University Fiscal Health Advisory Committee
Lighty 403
June 12, 2018
AGENDA
11:00a.m. to Noon

1. Introductions (Stacy Pearson)
    a. Attachment: Committee Roster
2. Committee charge and responsibilities (Stacy Pearson)

- Examine current budgetary practices and propose new budget models for the future.
- Suggest strategic ways to enhance revenue.
- Suggest strategies for streamlining administrative operations to decrease costs.
- Review programs or initiatives proposed for discontinuation to determine the larger impact on the campus community and student experience.
- Examine administrative costs versus instructional costs and submit recommendations for making our ratio comparable to our peer institutions.
- Solicit suggestions from the greater WSU community about general university budget matters and provide responses to ideas on a periodic basis.
- Facilitate communication about the budget in a transparent and informative manner with the university community.

3. Fiscal recovery plan and current status for FY2018—Kelley Westhof
    a. Attachment: May 2018 year end projection
    b. Attachment: Unfunded Commitments
4. Athletics fiscal recovery plan—Stacy Pearson
    a. Attachment: Athletics five year budget plan
5. Some history and a path forward
    a. Attachment
6. Next steps
    a. Attachment: Budget Model Machine Graphic
    b. Meeting schedule and frequency

ACTION ITEM #3
2018-2019 Athletics Budget Approval
(Joan King)

June 8, 2018

TO ALL MEMBERS OF THE BOARD OF REGENTS

SUBJECT: 2018-2019 Athletic Budget Approval

PROPOSED: That the Washington State University Board of Regents:
(1) Approve the 2018-2019 WSU Athletics budget; (2) Approve the plan for reducing operating deficits in future fiscal years; and (3) Approve transfers necessary at FY18 year-end to cover the deficit balance.

SUBMITTED BY: Joan King, Associate Vice President/Chief University Budget Officer

SUPPORTING INFORMATION: Washington State University has implemented a 3-year fiscal health restoration plan and has nearly completed the first year of the plan. As a part of the University's plan, WSU Athletics has developed a targeted plan to ensure that it will return to an operating breakeven position in the next few years. The Athletics plan also ensures that WSU is fully compliant with Substitute Senate Bill 6493, which was passed by the 65th Legislature during its 2018 regular session. This bill requires certain actions of the boards of the state's colleges and universities, related to intercollegiate athletics programs. (See SSB 6493, attached.)

This bill requires that the WSU Board of Regents specifically approve, in an open public meeting, the annual budget for the Athletics program; the plan for reducing the operating deficits in future fiscal year; and any transfers that are necessary at year-end for WSU Athletics. The three prior fiscal years' financial statements for the program will also be conspicuously posted to the University's web site.

ATTACHMENTS: Attachment A: Substitute Senate Bill 6493
Attachment B: FY15 – FY17 Athletics Actual Revenues and Expenditures

Attachment C: FY18 Athletics Budget, including estimates of May and June activity plus FY 2019-2023 Proposed Budgets with breakeven in 20-23
Attachment D: Transfer Process and Projected Amounts, based on financial information as of 4/30/18

Attachment A

S-4650.1

SUBSTITUTE SENATE BILL 6493

State of Washington 65th Legislature 2018 Regular Session

By Senate Higher Education & Workforce Development (originally sponsored by Senators Billig, Palumbo, Ranker, Carlyle, Hasegawa, and Kuderer)

READ FIRST TIME 02/01/18.

AN ACT Relating to increased transparency and accountability for intercollegiate athletic programs at public colleges and universities; and adding a new section to chapter 28B.15 RCW.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec. 1.** A new section is added to chapter 28B.15 RCW to read as follows:

(1) The board of trustees or regents of each of the state's colleges and universities under RCW 28B.15.005 must specifically approve in an open public meeting, the annual budget for its programs for intercollegiate athletic competition in advance of any expenditure for that fiscal year.

(2) If a college or university's programs experience an operating deficit at the end of any fiscal year, the board of trustees or regents must:

(a) Approve a plan for how the programs will reduce operating deficits in future fiscal years;

(b) Conspicuously post to the college or university's web site the financial statements of the programs for the three prior fiscal years and the plan in (a) of this subsection. Any public records request for a copy of the financial statements or plan must be at no cost to the requester;

(c) Approve in advance any transfer exceeding two hundred fifty thousand dollars; and

(d) Except as provided in subsection (3) of this section, approve in advance any expenditure over two hundred fifty thousand dollars that was not included in the approved annual budget, in an open public meeting.

(3) Approval of an expenditure by the board of trustees or regents may occur at the next regularly scheduled board meeting after the expenditure if the expenditure is:

(a) Time sensitive and the net fiscal impact of the expenditure results in a direct revenue gain to the program; or

(b) Required to meet an immediate public safety need.

(4) Unless the context clearly requires otherwise, the definitions in this subsection apply throughout this section:

(a) "Expenditure" means any discrete purchase, payment, contract amendment, or expense, unless that expenditure is required to meet an immediate public safety need.

(b) "Operating costs" means all direct and indirect costs to operate the programs including the value of any costs that are typically charged to departments, but have been waived by the college or university. Waived costs include, but are not limited to the value of tuition waivers for student athletes and any internal or central service costs not charged to the programs.

(c) "Operating deficit" means the amount by which the aggregate operating costs of the programs exceeds the aggregated receipts and revenue directly generated by the programs in the fiscal year.

(d) "Programs for intercollegiate athletic competition" or "programs" means those programs established under RCW 28B.10.703.

(e) "Transfers" means any transfer of moneys to an account used by programs for intercollegiate athletic competition from any account that holds moneys not directly generated by the programs.

--- END ---

Washington State University
FY15 - FY17 Athletics Actual Revenue & Expenses

Attachment B

($ M)	Actuals		
	FY15	FY16	FY17
REVENUES:			
01 - Ticket Sales	6.8	5.5	7.7
02 - Direct State/Gov Support	-	-	-
03 - Student Fees	1.1	0.8	1.6
04 - Direct Inst. Support	3.7	3.7	3.3
05 - Less Xfer to Inst.	-	-	-
06 - Indirect Inst. Support	1.2	0.4	0.4
06A - Debt Service, Lease, Rentals	-	-	-
07 - Guarantee Revenue	0.4	0.3	0.3
08 - Contributions	6.4	7.6	8.1
09 - In-Kind	0.2	0.1	0.1
10 - 3rd Party Compensation	-	-	-
11 - Media Rights	17.0	17.9	18.8
12 - NCAA Distribution	1.3	1.3	3.2
13 - Conference Distribution	8.2	9.4	10.7
14 - Program/Concessions etc.	0.2	0.2	0.9
15 - Royalties/Advert. etc.	4.0	6.3	4.4
16 - Sport Camp Revenue	0.4	0.4	0.4
17 - Endowments	0.6	0.6	0.6
18 - Other Revenue	2.4	2.1	1.4
19 - Bowl Revenue	-	1.9	2.4
Total Revenue	54.1	58.8	64.3
EXPENSES:			
20 - Athletic Aid	9.7	11.0	10.7
21 - Guarantee Expense	1.3	1.7	1.6
22 - Coaches Comp: WSU	10.7	11.7	11.8
23 - Coaches Comp: 3rd Party	-	-	-
24 - Admin Comp: WSU	12.1	12.8	13.4
25 - Admin Comp: 3rd Party	-	-	-
26 - Severence	1.0	0.0	0.1
27 - Recruiting	1.2	1.1	1.2
28 - Team Travel	4.0	4.0	4.1
29 - Equipment	2.4	3.0	2.0
30 - Game Expenses	2.4	1.6	1.8
31 - Fund Raising/Marketing	1.9	2.4	2.2
32 - Sport Camp Expense	0.3	0.3	0.3
33 - Spirit Groups	0.2	0.2	0.2
34 - Facilities: Debt/Lease/Rental	11.5	9.7	9.3
35 - Direct Admin Expense	0.0	2.3	2.4
36 - Indirect Inst. Support	1.2	0.4	0.4
37 - Medical/Insurance	1.1	1.0	0.8
38 - Dues & Memberships	1.8	1.8	1.7
39 - Student-Athlete meals	-	0.8	1.0
40 - Other Expense	4.5	4.1	4.9
41 - Bowl Expenses	0.0	1.7	1.9
Total Expenses	67.4	71.7	71.8
Net Operating Income	(13.3)	(12.9)	(7.5)
Cumulative Deficit	(38.6)	(51.5)	(59.0)

Washington State University
FY19 through FY23 Athletics Budget

Attachment C

($ M)	Estimated FY18 Y-end	Budgets as of 5/25/18 FY19	FY20	FY21	FY22	FY23
REVENUES:						
01 - Ticket Sales	8.5	9.5	8.6	10.3	10.4	11.5
02 - Direct State/Gov Support	-	-	-	-	-	-
03 - Student Fees	1.6	1.5	2.3	2.3	3.2	3.2
04 - Direct Inst. Support	3.5	3.4	3.5	3.6	3.7	3.8
05 - Less Xfer to Inst.	-	-	-	-	-	-
06 - Indirect Inst. Support	0.4	0.4	0.4	0.4	0.4	0.5
06A - Debt Service, Lease, Rentals	-	-	-	-	-	-
07 - Guarantee Revenue	0.0	0.3	-	0.2	-	0.3
08 - Contributions	8.2	7.7	8.7	9.6	9.9	10.7
09 - In-Kind	1.6	1.6	1.6	1.6	1.6	1.6
10 - 3rd Party Compensation	-	-	-	-	-	-
11 - Media Rights	19.6	20.6	21.6	22.8	23.9	25.2
12 - NCAA Distribution	1.3	1.3	1.3	1.4	1.4	1.5
13 - Conference Distribution	11.9	12.1	12.8	12.5	13.0	12.9
14 - Program/Concessions etc.	0.9	1.0	1.4	1.4	1.5	1.5
15 - Royalties/Advert. etc.	2.9	4.1	4.2	4.3	4.4	4.6
16 - Sport Camp Revenue	0.3	0.3	0.3	0.3	0.3	0.3
17 - Endowments	0.6	0.6	0.6	0.7	0.7	0.7
18 - Other Revenue	1.9	1.8	1.7	1.8	1.8	1.9
19 - Bowl Revenue	2.3	2.5	2.6	2.7	2.8	2.9
Total Revenue	65.6	68.6	71.7	75.9	79.1	83.0
EXPENSES:						
20 - Athletic Aid	10.5	11.4	11.6	11.9	12.2	12.5
21 - Guarantee Expense	1.7	1.7	1.8	1.3	1.8	1.4
22 - Coaches Comp: WSU	12.7	13.3	13.8	14.9	15.4	15.9
23 - Coaches Comp: 3rd Party	-	-	-	-	-	-
24 - Admin Comp: WSU	13.8	14.0	14.1	14.3	14.6	15.0
25 - Admin Comp: 3rd Party	-	-	-	-	-	-
26 - Severence	1.0	-	-	-	-	-
27 - Recruiting	1.5	1.5	1.5	1.6	1.6	1.6
28 - Team Travel	4.1	4.3	4.6	4.6	4.7	4.8
29 - Equipment	2.3	2.0	2.0	2.0	2.0	2.2
30 - Game Expenses	2.4	2.4	2.3	2.5	2.6	2.7
31 - Fund Raising/Marketing	2.2	2.1	2.2	2.2	2.3	2.3
32 - Sport Camp Expense	0.3	0.3	0.3	0.3	0.3	0.3
33 - Spirit Groups	0.2	0.2	0.2	0.2	0.2	0.2
34 - Facilities: Debt/Lease/Rental	9.2	9.2	9.2	9.2	9.2	9.2
35 - Direct Admin Expense	1.7	1.8	1.9	1.9	1.9	2.0
36 - Indirect Inst. Support	0.4	0.4	0.4	0.4	0.4	0.5
37 - Medical/Insurance	0.9	0.9	0.9	1.0	1.0	1.0
38 - Dues & Memberships	2.2	2.2	2.2	2.3	2.4	2.4
39 - Student-Athlete meals	1.0	0.9	1.0	1.0	1.0	1.0
40 - Other Expense	4.3	4.3	4.4	4.6	4.7	4.8
41 - Bowl Expenses	2.4	2.5	2.6	2.7	2.8	2.9
Total Expenses	74.7	75.3	77.0	78.8	81.1	82.9
Net Operating Income	(9.1)	(6.7)	(5.3)	(3.0)	(2.0)	0.2
Cumulative Deficit	(68.1)	(74.8)	(80.1)	(83.1)	(85.1)	(84.9)

Washington State University

Athletics Transfers at Year End

Attachment D

	ACTUAL				*Cash balance*
	FY2014	**FY2015**	**FY2016**	**FY2017**	***as of 5/23/18***
Cumulative Athletics operating deficit before transfers	(25.3)	(38.9)	(51.5)	(59.0)	(78.2)

Note: Additional revenues and expenses are expected before the end of the fiscal year. These may change the FY18 results significantly. Three possible scenarios are shown below.

Athletic's projection of FY18 (full-year) activity is (9.1 M), which would result in a cumulative deficit of **(68.1 M).** This is the FY17 cumulative deficit (59.0 M) plus the FY18 projected deficit (9.1 M) after all revenue and expenses have been booked from May and June activity. This actual fiscal year end number will not be known until late in July.

