Minutes*

Senate Committee on Finance and Planning
Tuesday, February 16, 2010
2:00 – 3:45
238A Morrill Hall

Present: Judith Martin (chair pro tem), Jon Binks, David Chapman, Jennifer Dens, Devin Driscoll, Steen Erikson, Kara Kersteter, Lyndel King, Paul Olin, Richard Pfutzenreuter, Gwen Rudney, Michael Rollefson, Mandy Stahre, Michael Volna, Warren Warwick, John Worden, Aks Zaheer

Absent: Sarah Chambers, Lincoln Kallsen, Thomas Klein, Joseph Konstan, Russell Luepker, Fred Morrison, Kathleen O'Brien, Terry Roe, Karen Seashore, Thomas Stinson

Guests: Associate Vice President Gail Klatt (Department of Audits), Lynn Zentner (Compliance Office)

[In these minutes: (1) appetite for risk; (2) purchasing initiative; (3) EFS update; (4) statement on cost pools and financial aid]

1. Appetite for Risk

Professor Martin convened the meeting at 2:00, explained that Professor Luepker was out of town, and turned to Mr. Volna to lead a discussion about the University's appetite for risk.

Mr. Volna distributed copies of PowerPoint slides that he used in a report to the Regents' Audit Committee the previous week. That report was titled "EFS Update: Impact on Control Environment and the University's Appetite for Financial Risk," and was partly about the EFS system and partly about financial risk. The Regents want to know how the economy is affecting the University's tolerance for risk, whether that tolerance should be reassessed, and how the new financial system might help. The policy questions, Mr. Volna said, are these: (1) "To what extent are the current economic challenges causing the University to reassess its 'appetite for financial risk'?" and (2) "To what extent can the new Enterprise Financial System support and promote an appropriate risk management environment?"

Is it reasonable to say that the University has been more risk-averse the last decade or so, Professor Martin asked? It has been, Mr. Volna said, and that is in part because the outside influences (Enron, additional federal compliance, etc.) have made it more risk-averse.

While there is much information about risk on the web, Mr. Volna told the Committee, there is no generally-accepted definition of "appetite for risk." For these purposes, they have defined "appetite for risk" as "the amount of adverse exposure from an activity or *portfolio* of activities that an organization is willing to accept in pursuit of its mission and goals" and "the costs an organization is willing to impose on itself to reduce that exposure to an acceptable level." So this is only about downside risk, Professor Zaheer asked? It could be either up or down, Mr. Volna said, and the question gets to the risk-benefit tradeoff. The Board has taken the position that this must start with a discussion of the mission and goals, not just about saving money. Is there a risk variance in return, Professor Zaheer asked? There is not, Mr.

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Volna said, they are looking at exposure from activities (not ranges of tolerance, as is the case in some businesses). The discussion is in its infancy at the University and there will be a series of discussions with the Regents' Audit Committee about risk in various areas of University activity.

In terms of the University's current appetite for risk, Mr. Volna's presentation contained the statement that "there are perceptions that our current appetite for financial risk is too low" and that "internal controls [are] ratcheted down too tightly," that "current University culture leads to excessive process and over-regulation," and that "operational efficiency is being sacrificed." Mr. Volna also made the point that "EFS, as implemented, has contributed to these perceptions." The University's attitude is based on the economy and other events of the last 10-15 years—universities have long memories. People want to do the right thing, but when University policy is set, the colleges sometimes tighten them up a little and then departments tighten them up even more, and the resulting environment is so tightened that nothing happens. A risk-free university is one where not much happens, Mr. Volna observed, because it is bureaucratic and cautious.

In terms of the impact of economic challenges, "financial processes and activities must minimize administrative costs, be as efficient and effective as possible, and [must] leverage the new PeopleSoft technology." Mr. Volna reported that the "University is already reassessing its appetite for financial risk, as the state's economic situation becomes clear." He then noted a schematic "heat map" with risk and impact on the Y and X axes and various activities or units placed in the quadrant depending on whether one assesses the risks and impact (of things getting messed up) as high, moderate, or low. (For example, External Financial Reporting is identified as low risk but high impact; Alternative Investments are gauged to be high risk and high impact; Construction Transactions are identified as moderate risk and moderate impact.) The risks range from huge to small, Mr. Volna commented, and the schematic represented a point-in-time snapshot (May 2008) evaluating the risk of activities on a case-by-case basis to allow consideration of how to change the tolerance for risk in order to free up operational capacity for the University—without changing its level of risk.

