Minutes*

Senate Committee on Finance and Planning
Tuesday, November 4, 2008
2:00 – 3:45
238A Morrill Hall

Present: Judith Martin (chair), Jon Binks, Joao Boavida, Steen Erikson, Steve Fitzgerald, Zachary Gunderson, Lyndel King, Thomas Klein, Joseph Konstan, Russell Luepker, Mikael Moseley, Paul Olin, Richard Pfutzenreuter, Justin Revenaugh, Terry Roe, Karen Seashore, Michael Volna, Warren Warwick

Absent: V. V. Chari, Adam Faitek, Lincoln Kallsen, Kara Kersteter, Kathleen O'Brien, Michael Rollefson, Gwen Rudney, Thomas Stinson, Aks Zaheer

Guests: Stuart Mason (Director, Office of Investments and Banking); Vice President Stephen Cawley (Office of Information Technology)

[In these minutes: (1) report on the endowment; (2) update on EFS; (3) closed discussion of the biennial request]

1. Report on the Endowment

Professor Martin convened the meeting at 2:00 and welcomed Mr. Mason to provide a report on the endowment. Mr. Mason began by commenting that "flat is the new up and we're striving for flat." He distributed copies of the 6/30/08 Annual Report from his office, the Office of Investments and Banking, which he provided to the Board of Regents a few weeks ago. This is part of normal reporting on all managed funds, he said, and the last few pages provided an update since June 30.

Mr. Mason noted the economic setting with which everyone is familiar: the subprime meltdown, the lending liquidity crisis, the drop in the Fed funds rate to 2.00, the spike in oil prices to $146 per barrel, the drop in the domestic and international stock markets, and the steep drop in financial stocks. It has been, he observed, a period of high volatility. In that context he reviewed the value of the Consolidated Endowment Fund (CEF), the Long-Term Reserves (GIP), the Short-Term Reserves (TIP), and other assets. The numbers for June 30 were as follows (all in $ millions):

	2006	2007	2008
CEF	869.6	1167.7	1140.3
GIP	31.4	31.3	33.9
TIP	661.0	548.4	612.0

For the University of Minnesota Foundation, the corresponding values for the three years were 1196.5, 1413.0, and 1384.7. For the Minnesota Medical Foundation, they were 223.8, 262.0, and 248.8. Mr. Mason also noted the data for invested assets related to indebtedness (largely unspent bond funds) and

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RUMINCO, the University's self-insured insurance company. The total value of all these University funds is about $3.6 billion.

The total assets of CEF, $1.14 billion, were down 4.8% for the year ending June 30, 2008, the first time it fell below the benchmark (that year, 0.2% increase) in a long time. $75.9 million was contributed and $45.5 million was disbursed (a 4.7% rate of disbursal). The TIP saw a return of 3.8% for the year, against an (unattainable) benchmark of 6.2%, based on a broad mix of investments, with $21.9 million transferred to central reserves. The GIP increased in value by 2.7%, about what was expected.

Mr. Mason reviewed briefly the benchmarks and portfolio returns for the three funds. Over a five-year period the CEF and TIF outperformed the benchmark (the GIF did not), but in the last year they have not done as well. These are both reviewed each year by the Investment Advisory Committee and reported to the Regents.

One of the graphs Mr. Mason presented plotted the ten-year performance of the CEF against inflation. Except for a period in 2002-03, it has performed significantly better than inflation even with declines in the last year. The Board policy calls for the CEF to keep up with inflation after payouts are made, which it has done. Professor Konstan asked if there would be a different answer if one picked a different start time for the analysis. Mr. Mason replied that the Board has asked for a ten-year analysis; if one thinks intergenerationally, however, the period should be 20-30 years. As the number of years in the analysis is reduced, the question of keeping up with inflation is irrelevant—one is trying to beat the market. They are meeting their long-term goals, he said.

Mr. Mason then noted the spending policy and payouts from the CEF for the last 10 years. In FY 1997 the CEF paid out $19 million; in FY 2008 it paid out $45.5 million; over the last 10 years it has paid out $374.8 million. The payout rate in FY08 was 4.7%; it will be reduced to 4.5% in 2010.

Since June 30 there has been the meltdown of financial institutions, government intervention in the banking industry, frozen credit markets, a plunge in oil prices, US economic woes have spread overseas, and recession hits. The Russell 3000 index (the largest domestic stocks) had been trending down since July, 2007; in October 2008 it plunged downward. Mr. Mason observed there had been a precipitous decline (over time) up to October; in the month of October the markets fell by an amount equal to the amount they had fallen in the previous 15 months. International stocks did even worse. Market returns followed down, and CEF returns were down 7.1% as of 9/30/08. They have not been sitting on their hands while this has been occurring, Mr. Mason assured the Committee; they have changed the asset allocation of the CEF in order to reduce exposure to public stocks. CEF had been invested 50% in stocks, compared to a target of 35-40%. That practice served the University well when prices were going up, but in the last 15 months the percentage has been reduced to below the target.