	Projection 1 Best Case	Projection 2 Midpoint	Projection 3 Worst Case
Current position for Athletics based on snapshot of **cash balance** as of **May 23, 2018**	(78.2)	(78.2)	(78.2)
Possible range of additional anticipated revenue through June, 2018	14.2	13.2	11.7
Possible range of additional anticipated expenses through June, 2018	(2.1)	(3.1)	(4.0)
Anticipated ending balance on 6/30/18 + Transfers required	(66.1)	(68.1)	(70.5)
Transfers to offset deficit at the end of the fiscal year			
Housing and Dining	44.6	44.6	44.6
Parking & Transportation	4.8	4.8	4.8
Creamery Building Reserve	2.7	2.7	2.7
Misc. Auxiliaries and Self-Sustaining Activities	8.2	8.2	8.2
Health and Wellness Services	4.7	4.7	4.7
Real Estate Management	1.1	3.1	5.5
Total Transfers	66.1	68.1	70.5

WSU & Intercollegiate Athletics: A Closer Look

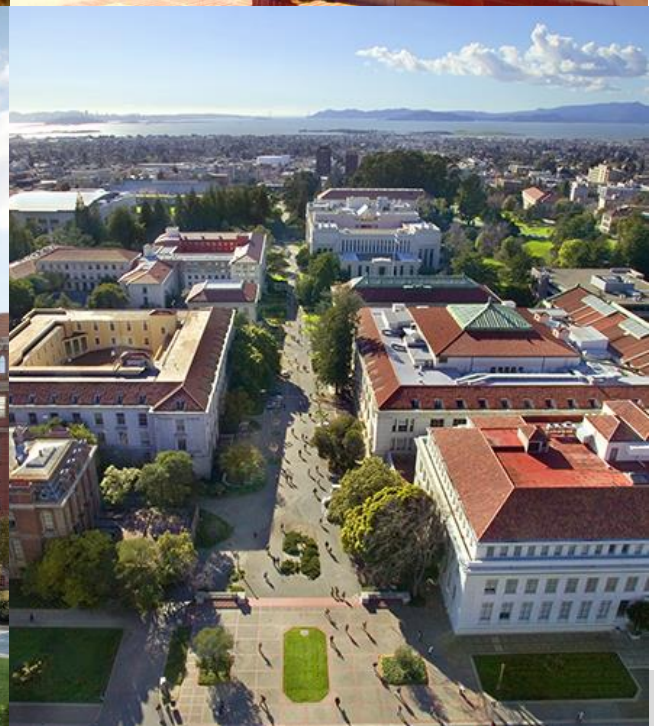
June 8, 2018

Kirk H. Schulz, President

Washington State University

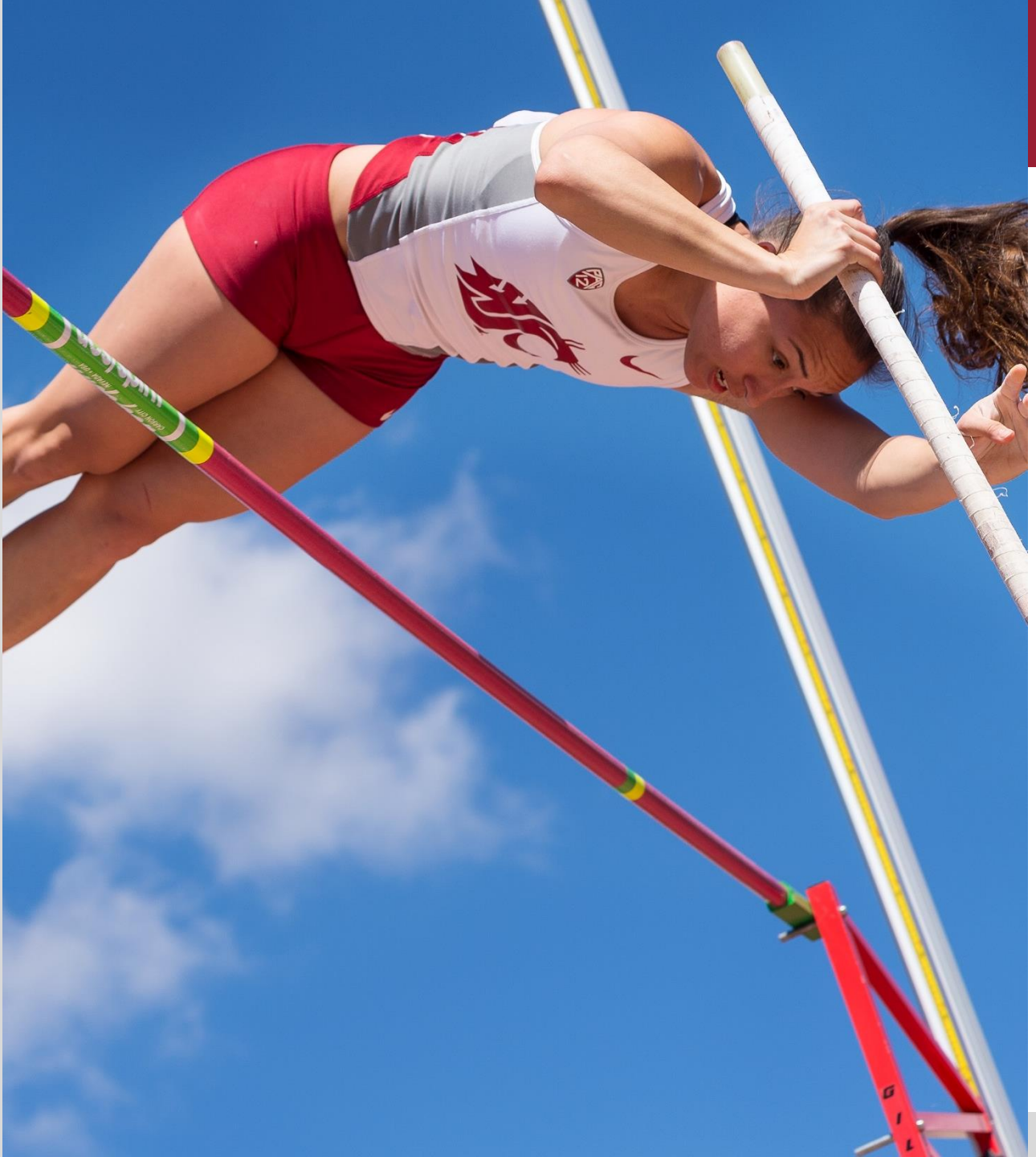
Benefits of Pac-12 membership