The guiding principles in looking at risk are to "analyze all situations and factors within an activity or process; focus on highest risk situations or factors, choose the least restrictive form of risk management for the desired level of exposure, [and] the benefits of an increased appetite for risk should outweigh the costs and consequences." These are rather self-evident, Mr. Volna commented, but there has been a tendency to design the response to risk at the lowest common denominator and to treat all risks as the same—which they clearly are not. When one tries to assess and quantify risk, one finds a series of activities and mitigating factors, so the analysis is complex.

Mr. Volna noted a grid laying out risk assessment in terms of impact and probability on the x and y axes (high or low on each measure). There are four quadrants with examples of the alternatives: low impact, low probability (so accept the risk); high impact, low probability (share the risk, such as with insurance); high probably, low impact (control the risk); and high probability, high impact (either mitigate or eliminate the risk). What the University does not do a good job of is accepting risk in situations of low probability and low impact. A few years ago there was a story on WCCO news about chairs the University purchased; the reporter spun the story so it looked like the University was wasting money, and that did not sit well in the public eye, but it was a actually good example of a type of transaction that represents small dollars (low impact) with a low probability of negative outcomes. The University will not remain successful if it does not accept some level of risk.

Professor Martin recalled that the Committee has had a number of conversations about risk aversion and has concluded that the University is too risk-averse. For example, EFS requires everything must be touched by four or five hands, which is overkill. Mr. Volna said he did not disagree. He pointed out, however, that in looking at the heat map, it is difficult to say that the University should accept fewer controls in all areas. In some areas, if something is messed up, the impact can be enormous. The question is where the University can accept more risk and thereby improve operations.

What are such areas, Professor Martin inquired? Some of the things he deals with, Mr. Volna responded, such as transactional processes; to the extent that one can get stuff through the system as efficiently as possible, there is a gain for the University. His office is already implementing changes in the direction of increasing the efficiency of transactions. Another area where risk needs to be considered more than it has is in setting policies; whatever the University establishes as policy is what Associate Vice President Klatt's office will measure against when conducting an audit.

Professor Zaheer asked what process would be followed to change the University's appetite for risk. First, Mr. Volna said, it is necessary to do a rigorous analysis of activities in terms of their risk profiles and opportunity costs of decreasing risk with more regulation. They did that with the per-diem allowances for employees who travel for the University: They concluded that the risk of fraud was minimal and far outweighed by the reductions in the cost of paperwork and to collect receipts and documentation.

It is also a cultural issue, Professor Zaheer said. For example, the proposed conflict-of-interest policy seems to be completely out of line to the faculty in the Carlson School. How would that get to the level of a cost-benefit analysis? Mr. Volna said he was not directly involved in the conflict-of-interest policy discussion and they would need to visit with colleagues to make that kind of decision. With respect to culture, it is a challenge, he said; there are still people who do not believe the current per-diem policy is correct and that it should be more restrictive. What needs discussion is that the tradeoffs between control and efficiency are the ability to put more resources into teaching and research if policy changes allow for increased risk in appropriate areas. For example, the external-sales policy was intended to allow people/units to make sales without a lot of hurdles, and they need to re-think our approach to complying with the tax and insurance rules that may be hindering the sales. "Do we understand the tradeoffs? I am not sure," Mr. Volna concluded.

Professor Warwick said he was bothered by the Governor's proposed cuts to science funding, which throws away opportunities. Kurt Amplatz did so much that he could generate enough money to allow a large donation to the University. Someone needs to tell the Governor he should not cut funds that generate business.

Professor Chapman said he has talked twice to Vice President Mulcahy about the University's risk aversion stifling work. The problem is often in the General Counsel's office. Is there a strategy to get the General Counsel's office in line with the notion of making the University less risk-averse? Mr. Volna said that in his view, this is only the first of several conversations that cover several areas of University activity, conversations that must include the General Counsel, the Vice President for Human Resources, the Vice President for Research, and so on. There is a need for frank discussions about how the units can work together to deal with the problem. He can say that something could change, Mr. Volna related, but if the General Counsel is not comfortable with the change, all he can do is nibble at the edges. There needs to be a candid discussion across offices.

