumbent to be Reviewed			
	President	General Counsel (1)	Treasurer (2)	Secretary of The Regents (3)
Responsibility for Providing Input and Review ▼				
Chair of the Regents	✓	✓	✓	✓
Vice Chair of the Regents	✓			✓
Chair of the Compensation Committee	✓	✓	✓	✓
Chair of the Education Policy Committee	✓			
Chair of the Investment Committee			✓	
Chair of the Finance Committee		✓	✓	
Chair of the Special Committee on Regents' Procedures		✓		✓

- (1) General Counsel would also receive feedback from the President
- (2) Treasurer would also receive feedback from UCOP's SVP Business and Finance
- (3) Secretary of The Regents would also receive feedback from the President

Performance Management Self-Assessment Instructions

- The instructions cover:
 - goals,
 - on-going responsibilities, and
 - leadership competencies
- The self-assessment may note performance areas beyond the full control of the incumbent (e.g., UC system-wide initiatives)

Next Steps

- Refine proposed approach and self-assessment instructions based on Regent input
- Develop three to six leadership competencies for each position, validate with incumbents
- Launch new performance management program in April, 2006