Affiliation with other world-class institutions

Boosts student recruitment

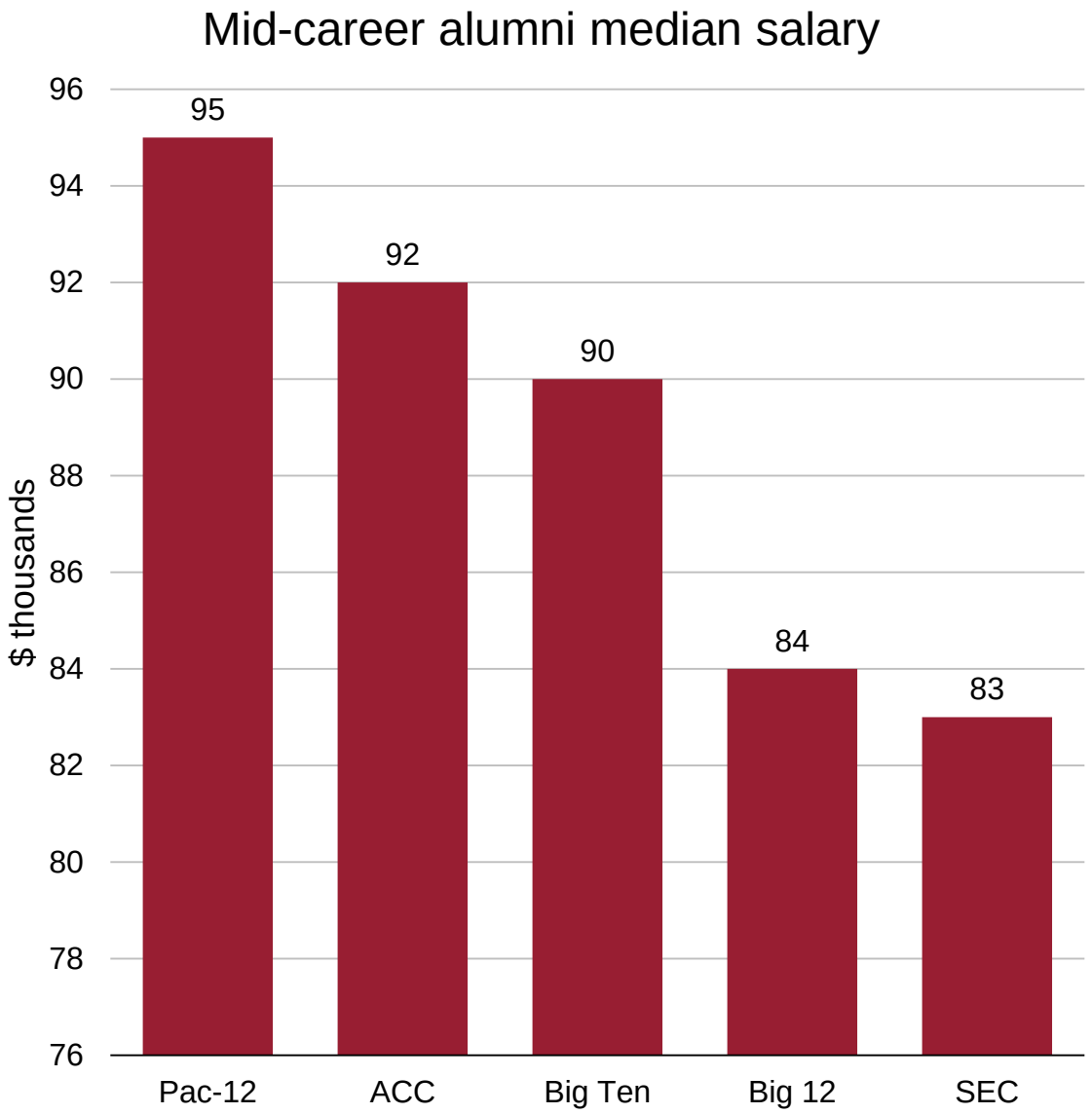


Tuition and fees paid by student-athletes

Benefits of Pac-12 membership

Boosts economy of Pullman and eastern Washington

Benefits of Pac-12 membership



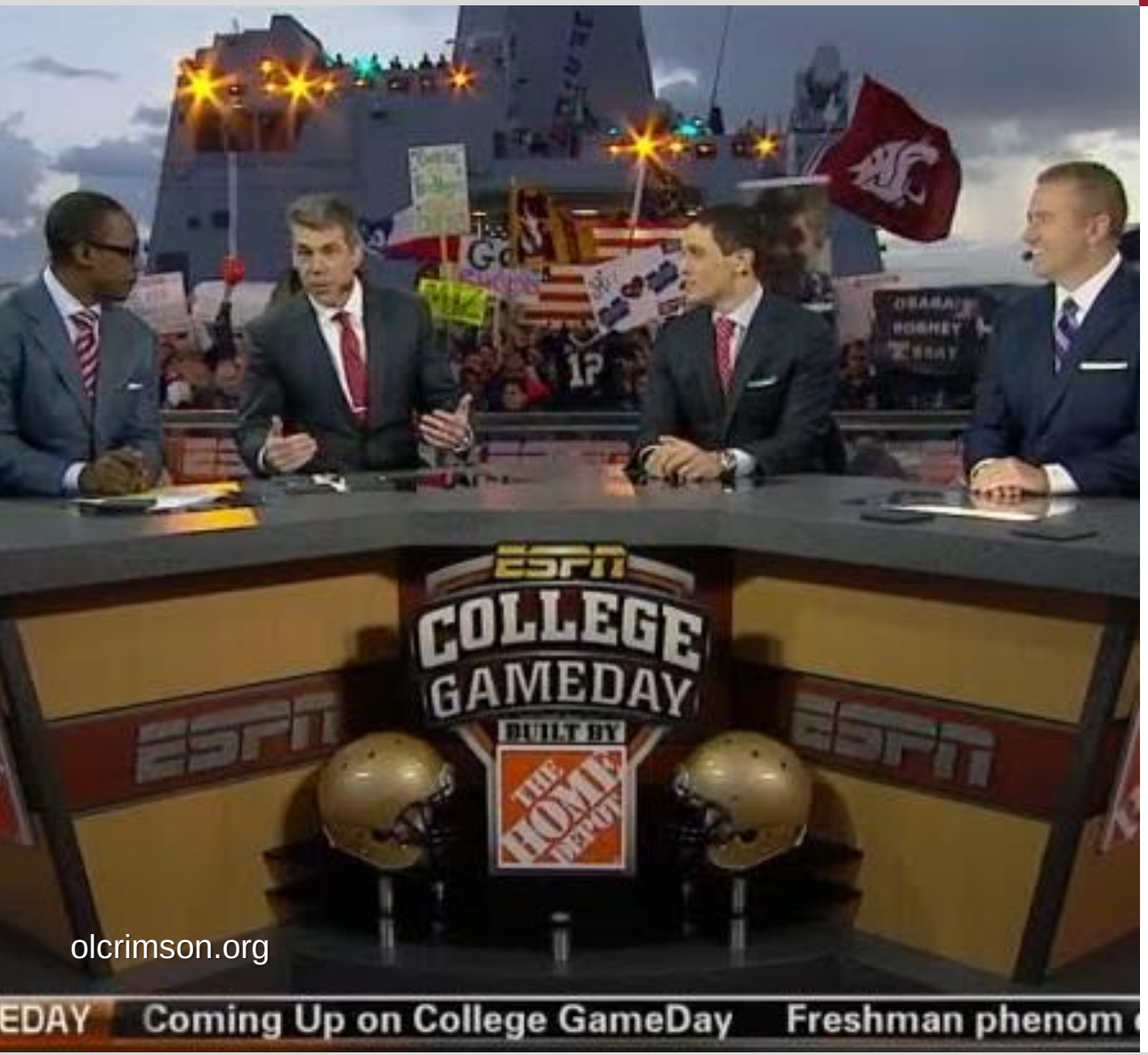
Boosts career salaries of alumni

Builds WSU brand

Builds WSU brand

National TV broadcast
Friday night football vs. USC

Builds WSU brand



Ol’ Crimson on ESPN College Game Day

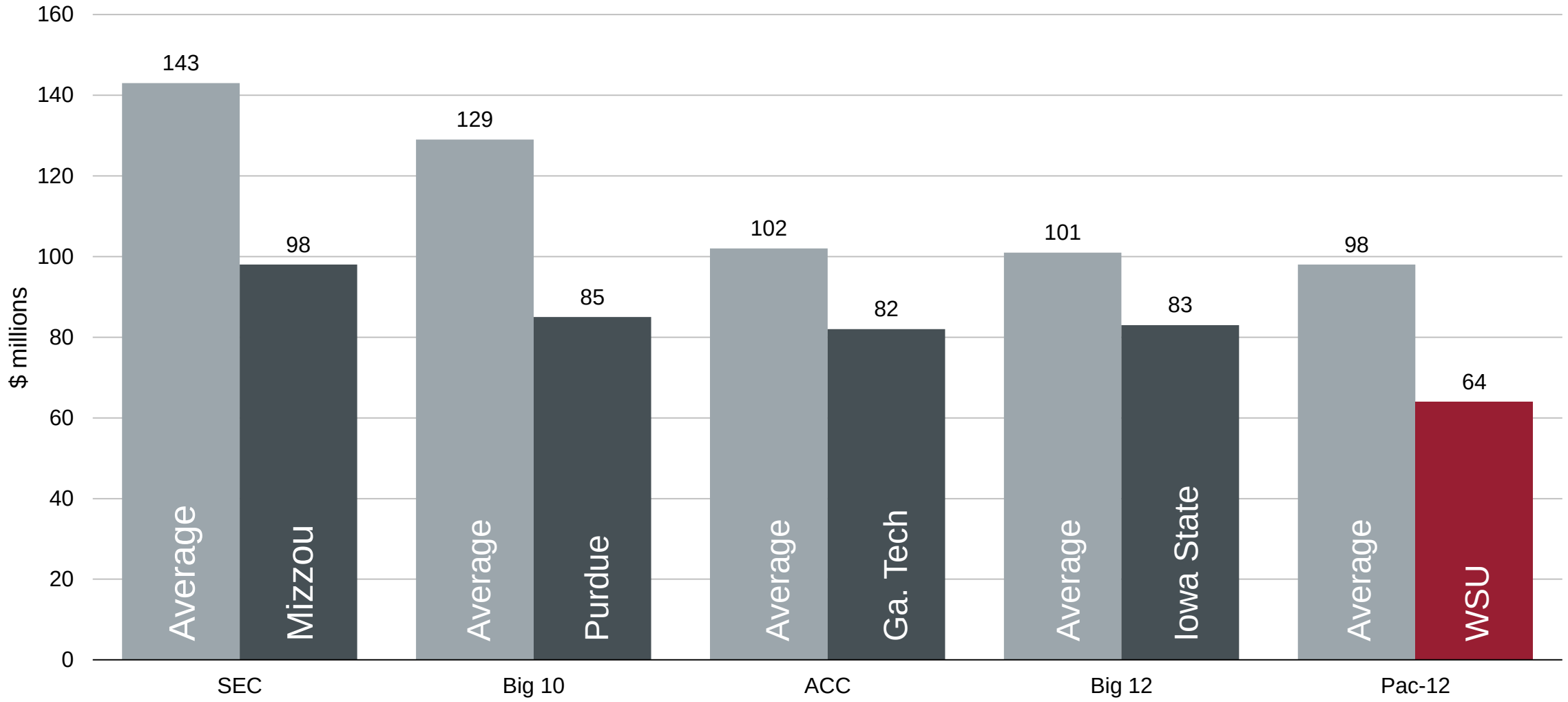
Builds WSU brand

Enriches the student experience and Pullman's college town reputation

Athletic budget: A closer look

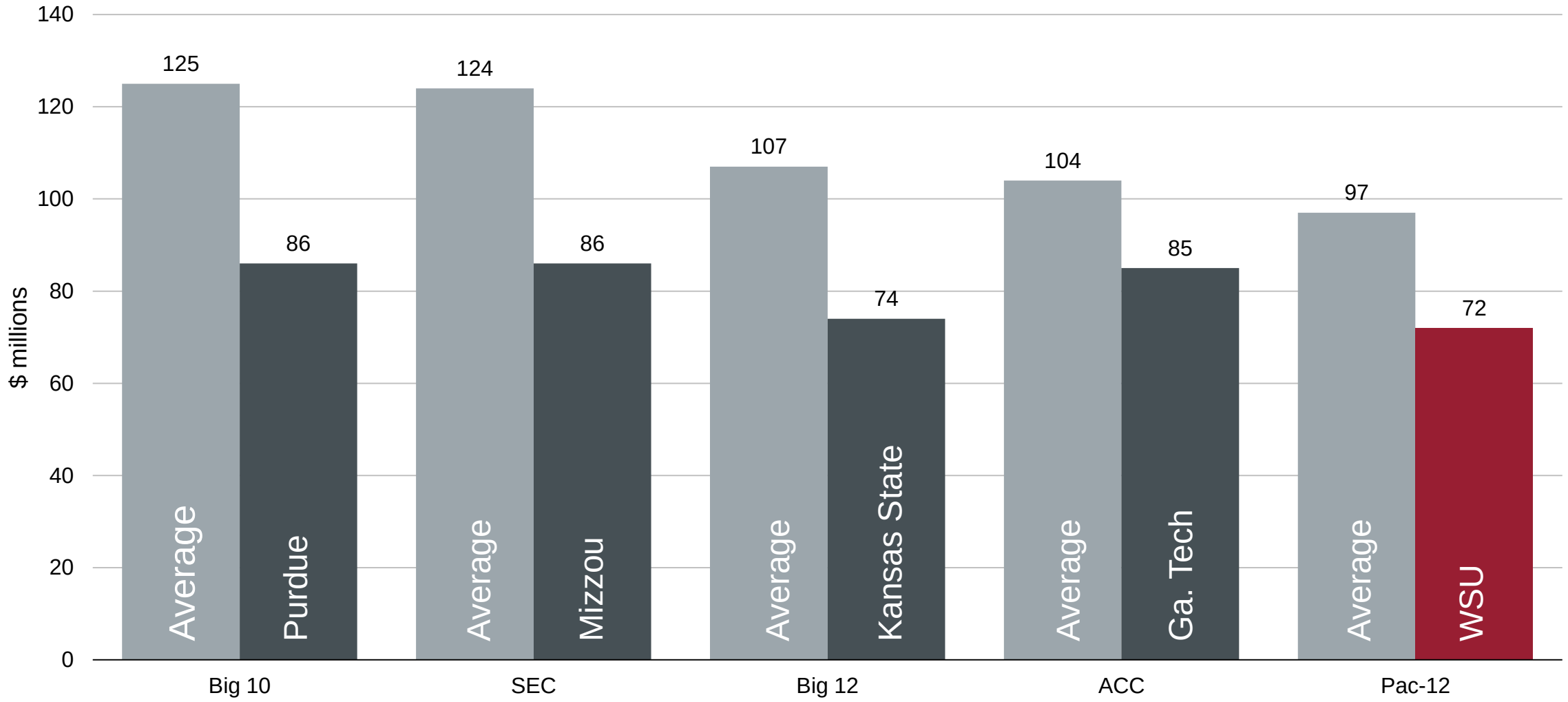
Athletic budget: A closer look

WSU revenues vs Power 5 peers, FY17



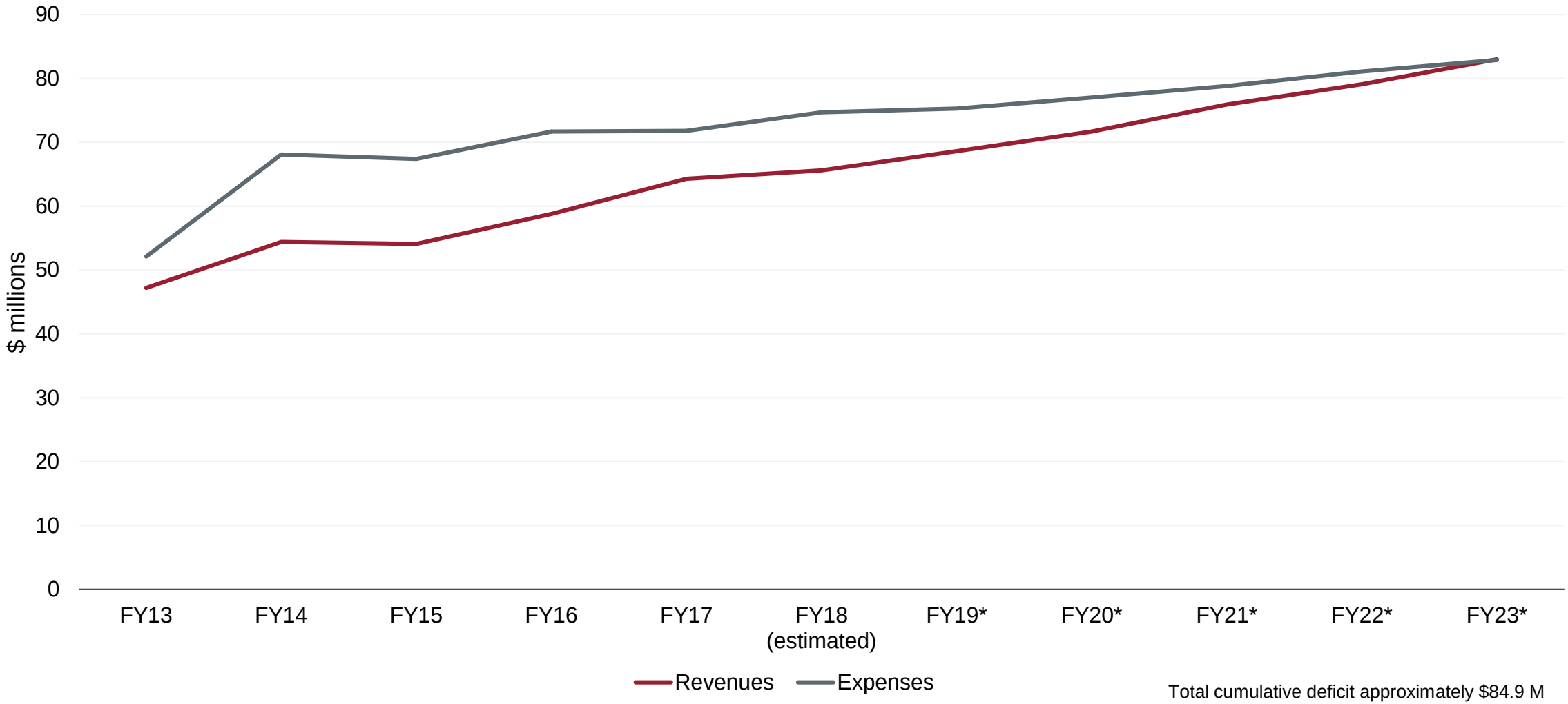
Athletic budget: A closer look

WSU expenses vs Power 5 peers, FY 17



Athletic budget: A closer look

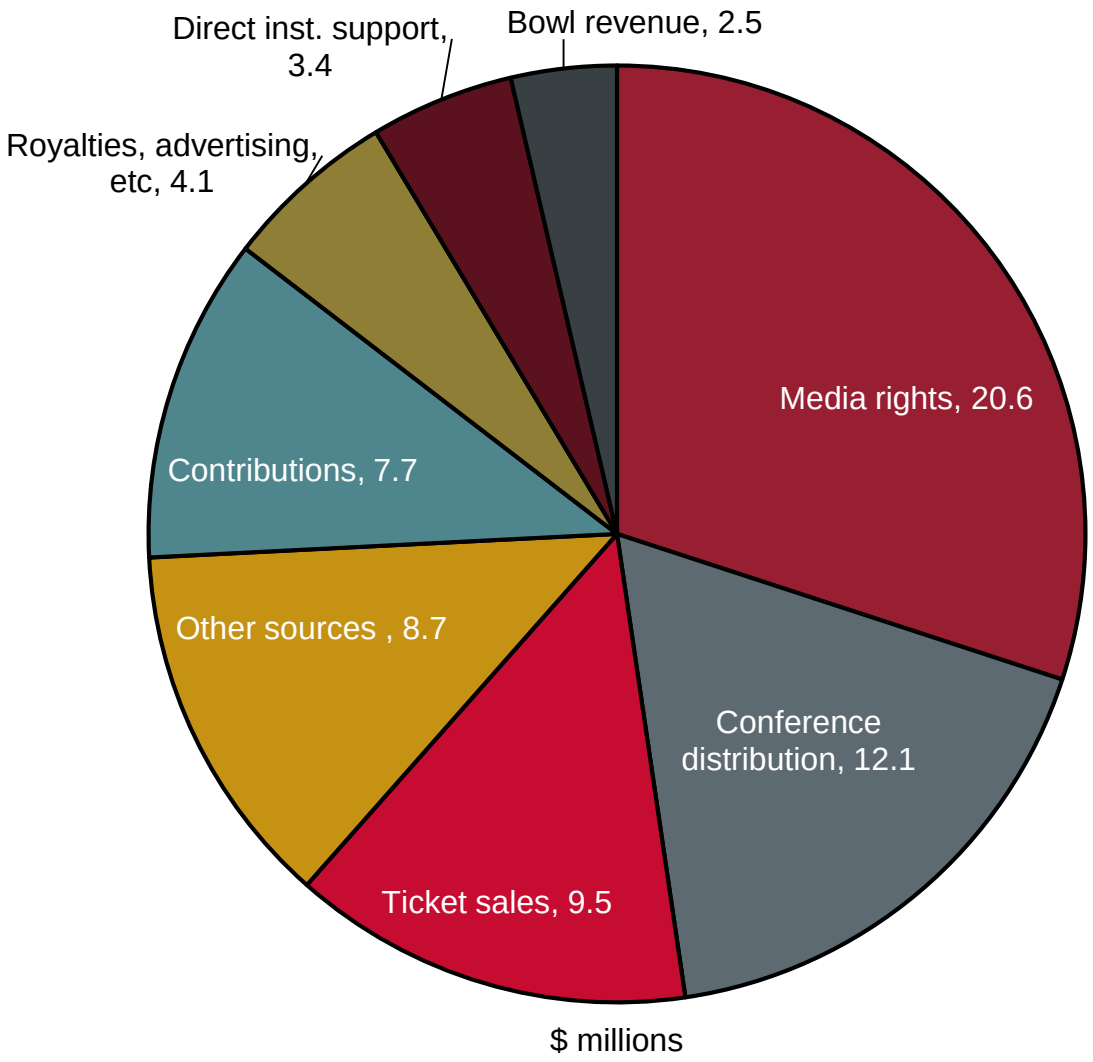
Athletics revenues & expenditures, FY13 to FY23