Ms. Zentner provided her perspective on risk, from the compliance area. They look at about 30 areas of the University—Boynton Health Service, Environmental Health and Safety, intercollegiate athletics, HIPPA, etc.—twice per year and ask their compliance partner in each area to identify risks and what must be done to address, reduce, mitigate, or eliminate them. After these exercises, her office identifies the greatest risks to the University (some of which can be one-time and some of which might be systemic) and prepares a report for Associate Vice President Klatt and General Counsel Mark Rotenberg.

One of their primary concerns, Ms. Zentner told the Committee, is a violation of federal, state, or local law, and University policy. The University cannot change the law but it can discuss its own policies. If a policy is not going to be monitored, of what value is it? If monitoring the policy will add another layer of bureaucracy, should it be retained? They can look at areas where policy may not be necessary and emphasize areas where the University must be in compliance.

Professor Martin asked if a statement from the Committee would be helpful. Mr. Volna said it would.

Later in the meeting, the Committee discussed adopting a statement, and following email exchanges in the days after the meeting, unanimously adopted the following statement:

> The Senate Committee on Finance and Planning has consulted numerous times in recent years both with administrators responsible for risk management and with those responsible for financial management. We have also heard from numerous faculty and staff on issues related to administrative mandates and the workload involved in the University's internal business processes. A common theme in most of the conversations is that the University has been in a risk-averse mode. We are now concerned that this risk-averse stance has been too severe for too long, and as a result is creating unwarranted administrative burdens on colleges, departments, faculty, and staff--a particularly serious problem during this time of reduced funding.
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> The Committee has discussed the University's appetite for risk and endorses a movement to increase the institution's tolerance for risk in appropriate areas, including, for example, human resources, research, student, financial, and other enterprise systems, and capital planning. The Committee (1) wishes to hear periodically from University officers about discussions with the Regents and administrators about reducing the level of risk aversion in various areas of University endeavor, and (2) asks that the administration present to the Committee a plan that identifies the rules/regulations that might be modified if the University pursues a stance of less risk aversion.

2. Purchasing Initiative

Mr. Volna next distributed copies of a handout entitled "Strategic Sourcing Master Plan," and related that about a year ago the President appointed an advisory committee to assist in identifying how to save money in purchasing. The University spends slightly over $1 billion per year on non-salary purchases, so even if 5% savings could be achieved, it would be a lot of money. The goal is to identify what the University is doing, through "spend analysis techniques"; they have had the benefit of the participation of a University faculty member who is an expert in the subject.

Mr. Volna reviewed briefly the major areas of University spending and pointed to five areas where they believe savings can be achieved readily and quickly: IT hardware, office-related products, air travel, scientific supplies, and courier services. In each case, there is an estimated saving range, and for each item there are three factors to consider in determining how aggressive the University wants to be in achieving savings (mission sensitivity, implementation complexity, and potential for demand management). The spending in the five areas totals about $35.6 million; they estimate potential savings of $1.8 to $4.4 million per year. The question is whether this pattern can be extrapolated to the $1 billion in total University non-salary spending. (Mr. Volna then provided the Committee, by way of example, a detailed explanation of how they assessed institutional spending on IT hardware—desktops, notebooks, servers, workstations, etc., and what they are doing to achieve savings. He noted, inter alia, that purchasers obtained very different levels of discount on the exact same product; in the case of one notebook computer, some buyers received the 38% discount provided by the University contract while others got only 22-34% because they purchased the item outside the contract.)

The bigger picture is the extent to which it will be possible to achieve savings in other areas. Mr. Volna provided a table suggesting where change would be easy and where it would be more difficult and noted the factors that affect the possibilities: industry complexity, market competition, change-management required, data availability, and overall difficulty. The areas where it is seen as most difficult to achieve savings are in IT software and services, insurance and benefits, administrative services, professional services, utilities, and facilities management and operations. The goal is to implement change in the first five areas and the move to other areas.

If they could make things happen in other spending categories, one can ask how much would the University save, Mr. Volna asked? The real question is "how much would you in departments save," he said to Committee members. They do not drive the decisions in central administration; the choices are made in the colleges and departments. They can provide information but it is the college that makes decisions. And the savings stay in the departments. In total, they believe that about 22% (~$231 million) of the non-salary spending is subject to savings; at the low end, 6%, the savings would be about $13 million per year; at the high end, 12%, about $28 million. A reasonable target is $18 million. Certain elements of University spending are invulnerable to savings, such as maintenance contracts, Oracle software, real estate, etc.

