Budget Assessment and Implementation Initiative

Steering Group Meeting | February 2, 2015
The goal of today’s meeting is to:

- Introduce model development elements
- Select or narrow a model philosophy
  - Review scorecard results
  - Walk through mock-up frameworks (separate hand-outs)
- Discuss model structure elements (funds, accounts, organizations)
- Begin allocation and incentives discussions
- Review next steps
Effective budget redesign typically requires four stages of decisions, with each level requiring increased levels of institutional insights and customizations.

1. **Philosophy** – reflects the university’s desired financial management model, considering elements such as centralization, authority, accountability and responsibility

2. **Structure** – reflects the elements of the model with respect to scope of funds, categorization of operating units, presentation of data, etc.

3. **Rules** – reflects how the model will portray the institution’s internal economy and drive behavior

4. **Customizations** – reflects model tweaks to address operational realities, institutional culture, and local unit needs
As part of our December discussion, Steering Committee members were asked to complete a score card that evaluates the intersection between the approved guiding principles and the different model frameworks.

Based on the tabulated results, it appears a performance or RCM-like (incentive-based) framework is best aligned with the desired goals for a new resource allocation model.
A review of benefits and considerations should be made as the group considers the top scoring frameworks (excluding ETOB due to stakeholder concerns).

<table>
<thead>
<tr>
<th>Potential Benefits</th>
<th>Incentive-Based Models (RCM)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Focus placed on achievement of university mission</td>
<td>Promotes entrepreneurship</td>
</tr>
<tr>
<td>Productivity data is used</td>
<td>Encourages efficient operation of administrative units</td>
</tr>
<tr>
<td>Encourages planning</td>
<td>Aligns revenues and costs</td>
</tr>
<tr>
<td>Rewards high-performing units</td>
<td>Facilitates conversations about priorities</td>
</tr>
<tr>
<td>May sacrifice quality of outputs</td>
<td>Requires strong central and local unit leadership</td>
</tr>
<tr>
<td>Poor performance may lead to a “downward spiral”</td>
<td>Criticized for replacing academic with financial focus</td>
</tr>
<tr>
<td>Units may experience time-lag between decision and results</td>
<td>Challenges academic collaboration</td>
</tr>
</tbody>
</table>

Based on the scorecard results, mock-up frameworks reviewed, and our discussion, can we confirm a single model framework for model development?
Following a confirmed philosophy, three critical components need to be addressed in order to build the base model structure.

**Fund Inclusion**
- What fund types should be included or excluded?

**Unit Organization**
- What units should be classified as “revenue-generating” units?
- What auxiliaries should be included? Service centers?
- How should Centers and Institutes be treated?
- How should administrative units be organized?

**Account Organization**
- How should revenues and expenses be organized?
As part of the budget development effort, Huron recommends that UWP adopt an “all-funds” approach to budgeting, as opposed to the “selected funds” approach that is used today.

Advantages
- Provides increased transparency by showing all sources of revenue and expense within UWP
- Shifts focus of budget planning conversations from single source of funds to all available
- Improves understanding across units of activities being conducted (e.g., volume of research activity)
- Supports projecting future periods by promoting discussions on all activities

Considerations
- Impact of simultaneous transition to a new model and type of funds being reported
- Results in additional assumption needs for previously non-budgeted fund types
- Represents increased administrative effort

Adopting an “all-funds” approach to resource allocation can provide considerable advantages to support UWP’s desire to align resources with activities tied with the University’s mission.
Selecting an incentive-based model will require a framework that categorizes campus units by their impact on revenue generation and their level of financial self-sustainability, with 2-3 categories of units.

<table>
<thead>
<tr>
<th>Revenue Units</th>
<th>Support Units</th>
<th>Hybrid Units</th>
</tr>
</thead>
</table>
| - Ability to influence revenue generation  
  - Price  
  - Quantity (not captive market)  
- Cover direct costs with generated revenue  
- Fully-allocated administrative (central) costs  
- Accountable for performance, retaining both surpluses and losses  
- Pay subvention tax  
| - Limited-to-no ability to influence revenue  
- Provide services and/or support to Academic, Auxiliary, and C&I Units  
- No allocation of central costs  
- Accountable for optimal service levels  
- Encouraged to justify funding levels through benchmarking  
- Accountable for fiscal performance  
- IT, HR, and Facilities may have service-level agreements with Revenue Units  
| - Units that do not fall cleanly into one of the other categories; could be a Revenue Unit or a Support Unit  
- If Revenue Unit, may not be fully burdened with cost  
- For simplicity and consistency, these are not typically recommended |
If support units require organization, the selection of administrative and support units should be driven by balancing the desired level of transparency and the desired level of model complexity.

**Number of Pools**

- **Few**
  - Simple
  - Drives academic focus to revenues
  - Provides flexibility to central administration
  - Avoids functional “witch-hunts”
  - Reduces time spent in committees

- **Many**
  - Increases transparency
  - Closer approximation of economic reality
  - Provides functional accountability
  - Connects costs and service levels
  - Allows for fine-tuning adjustments via multiple levers to achieve desired baseline cost allocations

---

Case studies suggest that mature incentive-based institutions have evolved to using few cost pools, while institutions new to incentive-based budgeting often utilized a high number of cost pools.
Revenue allocations are primarily focused on tuition and state appropriations, with the balance of revenues allocated directly to units as generated. Other allocations may be required based on UWP’s unique operating environment and selected model framework.