Total cumulative deficit approximately $84.9 M

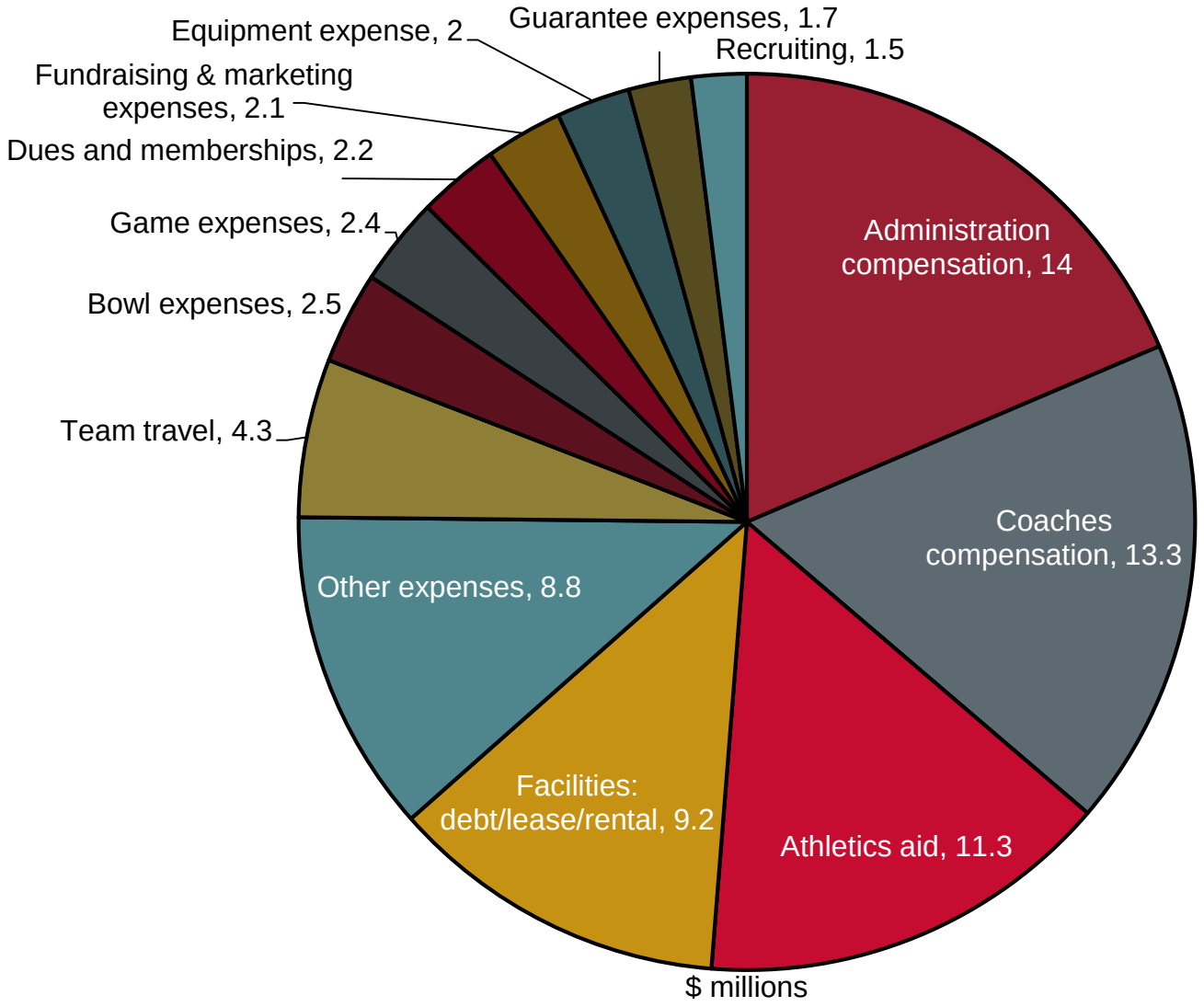
Athletic budget: A closer look

Projected athletics revenue, FY19: $68.6 million

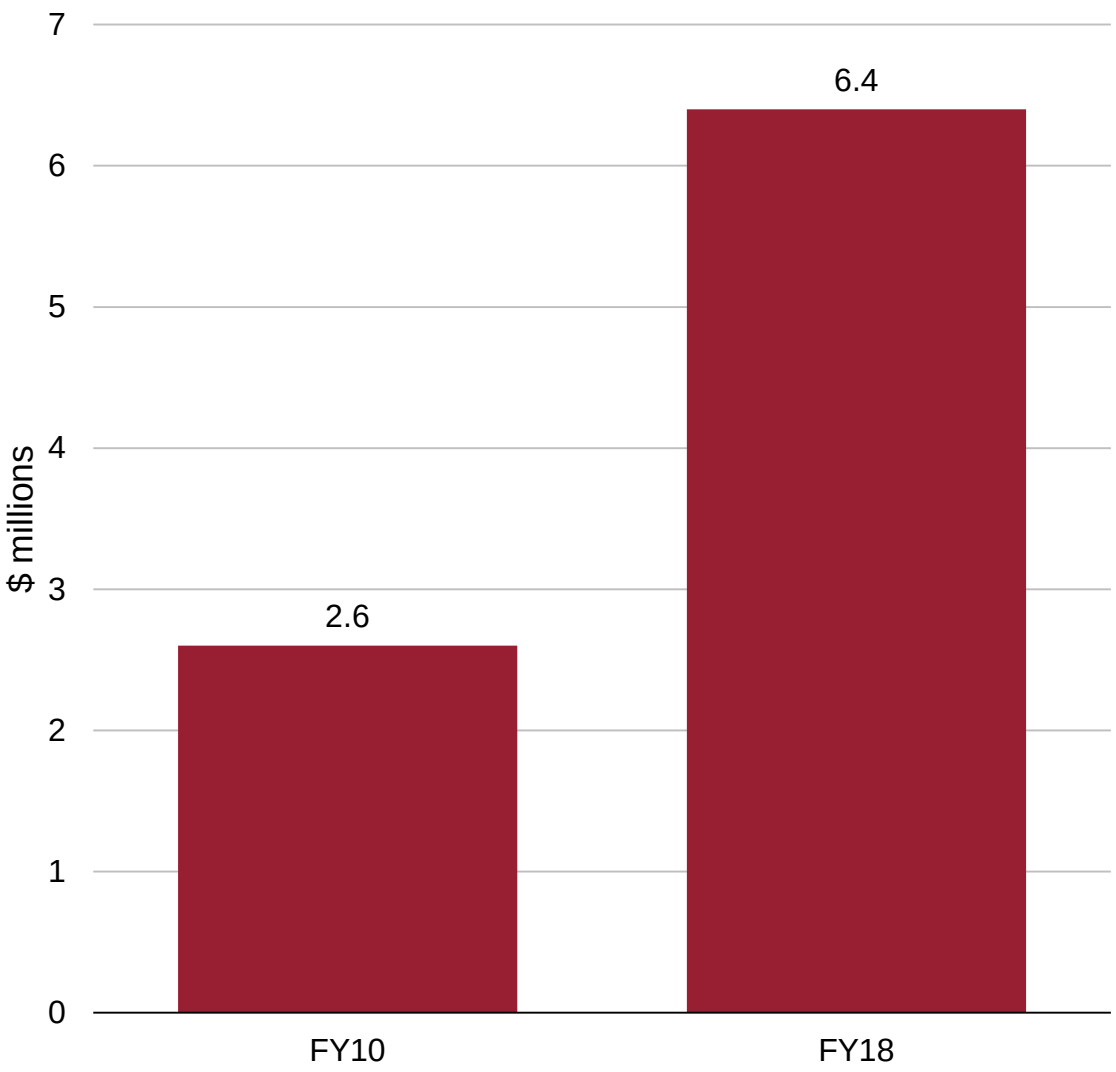


Athletic budget: A closer look

Projected athletics expenses, FY19: $75.3 million

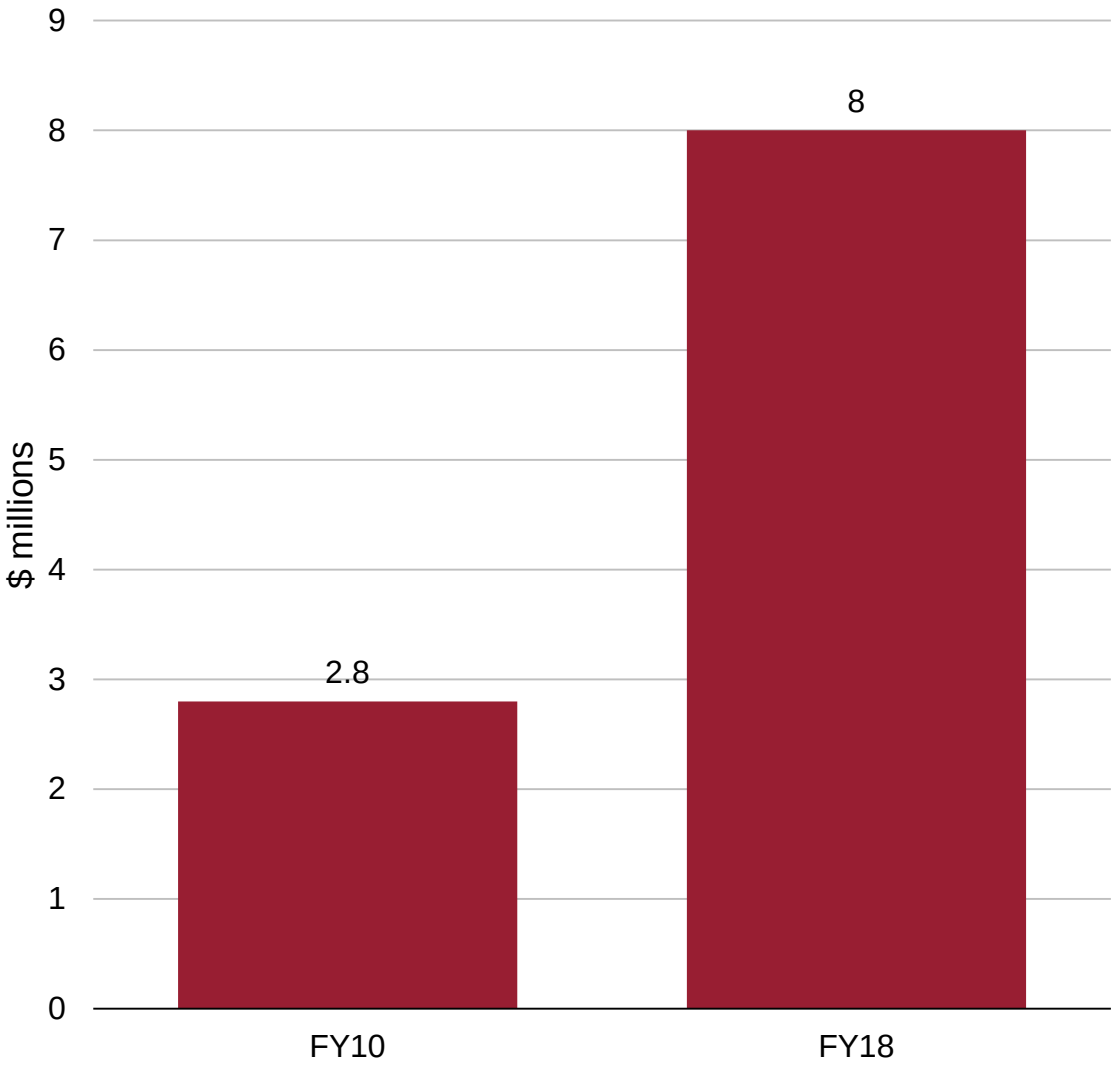


Athletics budget: A closer look



Cougar Athletic Fund giving at record level

Athletics budget: A closer look



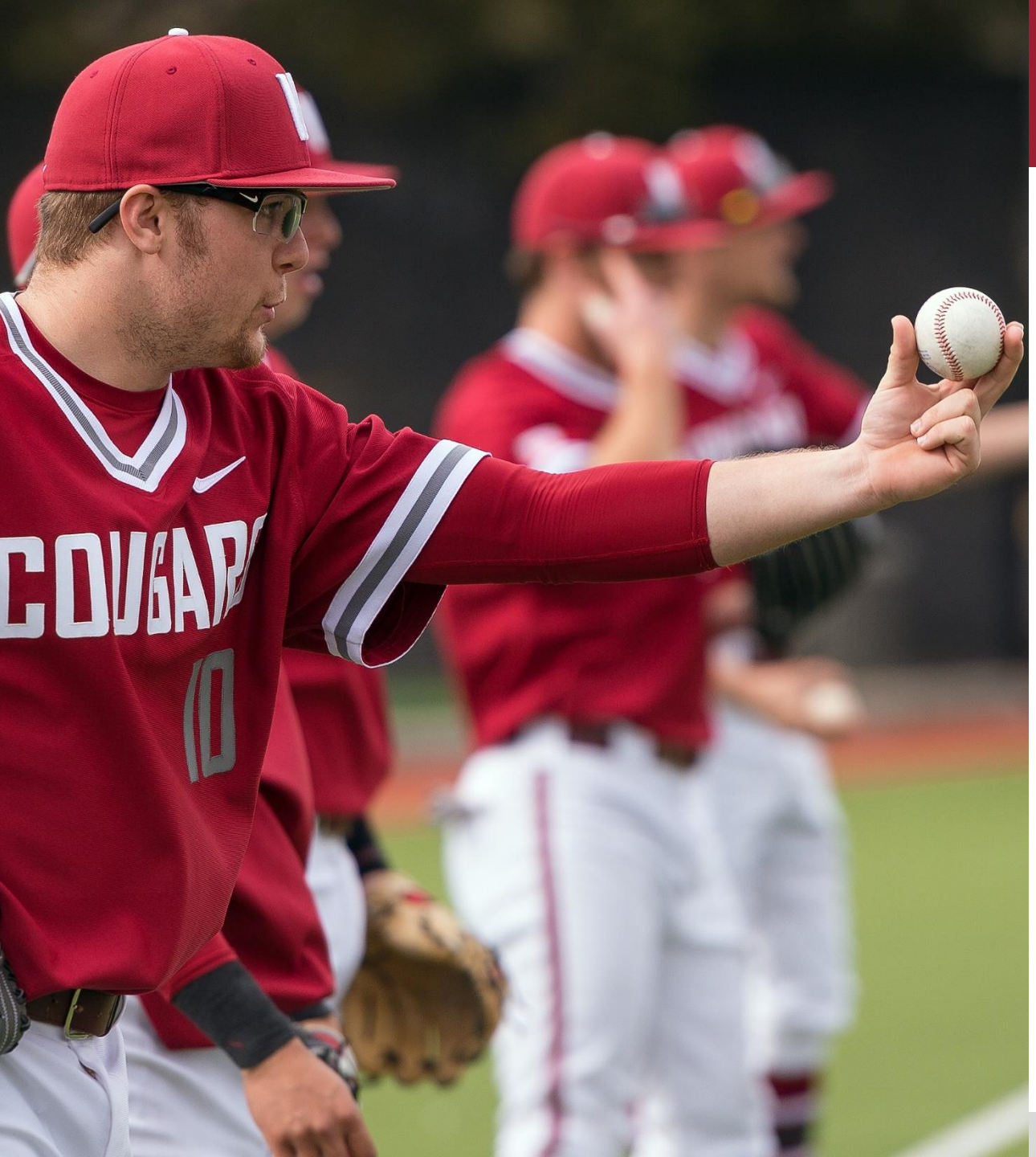
Football gate at record level

Decreased institutional support for athletics contributes to the athletics debt

Building a fiscally sound athletics program

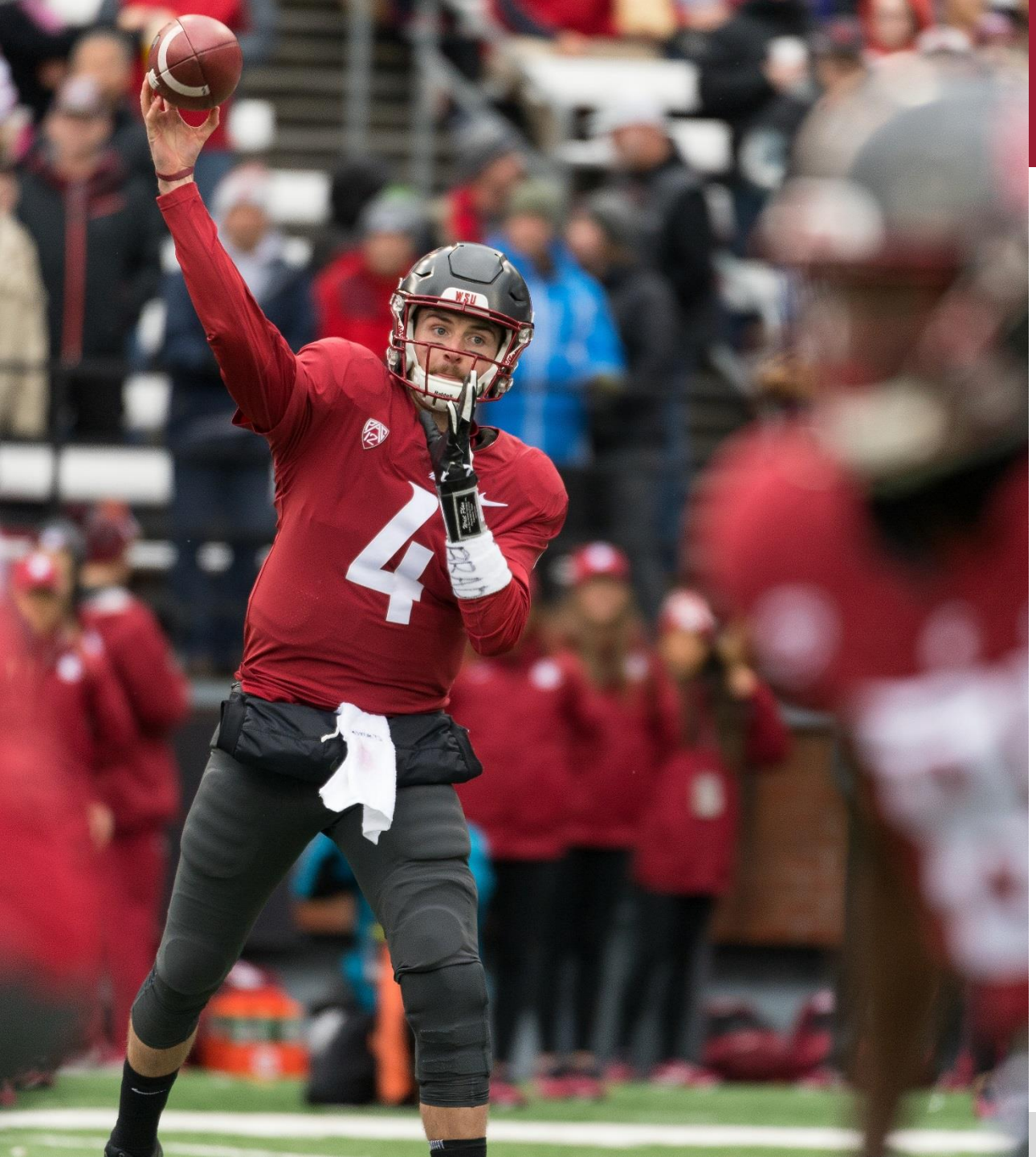
4 principles moving forward

No. 1:
The WSU community must solve the challenges



No. 2:
Athletics must achieve a balanced budget

No. 3:
Athletics must build budget reserves



No. 4:
Athletics will repay central reserves

Looking ahead

Thank you

EAB

Aligning the Budget Model to **Strategic Goals**

Executive-Level Decision Points to Ensure Impact on Cost, Growth, and Strategy

Business Affairs Forum

EAB

Aligning the Budget Model to Strategic Goals

Executive-Level Decision Points to Ensure Impact on Cost, Growth, and Strategy

Business Affairs Forum

Business Affairs Forum

Project Director

Stephen Rowe

Contributing Consultants

Kaitlyn Maloney, MS Ed, CPA
Kimberly Rose

Design Consultant

Courtney Jenkins

Managing Director

John Workman, PhD

Table of Contents

Supporting Members in Resource Allocation

Related Tools, Services, and Publications Available Within Your Membership

This publication represents only one of EAB's many resources to support members in their goals to develop more strategic resource allocation models. Detail about additional tools, services, and publications is provided below.

For additional information about any of these services—or for an electronic version of this publication—please visit our website (eab.com/baf), email your institution's dedicated advisor, or email research@eab.com.

Optimizing Institutional Budget Models

Strategic Lessons for Aligning Incentives and Improving Financial Performance

This study helps colleges and universities develop more strategic resource allocation systems. It includes four executive-level lessons on budget design and a compendium of 29 budget model elements to guide business executives and their teams in strategic resource allocation model design.

Increasing Central Fungible Dollars

Executive Tactics to Secure Funding and Garner Buy-In for Strategic Priorities

This study examines eight tactics institutions can implement to increase central fungible dollars and fund and garner support for strategic priorities.

On-Demand Webconferences

Register for upcoming sessions to hear our latest findings or access archives of past presentations. Many members convene campus leaders and task forces to attend and share ideas on practices and implementation.

Unlimited Access to Experts

Business Affairs Forum members may contact EAB researchers at any time to discuss our findings, request networking conversations, or review related resources and practices.

All Business Affairs Forum resources are available to members in unlimited quantity.

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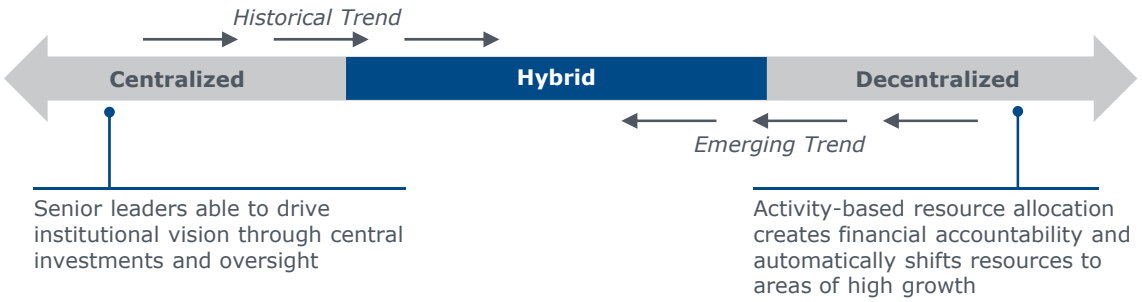
Executive Summary

Institutions Adjusting Budget Models to Reinforce Financial and Strategic Goals

Budget models remain an area of scrutiny in higher education, as scores of institutions consider either adjustments to their current model or wholesale model changes. And while some institutions are changing models in response to current financial pressures, others are proactively making changes to reorient institutional decision making and build resilience against unknown, future threats. Finance and administration leaders, in particular, view the budget model as one of the most impactful ways to align stakeholders to financial realities, automate smarter resource allocation decisions, or create a workaround for shared governance and weak strategic planning common in higher education.

Struggling to Find the Middle Ground in Model Design

In contrast to the RCM-or-bust attitude of the previous decade, many institutions are now looking to adopt hybrid models that incorporate the best elements of centralized and decentralized models. However, leaders have struggled to determine which institutional goals are best achieved through decentralized incentives versus central investment and oversight. And as there is not a uniform "one-size-fits-all" hybrid model that every institution should emulate, designing a model that aligns with an institution's strategic priorities, mission, and culture requires hundreds of individual decisions—which can quickly become overwhelming.