These savings do not eliminate positions, Mr. Volna affirmed in response to a question.

They have been implementing the changes for the initial five target areas since December and saw savings of about $305,000 in January; they will probably see a total savings of about $900,000 by the end of June, which is about where they expected to be, Mr. Volna related. They hope to get more information out so that departments/units adopt recommendations and the savings will increase. He said it would take about three years to achieve the full $18 million in annual savings. The real challenge, he said, is SUSTAINING the savings.

Mr. Rollefson said he has been at the University for 25 years and has been doing the kinds of things Mr. Volna described for a long time. Are there a lot of places in the University that buy things willy-nilly, or don't care about the price? Professor Martin said there are places where price-consciousness isn’t a priority. Mr. Rollefson did acknowledge that in some areas, the savings are not worth it (e.g., getting cheaper airfare but then required to depart at midnight and arrive home at 2:00 in the morning). Professor Martin recalled that the University has talked about negotiating with Delta and gotten nowhere; Mr. Volna reported that Delta was unimpressed that the University spends about $8 million per year with them and concluded that the airline merger is not going to benefit the Twin Cities area.

Organizations do these kinds of things and then they forget, Professor Zaheer observed. If there are no sanctions for spending more, and the effort is totally voluntary, how do they expect it will actually happen? Mr. Volna said that the last cuts were nothing like what is coming; in that case, the University responded by across-the-board cuts in travel and food budgets. It will be difficult to make institutional cuts of that kind this time due to the amount of the financial challenge and the institution's breadth and complexity: Athletics is like an entertainment complex, there is a research vessel in Lake Superior, there is all the research being conducted in the Academic Health Center—it is impossible to adopt a single set of rules. He said he believed most units would decide that achieving the savings is in their own best interest if they are provided the information they need.

Professor Zaheer agreed that information can be provided to department heads to tell them how to save money by doing small things, but they will need information on a regular basis, so he will need to create an information system that provides data on a monthly basis. Mr. Volna agreed and said they are looking at a tool that will provide information at a more granular level, although he thought it might be quarterly or during the annual budget-preparation process rather than monthly. They also recognize they have to communicate with the right people—IT people for IT issues, etc.—so they get the information to people who can use it. They may need a budget to create such a system, Professor Zaheer observed.

3. EFS Update

Professor Martin next asked Mr. Volna to provide an update on the Enterprise Financial System.

Mr. Volna said they have been following their FY10 work plan, which is seeking to address parts of the system that users said did not work or were inconvenient. He received a budget for the work but not all of the money will be needed because the Office of Information Technology was able to accommodate some of the changes within its existing budget. There were six categories of things they wanted to fix and they expect to get through four of them by March. The feedback they have received suggests that the changes are improving usability.

In terms of appetite for risk, there was a feeling when EFS went live that it was important to create a separation-of-duties environment (which in general is not a bad idea because it helps protect institutional assets). The mistake they made was they were not sure how much of the separation would be in the system and how much in roles and responsibilities; as things have worked out, the screws got turned a little too tightly, so on February 1 they relaxed some of the separation requirements that were created through limiting people's roles. Now there are only two or three roles that people cannot hold simultaneously, compared to five or six before. This allows more flexibility in the unit and more cross-training.

In the approval process, the system had capabilities that the University modified, Mr. Volna reported, but they repeatedly heard that even with back-up approvers, the system can be slow. So they are piloting changes with a number of units to give each an emergency approver. There was only one for the system, but the person did not receive very many calls, so they did not know if the person was not needed or units just didn't call. They heard anecdotes, however, that made them realize the position was needed. Emergency approvers can approve ANY purchase in the system, so they are developing techniques and rules to see if it works to have emergency approvers at the college, campus, or RRC level. If it does, that will provide easier access for every unit. This will entail accepting a little more risk for the University, but thus far he personally knows all of the individuals designated as emergency approvers for the pilot, and their skills and experience, and he is comfortable they will not increase risk. He said he does not regret not expanding the number of emergency approvers beyond those in place when the system went live—but he wished they could have expanded the number earlier.

The other major area of concern is reporting and a lot of changes have been made. There are a lot more "canned" reports now available and more revisions in the queue for April. People want a tool to download and use data, but the system tools are not as easy to use as they could be or what people had before EFS, so they have had meetings with a large number of people to develop a set of requirements for what people want in the download and data-warehouse tools. They are seeking approval to proceed with a selection and implementation of the tools from the vice presidents in the very near future.