<table>
<thead>
<tr>
<th>Revenue Category</th>
<th>Illustrative Allocation Rules</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undergraduate Tuition &amp; Fees</td>
<td>• Two-year average of generated tuition</td>
</tr>
<tr>
<td></td>
<td>• Based on student credit hours (weighted undergraduate)</td>
</tr>
<tr>
<td></td>
<td>• Split: 50-80% (instruction) and 20-50% (major or record)</td>
</tr>
<tr>
<td>Graduate Tuition &amp; Fees</td>
<td>• As earned</td>
</tr>
<tr>
<td>General Fees</td>
<td>• Based on student credit hours or headcount</td>
</tr>
<tr>
<td>State Appropriations</td>
<td>• Split between instruction and research</td>
</tr>
<tr>
<td>Grants &amp; Contracts</td>
<td>• As earned</td>
</tr>
<tr>
<td>F&amp;A Recovery</td>
<td>• As earned</td>
</tr>
<tr>
<td>Gifts</td>
<td>• As earned</td>
</tr>
<tr>
<td>Sales &amp; Services, Other Sources</td>
<td>• As earned</td>
</tr>
<tr>
<td>Investment Income</td>
<td>• As earned (based on flat rate)</td>
</tr>
<tr>
<td></td>
<td>• To CFO’s subvention fund</td>
</tr>
</tbody>
</table>

What revenues should we include as part of future revenue allocation discussions?
Universities may employ several methodologies to allocate tuition; many institutions opt to take an iterative approach that splits the allocation of general tuition revenues.

### Direct Tuition Revenue
- Tuition revenues for programs tracked specifically within academic units are identified within the general ledger.
- Those revenues are directly assigned to the appropriate academic unit.

### General Tuition Revenue
- The general tuition revenue pool is divided according to the proposed instruction-record split.
- Each sub-grouping is allocated according to the academic unit’s share of either instructed or enrolled (major or record) credit hours.
Benchmarking revenue sharing agreements between the college of instruction and the college of record generally yields splits between 50/50 and 80/20.

**Distribution of Tuition Revenue**

- **Tuition Allocated to College of Instruction**
  - + Recognizes direct costs of instruction
  - − Incentive for course competition and redundancy
  - − Misaligned incentives for academic advising

- **Tuition Allocated to College of Record**
  - + Promotes recruitment
  - − Does not recognize direct costs of instruction
  - − Leads to “holding company” mentality
Model Development Elements
Credit Hour Weight Consideration

Some institutions have adopted a model that includes a credit hour weight for purposes of allocating tuition; this approach has a number of pros and cons that must be considered as part of the development process.

<table>
<thead>
<tr>
<th>Description</th>
<th>No Weighting</th>
<th>Weighting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tuition revenues are allocated based on unweighted student credit hours (SCH)</td>
<td></td>
<td>Tuition revenues are allocated based on SCH weights</td>
</tr>
<tr>
<td>Assumes price points and the cost of delivery is equal for all SCH</td>
<td></td>
<td>Accounts for different price points and the cost of delivery for SCH</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pros</th>
<th>Incorporates variation in delivery costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emphasis is placed on credit hours</td>
<td>Reduces importance of subvention fund subsidies</td>
</tr>
<tr>
<td>Incentives align with revenue generation</td>
<td></td>
</tr>
<tr>
<td>Simple and transparent; subsidies are explicit</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cons</th>
<th>Too much emphasis may be placed on weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does not incorporate academic delivery costs</td>
<td>Less transparency as subsidies are implicit in the allocation formulas</td>
</tr>
<tr>
<td>Requires large subventions to support units with high academic delivery costs</td>
<td>Cost-based weighting may dilute incentives for cost reduction</td>
</tr>
</tbody>
</table>

**Example Weighting Factors**

- Historical cost per student credit hour
- Faculty-to-student ratio
- Faculty teaching load
- Cost per faculty FTE
- Differential tuition
- Peer/industry indices
State appropriations are often leveraged to create incentives that support the research and instruction missions.

- Calculated and targeted indirect cost recovery rates can be used to set a targeted subsidy rate to identify an amount of resources to support sponsored programs activity.
- These resources are captured as an “off-the-top” component from appropriations, with the balance remaining used to support instruction and academic support.
Next Steps

Huron

- Incorporate feedback from today’s discussion
- Build selected model framework (dependent on decision confirmation)
- Draft next campus-wide leadership message (topic: philosophy and next steps)
- Prepare for February 16th Steering Committee discussion

Steering Group

- Provide Huron with continued feedback
- Continue to engage colleagues and local units on initiative progress
- Participate in February 16th Steering Committee discussion

Dean Scheduling

Does the week of February 16 work for individual college discussions (1 hour)?

Goal: Share an actuals income statement and potential allocation variable

Participants: Dean, Associate Dean, Business/Budget Officer Representative