Targeting the Most Important Budget Model Design Decisions

Fortunately, a small handful of decisions have a disproportionate impact on model success or failure. To help business executives focus on the most impactful budget model design elements and align the model to strategic goals, this publication details 13 executive-level budget model decision points that break into three major categories. First, institutions must allocate some revenues and costs to create financial accountability for units. Second, institutions must structure and deploy strategic reserves and subvention to safeguard mission-critical activities. Finally, institutions should incorporate strategic goals into the model through a mix of decentralized incentives and centralized funding to ensure units invest in institutional priorities.

1

Create Unit-Level Financial Accountability

Allocate some revenues and costs to align unit-level operational responsibility with institution-wide financial imperatives

2

Preserve Mission-Critical Activities

Protect mission-critical but financially dependent units from harm in the new model to protect institution brand, and build central reserves for major investments

3

Incorporate Institutional Strategic Goals

Align stakeholders with strategic goals through performance funding, seed funding, and governance policies

Shifting Trends in Higher Education Resource Allocation

INTRODUCTION

Pressures Causing Reactive Model Change

Budget models remain an area of intense scrutiny, as scores of institutions consider either adjustments to their current model or wholesale model changes. While a host of challenges and industry shifts are driving this interest, four major pressures in particular are pushing institutions to consider changing budget models. First, incoming executive leaders often initiate budget model transitions at their new campuses, which is occurring more often as average President and Provost tenure decline. Second, some institutions have been forced to make model changes to meet stakeholder demands for greater financial transparency.

Internal Mandates

Executive Leadership Change

- New presidents, provosts bring preferred budget model to institution
- Queen's University transitioned to a new budget model after hiring a provost who used activity-based budgeting at previous institution

Demands for Transparency

- Faculty push for greater budgeting transparency, particularly in tight budget environment where administrators (necessarily) make unpopular decisions
- Suspicion of administrator compensation at one institution forced launch of a budget taskforce to reevaluate budget model and promote transparency

Industry-Wide Threats

Shifting Business Model Requires Major Investments

- Evolving business model requires large strategic investments, yet financial pressures strain ability to fund investments with incremental, new revenue
- CBOs look to budget models for greater flexibility reallocating funds away from costly, historic activities and towards new growth opportunities

Academic Leaders Not Incented to Balance Mission with Financial Impact

- Financial responsibility and operational responsibility are not aligned
- Colleges and departments often make decisions based on mission and college-specific considerations
- As a result, units do not prioritize programs with high-growth potential, drive academic efficiency initiatives across programs, or reposition unit to support strategic goals

In addition to internal mandates, two industry-wide threats are further driving budget model changes. First, as higher education's shifting business model requires resource reallocation and strategic investments to fuel growth, many institutions look to new models to create greater fund flexibility. Second, as institutions face tightening budgets, some change budget models to incent mission-focused academic leaders to make program decisions with financial impact top of mind.

Source: Business Affairs Forum interviews and analysis.

Proactively Anticipating Future Needs

Model Structure Can Address Limitations of Shared Governance

While some institutions are changing models in response to current pressures, others are proactively making model changes to reorient institutional decision making and build resilience against unknown, future threats. Finance and administration leaders, in particular, view the budget model as one of the most impactful ways to reinforce financial goals and strategic priorities. Three key aspirations business leaders have for budget model changes are detailed below.

First, the budget model can align campus stakeholders to financial realities. Rather than time-consuming town halls or educational sessions, the model can help leaders understand and buy in to necessary financial tradeoffs.