Mr. Mason noted the trend line in CEF payouts, which now uses a five-year trailing average (it had been a three-year trailing average before June, 2004). The line has been sloping up since September of 2004, including through September of this year. The question he has heard from deans, Mr. Mason related, is how the market will affect what they receive in CEF distributions. The payouts will continue to increase for a while because they are based on a rolling three-year average. Professor Roe asked if there will be a review of the payout rate if the line begins to trend down rather than up. There is a discussion of the payout rate planned with the Regents, Mr. Mason reported, as part of a broader discussion. That discussion is driven in part by Senator Grassley's urging that college and university foundations be required to pay out at least 5% each year, Mr. Pfutzenreuter commented. Mr. Mason recalled that the averaging was extended to five years and the payout rate was reduced when the market was going up (so units received more dollars in absolute terms even though the rate was being decreased). These changes will help to ensure the success of the endowment over the long term. But the line will go down, he said, if there is a long period of negative results in the market. The good news, he said, is that CEF has a broadly diversified portfolio so is less affected by market turmoil— it is sees less of an increase when markets are roaring but less of a decrease when they crash.

Professor Martin thanked Mr. Mason for his report.

2. Update on the Enterprise Financial System

Professor Martin turned now to Messrs. Pfutzenreuter and Volna and also welcomed Vice President Cawley to the meeting to provide an update on EFS. She said she asked Mr. Volna to join the Committee again to talk about the level of angst that EFS has caused—and asked him if it has gone down.

Mr. Volna said he heard loud and clear that reporting was the number one issue and they have changed their strategy to put everyone on it to address the problems. The original strategy had been to use the tools that came with the software, but they have learned that while those tools are very powerful, they are not user-friendly and will be more useful for analysis than for day-to-day management reports. As a result, they are developing new tools that look like the ones from the previous system that will deliver reports at the program level; those tools are about ready to go. Users will be able to go outside PeopleSoft and will have the same access to UM Reports. They will also deliver reports that roll up to the department level or down to an optional chart level, to better allow department management of accounts. There will also be a detail report (which will come a little later than the first two because of the complexity of pulling data to compile it). The reports should be ready within 2-4 weeks.

Professor Konstan asked what information must be provided in order to get to different accounts. Mr. Volna said that three or four variables are required but that it will be similar to what one goes through to get to UM Reports, and one need not go into PeopleSoft.

The other thing they have heard about is data integrity, Mr. Volna said. They believe they have fixed that problem, and encumbrances and payroll are now being budget-checked properly. This will resolve problems with payroll encumbrances not being reported. They have heard that a lot of the pieces that are available people don't know about, so they are also building a library of the 30-40 most-used inquiries and queries of the system and will explain what they are for.

These changes should address the vast majority of the major concerns about reporting, Mr. Volna said. He gave credit to the Academic Health Center, which developed similar tools for their own use; his office expanded them to the system. The Committee had a lengthy discussion of the technical elements involved in generating summary reports and the time they take.

Mr. Volna identified the other priorities they are dealing with.

-- Fixing bugs
-- Providing as much end-user support as they can; they have added people and training for the help line, so 60% of problems are now solved with the caller on the line while 40% are referred to appropriate

staff or the swat team (and it can take anywhere from a few hours to a couple of days to research the problem)

-- Training staff is available for labs and for on-site training
-- Providing more user support for vendor payments.

Once these are completed, they will be able to evaluate the assumptions made when the system was configured, Mr. Volna said. What works as designed—but is ugly (e.g., matching rules on invoices: perhaps some of them can be eliminated). Mr. Pfutzenreuter said they needed first to get the data and reporting right and now must visit other issues—and they will, he promised.

Mr. Klein asked Mr. Cawley if OIT felt they had adequate staffing and the right mix of skills to handle the fixes and complete the EFS implementation. Mr. Cawley said the size is about right from a technical staffing standpoint.

Professor Seashore said that with the previous system, if one ordered 5 of something at $50 each but received 4 at $80 each, the problem could be solved at the department level. Why is not the notice now located at the level with the information? Mr. Volna said that is proving to be difficult. The notice is to go to the department where the goods go and the invoice to the procurement specialist, and the department and procurement specialist are supposed to talk about matching problems (did the department get what it wanted?). That did not have to take place in the previous system, and that will be one reason they may eliminate some of the matching rules. So is it because the system does not know the match, the department's inability to work within the new system, or problems at the procurement specialist level that is the main source of current problems and concerns? They need to analyze the problem before they address the question, Messrs. Cawley and Volna both responded. They need to know why this is occurring, Professor Seashore said—that is the crux of the problem, and there is not currently enough information in the system to allow one to identify where and why the problems are occurring. The information hot-line statistics are an insufficient data source.