One challenge in reporting is the technology behind UM Reports. That was a 15-year-old homegrown tool that is running out of support knowledge and capacity, Mr. Volna said, and they need to identify a replacement tool. That will not mean the reports will necessarily look different. They have a good understanding of what people want; the question is whether the Office of Information Technology can support the request. OIT faces large budget cuts, so they are under pressure to do things as effectively as possible for them, but he said they do not want something that is cheap for OIT but that is not easy to use in the units.

The Committee at one point expressed concern about the speed at which changes are being implemented and a possible need for training. They have put a lot of work into revising training and job aids with additional information on the changes that have been made since go-live. That will continue through the end of the year. In response to a question about requiring people to be retrained, Mr. Volna indicated that nothing is mandatory but they hope people take advantage of what is available. Last year they made 45 site visits in preparation for the year-end closing; this year they will make fewer and will try to open them up to multiple colleges and units, because they do not feel there is as much need for one-to-one interaction, but they will have someone available to help units.

Professor Martin asked what the two areas are (out of six) that they have not addressed. The two that have proven to be slower and more problematic, Mr. Volna said, are reporting (they have a list of 25 reports that are wanted but they only have the capacity to add about five per month) and workflow/approval (people want Forms Nirvana, but that would take an enormous amount of work and money to re-create, so they hope that with the other changes they are implementing, they can reduce the time that transactions are stuck or waiting to the point that users find it acceptable).

Mr. Rollefson thanked Mr. Volna for his willingness to listen and change his views and to move the bureaucracy in a good direction. Things are going in the right direction.

Are the clusters working, Professor Martin asked? They have morphed a bit, Mr. Volna said; they have made changes and compromises so that they seem to be working better. They had to add staff, Mr. Rollefson said, but some units could eliminate department positions. The clusters started as a one-size-fits-all approach but they have evolved over time. Mr. Volna said the cluster concept was based on understandings and assumptions about a lot of things, but he is not opposed to change if those are things that need not be worried about. They can change.

Mr. Volna was asked about future plans, such as for the Internal Service Organizations (ISOs), which buy and sell within the University. The practices are driven by circular A21 from the federal government, which establishes cost principles. The biggest problem in terms of processing transactions through the system is Research Animal Resources, Mr. Volna said. There have been a variety of billing practices that have been terrible for departments, so they are working on a new approach that provides a summary and back-up rather than massive detail. They also dealt with the same issues 15-16 years ago and ended up with tough policies for ISOs and specific requirements on billing; they are re-evaluating all the issues with respect to developing new practices.

Professor Martin thanked Mr. Volna for all his reports.

4. Statement on Cost Pools and Financial Aid

The Committee had a discussion of a draft resolution on cost pools and financial aid and decided to revisit the draft at a later meeting. Several points were made in the discussion.

The question, Professor Martin said, is whether, in this environment of declining state support, the University can afford the open-ended commitment to financial aid that is currently in place. Mr. Pfutzenreuter pointed out that as tuition increases, the Founders scholarships obligations must be met while those of the middle-income scholarships need not be. The question is how wealthy one must be, how high a family income must a student have, before he or she does not qualify for the latter. 43% of the increase in the cost pools for next year is due to the undergraduate and professional-school financial aid matches.

Vice President Pfutzenreuter noted that the cost-pool charges for cost pools with financial aid for undergraduates are levied on the undergraduate colleges. Professor Martin said that the arrangements worked well for a number of years but the financial-aid piece has now become a significant part of the cost pools; the question is the level of commitment that can be sustained. Mr. Pfutzenreuter said that from his point of view, the question is about the long-term strategy for financial aid, and then comes the question of how to pay for it. The real issue, he said, is the long-term approach to tuition and financial aid, given that the University is moving rapidly into a "high-tuition, high-aid" environment. How to attribute the costs of the aid is secondary to paying for it.

Ms. King said that a general statement is needed and then a question about the cost pool. The question is how to pay for financial aid programs, Professor Martin reiterated. Mr. Pfutzenreuter agreed; the question is not about the cost pool, the question is about the programs.

It was agreed that the Committee needed to consider this statement further, and decided to bring it back at the next meeting. Professor Martin adjourned this one at 3:55.

-- Gary Engstrand

University of Minnesota