Key Aspirations for Budget Model

Align Stakeholders to Financial Realities

- Faculty and other stakeholders do not understand budgetary limitations or trade-offs facing institution, resulting in CBOs devoting significant time to campus education efforts
- Budget model can serve as a clear education tool, informing campus of financial realities

Automate Smart Resource Allocation Decisions

- One-time divestment from historical funding levels to shift resources to new opportunities requires involved, contentious conversations
- Budget model allows CBO to embed smart decision making into the model, automatically shifting funds across unit lines
- Deans focus on increasing financial independence by making smart reallocations within unit and working towards institution-wide goals

Create Work-Around for Weak Strategic Planning

- Inclusive, committee-based decision making leads to overly broad strategic plans without clear prioritization for funding initiatives
- Budget model serves as proxy for strategic plan, setting up funding and incentives to move toward strategic goals that advance the institution's mission and financial health

Second, the budget model can automate smarter resource allocation decisions. The right budget mechanisms ensure funds naturally flow to high-growth or high-demand areas—thereby preempting politically contentious reallocation and downsizing decisions. Last, the budget model can serve as a workaround to weak strategic planning. Unlike broad and all-encompassing strategic plans common in higher education, the budget model can provide more concrete direction with funds and incentives for top institutional priorities.

Of course, changing the budget model is not a panacea that solves all institutional problems. All models require strong executive leadership and direction to be successful, as well as sufficient IT and data capabilities. Nonetheless, the budget model can create a decision-making structure for long-term success and alleviate some of the problems associated with shared governance.

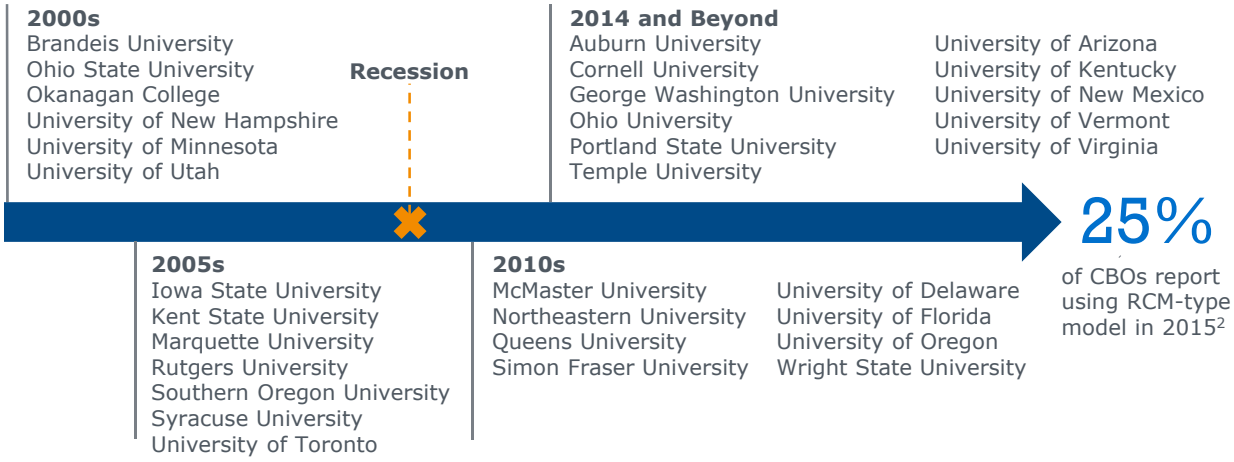
Source: Business Affairs Forum interviews and analysis.

The Allure of RCM

Pace of RCM Adoption Accelerates After Recession

Across the 2000's, most colleges and universities changing budget models implemented some form of Responsibility Center Management (RCM). While the industry was already trending toward RCM before 2008, the number of RCM institutions increased dramatically after the recession, as institutions facing flat tuition sought to create stronger incentives and quickly improve finances. By 2015, 25% of CBOs reported using an RCM-type model.

Timeline of Institutions Moving to RCM Budget Models[1]



Institutions Adopting RCM Accelerates After Recession

Facing significant downward pressure on tuition revenue and declining state support, many institutions adopted RCM models after the recession to create transparency, control costs, and incent units to seek revenue growth opportunities.

1) Institutions above may not have fully adopted RCM, but were cited in media or interviews as considering a shift to an RCM model at some point
2) "2015 Survey of College and University Chief Financial Officers." *Inside Higher Ed.* 2015..

Source: Business Affairs Forum interviews and analysis.

Breaking Ranks

Select Institutions Moving Away from RCM

However, more recently a handful of institutions have deliberately moved away from RCM. For example, the University of Oregon is overhauling the RCM model leaders adopted after the recession, citing the model's inability to provide sufficient central resources or incent research growth. While not completely abandoning RCM, many other institutions are intentionally watering down the decentralized elements of their models. The common theme across this emerging trend is that while RCM creates impactful incentives to grow revenue, it also reduces central control and discretionary resources.

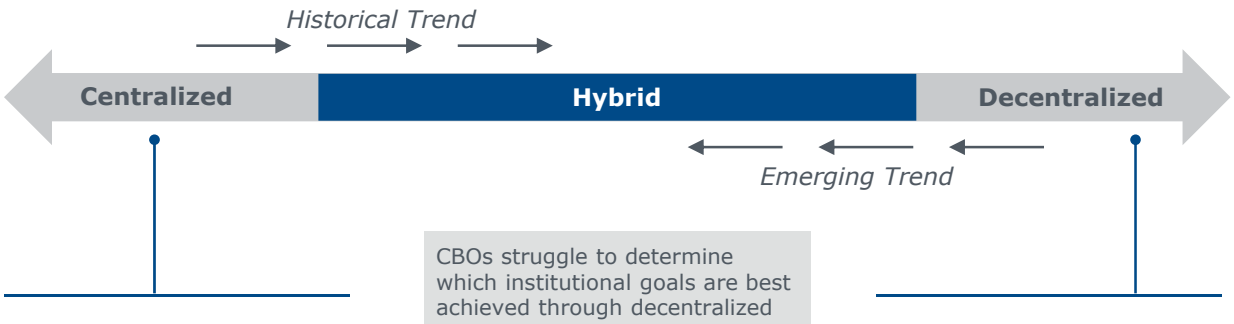
Institution	RCM Lifespan	Reason for Model Change	New Model Characteristics
University of South Carolina	2003-2011	RCM model yielded insufficient central funding and control over resource decisions to navigate state budget cuts	Mostly incremental
University of Oregon	2010-2016	RCM model yielded insufficient central funding and control over resource decisions to advance institutional strategic goal of enhancing research profile	Still in development
University of Kentucky	2011-2015	Leadership anticipated RCM model would divert units' focus away from strategic priorities of student success	Incremental with performance pot for strategic initiatives

Source: University of Kentucky, Lexington, KY ; University of Oregon, Eugene, OR; University of South Carolina, Columbia, SC; Business Affairs Forum interviews and analysis.

Finding the Middle Ground

Increasing Number of Institutions Moving Toward Hybrid Models

Instead, seeking the best of both worlds, many institutions are adopting hybrid models that include elements of classic centralized and decentralized models. The primary advantage of centralized models is the availability of resources for senior leaders to invest in strategic priorities and drive the institutional vision. Conversely, decentralized models create unit-level financial accountability and automatically shift institutional resources to areas of high-growth. Given the merits of each model type, many institutions have tried to design hybrid models that capture the benefits of both while minimizing or eliminating their respective limitations.



CBOs struggle to determine which institutional goals are best achieved through decentralized incentives versus central investment and oversight

Advantages:

- Resources available for central investment
- Senior leaders able to drive institutional vision

Limitations:

- May not incent unit revenue growth or cost control
- Difficult to maintain in periods of stagnant growth
- May not accommodate changes in enrollment patterns

Advantages:

- Creates unit-level financial accountability
- Automatically shifts resources to areas of high growth

Limitations:

- Yields few resources for central strategic investment
- Devolves decision-making power to units at expense of central strategic vision
- Shifts resources to units based on year-to-year performance and market trends rather than institutional priorities

Unfortunately, there is not a single one-size-fits-all hybrid model that every institution should emulate. Institutions have adopted widely different hybrid models, ranging from 100% activity-based tuition revenue allocation with centrally held state appropriations to primarily incremental models with an activity-based formula for new tuition revenue. Given this wide variation, the challenge for business executives is to design a model that fits the institution.

Source: Business Affairs Forum interviews and analysis.

Targeting the Most Important Design Decisions

Hundreds of Decisions, but Not All Need Executive Attention

However, designing any budget model requires hundreds of individual decisions—which can quickly become overwhelming. Fortunately, a small handful of decisions have a disproportionate impact on model success or failure, and focusing energy on just this handful can generate a model that aligns with an institution's strategic priorities, mission, and culture. These core budget model decisions, detailed in this publication, should be made by a narrow group of senior leaders, including the CBO, the Provost, the President, and the budget director.

Start Narrow for Big Decisions…

Ideal Core Budget Model Team

- CBO
- President
- Provost
- Budgeting Expert
- Faculty Member with Financial Expertise

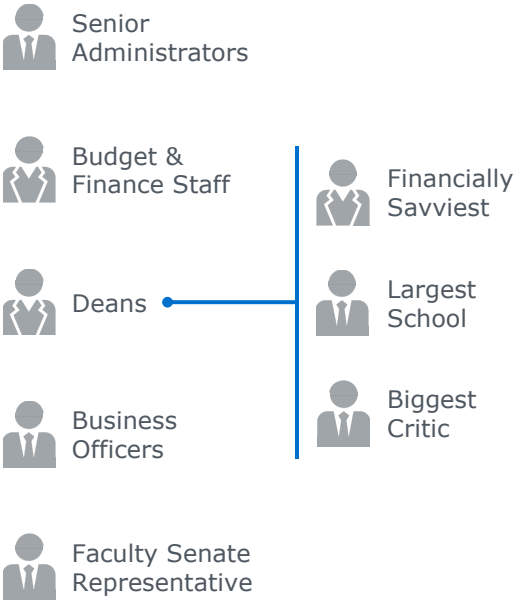
Separating the Wheat from the Chaff

"We knew there were certain key things that our model had to accomplish, and we made sure they were built into the model. There were 100 other smaller decisions that honestly could go one way or another and really wouldn't affect the outcome."

Ken Kaiser, CBO
Temple University

…Then Go Wider to Gain Buy-In

Ideal Budget Model Steering Committee



After these (few) key decisions are made, the remaining (many) decisions can be largely delegated to the budget model committee or taskforce composed of campus stakeholders, including deans and faculty. This division of labor has two advantages. First, it gives the academic leaders on the budget model committee a sense of ownership over the model, creating goodwill and buy-in. To maximize buy-in, institutions should consider including the dean with the most financial expertise, the dean of the largest college, and the dean likely to be the biggest critic. Second, and more importantly, this division of labor ensures that senior leaders dictate the decisions most critical to model success.

Source: Temple University, Philadelphia, PA; Business Affairs Forum interviews and analysis.

Executive Framework

To help business executives focus on the most impactful budget model design decisions and align the model to strategic goals, this publication details 13 executive-level budget model decision points that break into three major categories. First, institutions must allocate some revenues and costs to create unit-level financial accountability. Second, institutions must build in elements of centralized models to safeguard mission-critical activities. Finally, institutions should incorporate strategic goals into the model through a mix of decentralized incentives and centralized funding and oversight to ensure units invest in institutional priorities.

For institutions considering a wholesale model change, this publication offers a decision framework to guide model design. Institutions seeking only to make targeted model improvements should review all decision points to affirm current approaches are working and then focus efforts on isolated improvement areas.

1

Creating Unit-Level Financial Accountability

Incenting Program Growth Through Revenue Allocation

1. What percentage of tuition revenue should we allocate through an activity-based formula?
2. How should we weight SCH versus majors in tuition allocation?
3. Should we use enrollment smoothing to allocate tuition revenue?
4. Should we allocate any forms of differential tuition revenue?
5. Should we allocate unrestricted state appropriations?

Driving Unit-Level Cost Containment

6. How do we allocate overhead costs to maximize incentives and maintain buy-in?
7. How do we regulate unit spending to protect institution finances and strategic goals?

2

Preserving Mission-Critical Activities Through Subvention and Strategic Reserves

8. How do we ensure sufficient central reserves for strategic investments?
9. How overt or hidden should subvention be?
10. How do we motivate units receiving subvention to still make financial improvement?

3

Incorporating Institutional Strategic Goals into the Model

11. How do we incent student success goals through the budget model?
12. How do we incent research growth through the budget model?
13. How do we incent targeted new program launches through the budget model?

Source: Business Affairs Forum interviews and analysis.

Summary of Decision Points

Revenue and Cost Allocation Decision Points

A Note About Our Guidance

The following table provides a high-level summary of the Business Affairs Forum's guidance for each of the 13 executive-level budget model decision points detailed across the remainder of this publication. EAB provides guidance for each decision point across these two pages, with the aim that business executives can use this table as a "cheat sheet" to guide budget model discussions with other senior leaders. The guidance will be one of three types:

- First, some decision points have competing options with meaningful pros and cons rather than a universal right answer.
- Second, in other cases conventional wisdom says there is no universal answer, but there is actually an approach most institutions should adopt.
- Lastly, sometimes a little-known third approach offers the best of both worlds.