Mr. Pfutzenreuter said that there is not a widespread problem with vendor payments but the processes have made the work more difficult, and this is a problem they are still trying to address. Part of the problem is the centralization-decentralization issue, Professor Roe said, and the lack of coordination between different decision-making processes. Mr. Volna said that some Big Ten institutions are more centralized than the University but they still manage to make the system work.

From whose perspective, Professor Seashore asked? It can work at the institutional level but be very cumbersome at the individual and department level. She added that comparisons gained by speaking only with university financial administrators may not give a full picture of inefficiencies that occur at lower levels. The effectiveness of the EFS system must be judged, in the long run, by whether departments are able to get by with fewer personnel to manage their financial systems and by their satisfaction with the responsiveness of EFS to their needs. Mr. Mason, who had stayed at the meeting to hear the EFS discussion, commented that his office works in financial systems and what they have seen is that in some departments there is enormous resistance to change and resistance to being trained on a relatively simple system. Not all problems are in the system; there are some people problems, but the user-friendliness of the system will be solved over time.

Mr. Erikson commented on transparency and said that in the old system, one could find what one wanted at the level of detail needed. In the new one, one cannot (although perhaps he did not have the access he needed); will that improve so that people can track things down? He also asked why there is such a strict separation of duties and such a limited ability to see the entire transaction. If more people could see the entire transaction and its history, there would be less delay and confusion. Mr. Volna said that the older system was custom-built and very different from EFS in the opportunity to provide access. EFS is different in security but he said he was willing to revisit the rules if it has locked things up too much. The system is designed so that if something is bought at the local level, local approval is all that is required if there are no exceptions involved. If there are exceptions required, the procurement specialist can override the system and approve a transaction, so they want to be careful about granting that authority.

Professor Konstan said it is important not to lose sight of the cultural changes, even with something as simple as receiving. With the previous system the University had a small-business model that worked well. Packages were received at departments and placed right in the mailboxes of faculty, students, and staff. Now it is trying to add a receiving function, which means that someone else receives packages and takes the packing slip; in his department, this has raised concerns since faculty don't want packages that may have confidential contents opened (like requests for tenure letters). Nobody can explain why things will be better by having a single point of opening packages.

Professor Konstan said his department has six or seven FTE staff who process transactions, similar to other departments, and the department would love to learn that investments in these new enterprise systems will mean they can spend less on accounting staff and more on their mission. If there is no net benefit to the unit, and just a change in culture that results in needing more people to provide a measure of central control, then the change was not worth it.

Mr. Klein suggested it would be helpful to have a short list of frequent questions that pop up and to report on how the EFS team followed through, what caused the problem, and what the people using the system now are saying about the improvement. They are trying to track that at the macro level, Mr. Volna said, and would be glad to report on what they are seeing and what they are doing.

As for morale, the accounting staff feel they are no longer trusted and that they are seen as stupid because they don't get it and it was just a matter of training, Ms. King said. It would help if they would address the morale issue.

There is a critical question beneath Mr. Klein's request, Professor Seashore said: there is need to look at the costs and benefits at the level of the user: the department, center, program. If EFS can't be translated to a significant benefit in efficiency and morale, the Committee needs to know that. Professor Martin added that the whole idea of EFS was that it was needed because CUFS was no longer supported. So the University spent a lot of money on EFS and now has the added cost to fix it. It would help to know the total cost (quite apart from the "cost" in morale). Professor Seashore said she would like to see a cost/benefit analysis down the line—to colleges, departments, and individuals. That will take some time, Mr. Volna said. Mr. Erikson said he regularly hears that everything takes longer to do; is there any way to quantify that problem? Mr. Pfutzenreuter said he has also heard from Vice President Mulcahy that it takes twice as long to enter information (e.g., for a grant), and maybe the University needs to seek a fix from PeopleSoft. Mr. Cawley said they did do an analysis of business processes, and could do so again once the system is running.

Professor Martin thanked Messrs. Cawley and Volna for joining the meeting. Mr. Volna said he would be glad to provide another update as the Committee wishes.

3. Biennial Request

Professor Martin closed the meeting for a discussion with Vice President Pfutzenreuter about the upcoming biennial request and the University's economic situation. In the course of discussion, the Committee touched on the issue of classes offered at non-standard times and the corresponding demand on classroom resources, whether or not the Committee should recommend to the President that he not issue the $180 million in debt that has been authorized, on the need to look at the data and facts on productivity as the basis for making any cuts that may be necessary, that with respect to physical facility improvements, "the University is not here to remodel, it is here to teach," the difficulty that a small group of five central officers faces in making decisions about targeted cuts, the need to have a conversation with Senior Vice President Cerra about the status of the Medical School budget, and the fact that until more people at the University understand the financial challenges coming, and begin to track budgets more closely, the University's business will not be conducted more efficiently.

Professor Martin adjourned the meeting at 4:00.

-- Gary Engstrand

University of Minnesota