Decision Point	EAB Guidance
1. What percentage of tuition revenue should we allocate through an activity-based formula?	Most institutions should allocate bulk of revenue (70% or more) via an activity-based formula to break up base budgets and create P+L[1] incentives for units.
2. How should we weight SCH versus majors in tuition allocation?	Most institutions utilize a split between 85/15 and 70/30, but more important for senior leaders to set range and let deans pick exact split for buy-in.
3. Should we use enrollment smoothing to allocate tuition revenue?	Allocate tuition revenue based on prior-year enrollment or current-year projections and establish central loan pool to quickly reward growth and smooth unit budget volatility.
4. Should we allocate any forms of differential tuition revenue?	Aside from rare exceptions, institutions should not allocate out-of-state tuition, financial aid, or weighted credit hours to avoid perverse incentives and keep units focused on right priorities.
5. Should we allocate unrestricted state appropriations?	Institutions can either allocate state funds along with tuition or hold centrally for subvention or strategic investments. Senior leaders must decide on which method to use early in the design process.
6. How do we allocate overhead costs to maximize incentives and maintain buy-in?	Institutions should aim to allocate 4-6 overhead cost pools and 1-2 drivers per pool to strike a balance between simplicity and precision.
7. How do we regulate unit spending to protect institution finances and strategic goals?	Institutions should integrate oversight of unit-level spending decisions with ongoing central resource planning to ensure unit alignment with institutional finances and strategic goals.

Three Types of Guidance

Competing Options

Recommended Right Answer

A Third Way

1) Profit and Loss Statement.

Source: Business Affairs Forum interviews and analysis.

Summary of Decision Points (cont.)

Preserving Mission and Institutional Strategic Goals Decision Points

Emphasizing Transparency

An important theme across these 13 decision points is maintaining budget model transparency. In general, greater model transparency creates stronger and more effective incentives. This is because units are less likely to act on incentives in a low-transparency model if they cannot easily understand how their behaviors impact unit funding levels. Worse yet, academic leaders may become actively suspicious of low-transparency models, spending more time and energy trying to decipher the model than focusing on growth or cost-savings initiatives. Importantly, model transparency is not binary. Instead, transparency is incrementally increased (or decreased) by a number of disparate decisions. Discounting the importance of transparency in these decisions can quickly make the entire budget model less transparent and thus less effective. Therefore, business executives should keep transparency top-of-mind across all model design decisions.

Decision Point	EAB Guidance
8. How do we ensure sufficient central reserves for strategic investments?	Institutions should create a separate 3-5% tax on all revenue to fund central strategic reserves, and promise to use a portion of funds on unit priorities to win buy-in for tax.
9. How overt or hidden should subvention be?	Institutions should make subvention as overt as possible to avoid perverse incentives and maintain P+L transparency.
10. How do we motivate units receiving subvention to still make financial improvement?	Institutions should set a clear end date for units on bridge subvention and allocate subvention with strings attached for mission-critical units to continuously motivate units.
11. How do we incent student success goals through the budget model?	Institutions can use financial incentives and seed funding to encourage units to achieve student success goals. Institutions should monitor and correct for perverse budget model incentives that may impede student success.
12. How do we incent research growth through the budget model?	Institutions can use financial incentives and seed funding to encourage units to achieve research growth goals. Institutions should monitor and correct for perverse budget model incentives that may impede research growth.
13. How do we incent targeted new program launches through the budget model?	Institutions can use financial incentives and seed funding to encourage units to launch targeted new programs. Institutions should monitor and correct for perverse budget model incentives that may impede new program launches.

Three Types of Guidance

Competing Options

Recommended Right Answer

A Third Way

Source: Business Affairs Forum interviews and analysis.

What Else to Consider?

Tools, Policies, and Data That Complement the Budget Model Change

In addition to this publication, EAB offer members many resources to support institution resource allocation more broadly. This publication focuses on the core mechanics of building or tweaking a budget model. However, institutional leaders can pursue several other strategies to ensure the effectiveness of budget model changes—including program prioritization, supporting stakeholders with data, and conducting vacancy reviews. These strategies and others are detailed in the resources listed below, all of which are available on eab.com.

Studies

- **Optimizing Institutional Budget Models**
  Draw on detailed compendium of 29 budget model elements to develop a more strategic resource allocation system
- **Increasing Central Fundable Dollars**
  Increase central dollars to fund and garner support for critical, cross-unit investments
- **Bending the Administrative Labor Cost Curve**
  Implement cross-silo tools and incentives that slow administrative labor growth and help achieve meaningful savings
- **Revitalizing the Program Portfolio**
  Use program review to improve and prioritize programs for investment and expansion by integrating data on academic quality, student demand, and resource utilization
- **Breaking the Tradeoff Between Cost and Quality**
  Enhance academic quality and drive program efficiencies by reallocating resources from lower impact activities to higher impact, mission-aligned priorities
- **Developing a Data-Driven University**
  Develop business intelligence capabilities to support analytics, dashboards, and change-management initiatives

Toolkit

- **Center for Administrative Excellence**
  Compendium of all BAF resources to drive administrative unit effectiveness and leverage efficiencies

Source: Business Affairs Forum interviews and analysis.

Creating Unit-Level Financial Accountability

SECTION 1

Incenting Program Growth Through Revenue Allocation

- **Decision Point 1**: What percentage of tuition revenue should we allocate through an activity-based formula?
- **Decision Point 2**: How should we weight SCH versus majors in tuition allocation?
- **Decision Point 3**: Should we use enrollment smoothing to allocate tuition revenue?
- **Decision Point 4**: Should we allocate any forms of differential tuition revenue?
- **Decision Point 5:** Should we allocate unrestricted state appropriations?

Driving Unit-Level Cost Containment

- **Decision Point 6:** How do we allocate overhead costs to maximize incentives and maintain buy-in?
- **Decision Point 7:** How do we regulate unit spending to protect institution finances and strategic goals?

Relying on the Deans

Deans Possess Knowledge to Grow Programs and Reduce Costs

Deans are central to any efforts to grow revenues and contain costs. While senior executives are well-suited to set long-term strategy and align units with overall institutional financial goals, much of the information required to grow existing programs or reduce spending exists at the front-line, unit level. For example, deans best understand how to adapt academic programs to meet uncaptured student demand or reduce space utilization. However, units could fail to appropriately act on this information, as they may lack proper budgetary incentives, be overly focused on mission, or fear growth activities will increase costs more than new resources.

Information Asymmetry

CBO Knowledge

- Overall institutional financial health
- Strategies for long-term financial sustainability
- Unit alignment with institutional goal and priorities

Dean Knowledge

- Academic programs in high demand
- How to adapt existing curricula to changing market
- Opportunities to reduce space utilization

Source: Business Affairs Forum interviews and analysis.

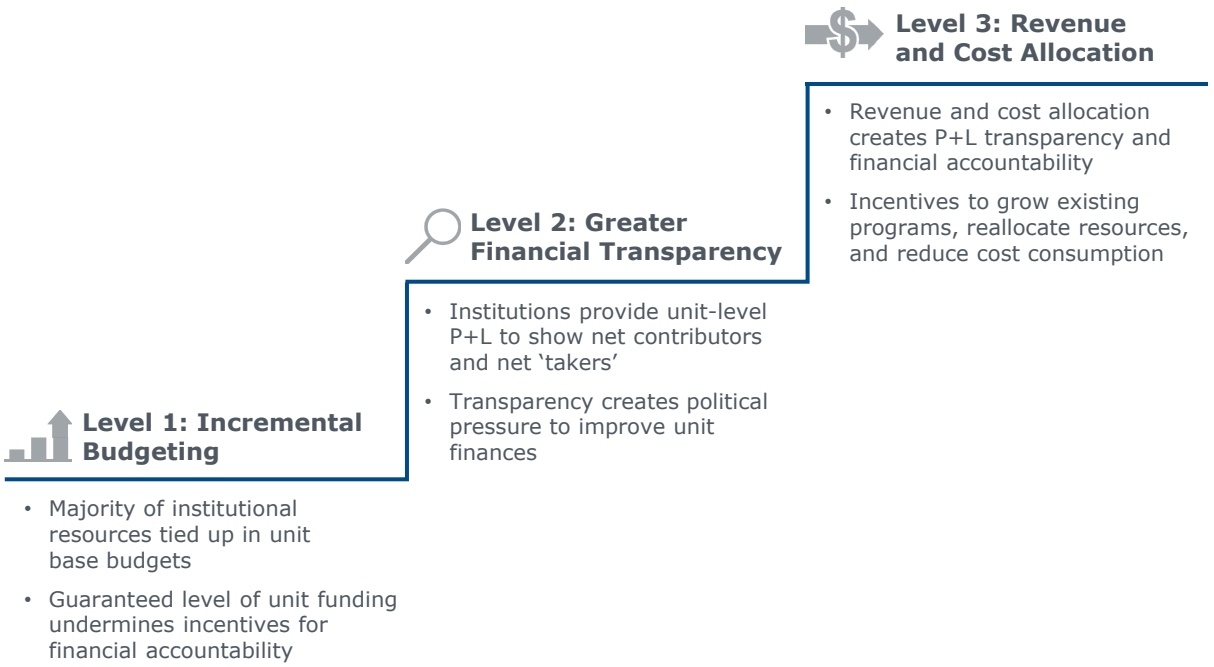
Breaking Down Base Budgets

Allocating Revenue and Costs to Instill Financial Accountability

As institutions seek to better align financial incentives for units, there are three primary levels of financial accountability, with each step up typically representing a more effective method.

- **Incremental Budgeting:** Incremental budgeting creates relatively low accountability, as units receive a guaranteed amount of resources each year regardless of activity.
- **Greater Financial Transparency:** Many institutions have begun to produce clear unit financial and contribution margin data, with the partial goal of creating social pressure for academic unit leaders to improve unit finances. While greater transparency is valuable overall, it may not provide a meaningful incentive for units to better manage their P+ L[1].
- **Revenue and Cost Allocation:** Institutions create the greatest financial accountability by directly allocating some revenues and costs to academic units. In addition to creating financial transparency, revenue and cost allocation ties unit resources to performance. This compels units to identify opportunities to grow programs, reallocate resources, or reduce costs.

Increasing Levels of Focus on Unit Profit and Loss Statement



The first section of this publication details seven executive-level revenue and cost decision points. These decisions points help executives optimize revenue and cost allocation design to best incent program growth and drive cost containment, thereby instilling unit-level financial accountability.

1) Profit and loss statement.

Source: Business Affairs Forum interviews and analysis.

1 What percentage of tuition revenue should we allocate through an activity-based formula?

Decision Point in Brief

Importance to Budget Model

The percentage of activity-based revenue allocation in the budget model impacts the strength of unit financial incentives to grow revenue and the models' ability to shift resources to high-importance or high-growth areas.

Observed Options

There is wide range in the percentage of tuition revenue that institutions allocate via activity-based formulas. Institutions with incremental or zero-based models do not allocate any revenue based on activity levels, while institutions with full RCM allocate 100% of tuition revenue to reward activity. Many institutions utilize models between the two extremes, allocating a percentage of funds based on credit-hour production while maintaining some level of incremental budgeting.

EAB Guidance

While a minority of institutions with unique characteristics (e.g., highly consistent leadership, strong religious mission) can successfully maintain centralized models, **most institutions should allocate 70% of tuition revenue or more through an activity-based formula.** A high degree of activity-based revenue allocation promotes financial accountability, as units must consider their unit P+L holistically and reallocate resources across programs to maximize their allocation. Moreover, greater activity-based revenue allocation unlocks historical unit base budgets, allowing resources to flow organically to high-growth areas.

Running the Gamut

Institutions Adopt Models with Varying Degrees of Activity-Based Allocation

The first executive-level decision point is to determine the percentage of tuition revenue to allocate to academic units through an activity-based formula. In activity-based revenue allocation, units receive financial resources based on their share of student activity as defined by the institution (e.g., number of students enrolled, student credit hours taught). As shown below, there is wide range in the percentage of tuition revenue institutions allocate to their units. The far left of the spectrum represents institutions with incremental or zero-based budget models that do not allocate any tuition revenue through an activity-based formula.

Moving to the right, some institutions utilize predominantly incremental models with small performance pots that reward credit-hour activity. The University of Utah allocates a small percentage of funds to reward activity. Other institutions like Ohio State allocate only new revenue while maintaining historical unit base budgets. While functionally similar to the University of Utah's model, this approach may be easier for some academic leaders to understand and react to.

Percentage of Tuition Revenue Allocated Through Activity-Based Formula

The other side of the spectrum represents institutions that allocate the vast majority of tuition revenue through an activity-based formula. At UC Davis, 70% of tuition revenue rewards activity while the remaining 30% is allocated incrementally. Institutions on the far right use full RCM models, allocating 100% of tuition revenue based on activity.

The next several pages provide more detailed information and guidance on the various approaches to activity-based tuition revenue allocation.

Source: The Ohio State University, Columbus, OH; University of California Davis, Davis, CA; University of Utah, Salt Lake City, UT; Business Affairs Forum interviews and analysis.

If It Ain't Broke….

Select Institutions Successfully Use Centralized Models

First, some institutions have deliberately maintained highly centralized budget models without formulaic tuition revenue allocation. For example, Arizona State University controls the budget process at the center and dictates funding for most unit-level initiatives. Rather than allocating revenue and costs to promote unit-level accountability, leaders at Arizona State promote financial stewardship through strong central oversight and guidance. Similarly, the University of Notre Dame uses a primarily incremental model with targeted strategic investments. To promote accountability and alignment with institutional goals, units must present three-year business plans detailing college-level priorities and justifications for additional funds from central administration.

Arizona State University

- Centralized model in which administration takes data-driven, strategic approach to identifying competitive opportunities at unit- and institution-level
- Promotes unit-level financial accountability through strong central oversight and guidance
- Center often dictates unit-level initiatives and provides the resources to invest

University of Notre Dame

- Incremental budget model with targeted investments made through a thorough vetting and prioritization process
- Units present priorities for upcoming three years through a business case detailing a clear business plan, long-term implications of requests, and alignment with strategic plan
- Revenue-sharing agreements for professional and online Master's programs led to new program launches in law, business, and architecture

While centralized budget models work well on some campuses, this is partially due to hard-to-replicate institutional characteristics—such as highly consistent leadership, a strong shared religious mission, or a lack of silo problems common at large institutions. Colleges and universities in these situations will (correctly) continue to leverage a highly centralized model. Their greatest opportunities for improvement are likely better regulating unit-level spending and incorporating strategic goals into budgeting, detailed in later sections of this publication.

Absent these rare circumstances, the limits of incremental budgeting eventually become apparent, including a lack of unit-level financial accountability and incentives for growth. Therefore, most institutions are actively exploring some degree of revenue allocation. In fact, even Notre Dame has established revenue sharing agreements to grow its professional Master's programs.

Source: Arizona State University, Tempe, AZ; University of Notre Dame, Notre Dame, IN; Business Affairs Forum interviews and analysis.

Allocating Only New Revenue Insufficient

Prevents Fund Reallocation and Undermines Holistic Financial Accountability

Seeking to create revenue growth incentives, most institutions have moved to models with at least a small percentage of activity-based allocation. At Underwood University, units retain new revenue generated through increased credit hour production, while historical base budgets roll over year-to-year. In theory, this model balances incentives for growth with stability—academic units have an incentive to increase credit hour production with the safety net of a guaranteed base budget each year.

Underwood University[1] Moving Toward Greater Revenue Allocation to Promote Unit-Level Financial Accountability

Current Modified RCM Model

- Units receive historical base-budgets each year
- Awards incremental revenues from increased SCH production and tuition increases to units formulaically to encourage and reward growth
- Incremental revenues absorbed into base budgets for subsequent years
- Goal is to perform rebasing exercise every decade to right-size inaccuracies in historical base budgets

Current Model Limitations

- Focuses purely on marginal gains rather than holistic unit financial performance
- Units not incented to make targeted investments or divestments within departments or programs as they are guaranteed a base-budget each year
- Prevents reallocation of funds across the institution
- Absorption of marginal growth into base budgets creates lack of transparency and accountability

> "Our current model focuses too much on marginal transactions...the units come back each year with their hands out [for their base budget] and the tough conversations about 'right your ship' don't happen."
>
> *Budget Director*
> *Underwood University*

However, this model has several limitations. First, the model mostly encourages marginal revenue growth. Because units receive consistent base budgets each year, they lack an incentive to consider their P+L holistically, reprioritize resources across programs, or reduce spending. Second, the model impedes reallocation of resources across the institution, as the majority of funds are locked in base budgets.

Due to these limitations, Underwood University plans to transition to a model with a higher degree of activity-based tuition revenue allocation.

1) Pseudonym.

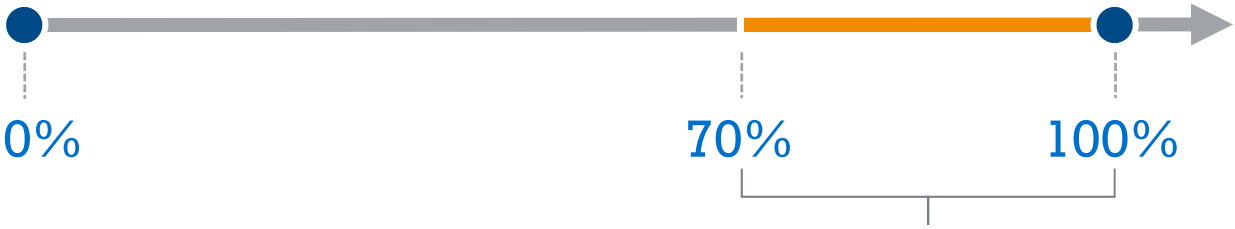
Source: Business Affairs Forum interviews and analysis.

Erring on the Side of Allocation

Full Activity-Based Allocation Unlocks Base Budgets, Incents Growth

Excepting a minority of institutions with effective centralized models, EAB recommends that most institutions allocate 70% of tuition revenue or more via an activity-based formula for two major reasons. First, greater activity-based revenue allocation unlocks historical base budgets. Rather than flowing to the same units each year due to historical precedent, resources subject to an activity-based formula will respond to market conditions and flow organically to areas of high-importance. Second, a high degree of activity-based revenue allocation encourages greater unit-level financial accountability. When institutions allocate the majority of revenue based on activity levels, the majority of a unit's budget is contingent on performance. Therefore, units must consider P+L holistically and seek growth, reallocation, and cost-control opportunities.

Percentage of Tuition Revenue Allocated Through Activity-Based Formula



Works for a Few…

Select institutions with particular culture, mission, and leadership team can succeed with largely centralized budget models

…But Most Should Be Here

- Creates organic flow of resources and unlocks unit base budgets for reallocation across institution
- Instills unit-level financial accountability and need to examine value of programs and make targeted reallocations

To be clear, institutions must also implement safeguards to balance incentives for revenue growth and ensure unit investments align with institutional goals and priorities. Sections 2 and 3 of this publication detail strategies institutions can adopt to maintain central oversight and structure subvention in decentralized models. Nonetheless, allocating the bulk of tuition revenue to the units is the engine that makes the model and the incentives work.

Source: Business Affairs Forum interviews and analysis.

Whose Line (Item) Is It, Anyway?

Center Can Retain Necessary Funds Up-Front or Recoup on the Back End

Beyond the percentage of tuition revenue to allocate through an activity-based formula, institutions must also consider a technical aspect of revenue allocation—the sequence of funds flow between central administration and academic units. Even in highly decentralized models that allocate all or the majority of revenue to the academic units, central administration requires resources to fund central overhead, subvention, and strategic reserves.

Allocation Approach	Step 1	Step 2	Step 3	Sample Institution
Front-End Center takes three central costs off-the-top before allocating revenue to the colleges via revenue allocation formula	Revenue ↓ Central Admin	Central Admin pulls out: • Central overhead • Subvention • Strategic initiatives	Allocation Methodology Academic Colleges	**Simon Fraser University** 35% of all revenues taken off-the-top for central costs, indirect costs, and institutional priorities
Back-End Revenue flows straight to the colleges via revenue allocation methodology, then center recoups three central costs	Revenue ↓ Allocation Methodology Academic Colleges	Colleges charged: • Central overhead • Subvention • Strategic initiatives		**University of Pennsylvania** 20% tax on undergraduate, graduate, and professional tuition for subvention and strategic initiatives; allocates central overhead costs to colleges through six cost pools

There are two options, shown above. With the front-end approach, central administration takes necessary funds off-the top and then allocates the remaining funds to the academic units through the revenue-allocation formula. The other option is the back-end approach, where revenue flows to the academic units and then central administration charges or taxes units for their share of costs. Mathematically, both approaches result in the same amount of resources to fund central costs. However, they can have different impact on cost and revenue incentives.

Source: Simon Fraser University, Burnaby, BC; University of Pennsylvania; Philadelphia, PA'; Business Affairs Forum interviews and analysis.

Better to Recoup Central Dollars After Allocation

Flow of Funds Affects P+L Transparency

In general, recouping funds on the back end creates stronger budget model incentives by maintaining P+L clarity and transparency hurts deans' ability to make informed business decisions. Even if deans' activities leads to actual enrollment growth, taking funds off-the-top distorts unit revenue allocations and hurts deans' ability to make informed business decisions. This can make units less likely to change behaviors or invest resources toward growth.

The one exception to this rule is strategic reserves, for which both approaches have advantages. Taxing units for strategic initiatives on the back end preserves P+L transparency, but the amount of central strategic dollars shrinks if unit revenues decline. On the other hand, taking funds off-the-top guarantees a certain level of strategic funds for central administration, but this approach can obscure P+L transparency.

Front-End Approach Obscures Revenue Sources and P+L

"Our current approach is like a big washing machine for revenue—we take some pieces out for central initiatives and then allocate revenue to the colleges as one lump sum. **We aren't able to produce P+Ls for individual colleges because the revenue streams lose their source.** The colleges don't know how much money they are generating, so they can't make good business decisions."

Chief Budget Officer
Large Public Research University

Central Need	Approach	Advantage
Subvention	Back-end	Maintains unit P+L transparency vital to creating financial accountability
Central Overhead	Back-end	Incents units to reduce consumption of overheard costs or change certain behaviors
Strategic Initiatives	Back-end	Maintains P+L transparency
	Front-end	Ensures central initiatives adequately funded

Source: Business Affairs Forum interviews and analysis.

2 How should we weight SCH versus majors in tuition allocation?

Decision Point in Brief

Importance to Budget Model

Institutions must strike the right balance between credit hours and majors when allocating tuition revenue to incent desired growth activities, avoid perverse incentives, and properly resource academic units. Moreover, the allocation weighting between student credit hours (SCH) and majors is critical for many campus stakeholders' buy-in.

Observed Options

Institutions take various approaches to weighting tuition revenue allocations between SCH and majors. Allocations weighted toward SCH reward teaching, but may create perverse incentives to create duplicative courses to poach credit hours from other colleges. Revenue allocations based on student majors reduce the incentive to poach, but this method may not adequately compensate colleges for the variable costs of teaching. Most institutions utilize a tuition revenue allocation weighting between 85/15 and 70/30 in favor of credit hours.

EAB Guidance

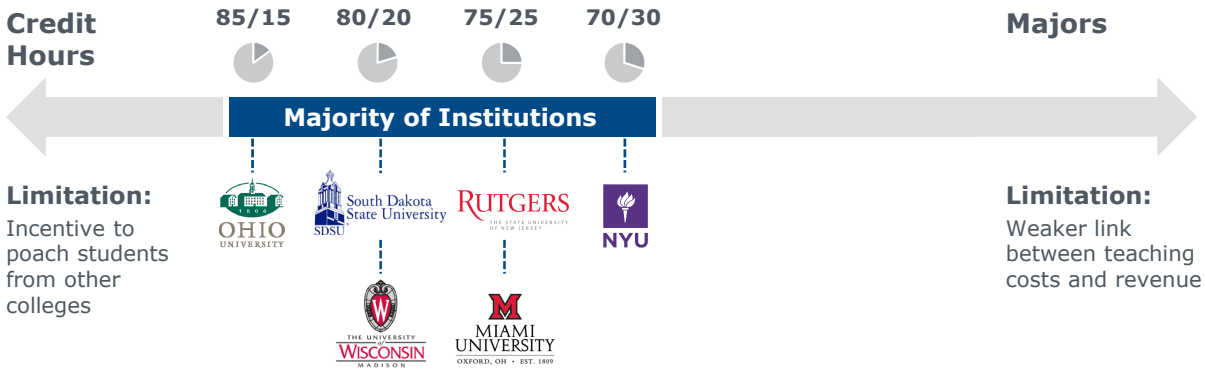
Provided that the weighting is within an appropriate range, the exact split will not significantly change the outcomes of the model. When building the allocation model, **senior leaders should define a suitable range and then allow the deans and budget taskforce to ultimately identify an allocation weighting** they collectively agree on, which will significantly increase that groups buy-in for the model. Note, executives may need to revisit this several years after model implementation to meet stakeholder demands for a more sophisticated analysis.

No Magic Number

Executives Should Define Range, Let Dean Preferences Guide Allocation Weight

After deciding how much tuition revenue to allocate through an activity-based formula, the natural next consideration is how to weight the allocation between student credit hours (SCH) and majors. The well-known trade-offs between the two approaches are depicted below. Allocations based on SCH rewards teaching, but may create a perverse incentive to create duplicative courses to poach credit hours from other colleges. Revenue allocations based on student majors reduces the incentive to poach, but this method may not adequately compensate colleges for the variable costs of teaching. So, institutions must strike the right balance to avoid perverse incentives and provide adequate resources to units.

Spectrum of Tuition Revenue Allocation Weighting



> "The revenue split between credit hour and major depends a bit on what you want to incentivize, but honestly there's no magic to our number."
>
> *Assistant Director, Finance & Budget*
> *Mid-Size Public Research University*

Provided that the weighting is within an appropriate range, the exact allocation split will not significantly change the outcomes of the model. In other words, there is no magic number. The vast majority of institutions have found an appropriate balance between an 85/15 and 70/30 weighting in favor of credit hours. EAB recommends that executives propose a weighting within this range and then largely leave the final numbers as a decision to be made by the deans and budget taskforce to win buy-in for the model.

Source: Miami University, Oxford, OH; New York University, New York, NY; Ohio University, Athens, OH; Rutgers University, New Brunswick, NJ; South Dakota State University, Brookings, SD; University of Wisconsin Madison, Madison, WI; Business Affairs Forum interviews and analysis.

Addressing Future Disgruntlement

Prepare to Revisit the Allocation Weighting Down the Road

While the exact allocation weighting may not require significant executive attention in the initial model design, this issue can become contentious in the years following model implementation. Once faculty better understand the model mechanics, they may push back on a "one-size-fits-all" revenue split for all colleges. In particular, colleges that perform a high volume of cross-teaching may not feel adequately compensated for increased costs.

What You Can Expect Five Years Later…

Better Academic Understanding of Model

Stakeholders possess better understanding of model mechanics and recognize shortcomings of a uniform revenue split for all colleges

High Cross-Teaching Colleges Not Compensated

Colleges that teach many students enrolled in other colleges may not feel adequately compensated by a revenue split that does not take into account increased costs incurred

The Problem Manifests at University of Toronto

1. A&S teaches a high number of Engineering students for core curriculum requirements and electives; A&S does not feel adequately compensated for cross-teaching
2. A&S does not prioritize Engineering students when scheduling courses or managing wait-lists, creating a course access problem
3. A&S hires more sessional instructors to reduce labor costs, risking Engineering failure to meet college accreditation requirements

The University of Toronto, which implemented an RCM model in 2008, experienced this situation between the faculty of Arts and Sciences and faculty of Engineering. Like at most institutions, Arts and Sciences taught many Engineering students, both for core requirements and electives. Because Arts and Sciences did not feel adequately compensated for cross-teaching, the college eventually stopped scheduling courses around Engineering labs and deprioritized Engineering students on waitlists. Additionally, Arts and Sciences hired more adjunct professors to reduce labor costs, which hurt Engineering's accreditation standards that require full-time faculty teach a certain percent of courses.

Source: University of Toronto, Toronto, ON; Business Affairs Forum interviews and analysis.

Recalibrating Cross-Teaching Incentives

University of Toronto Calculates Cost of Interdisciplinary Teaching

To recalibrate incentives and appease the faculty, executives at the University of Toronto transitioned to a more precise revenue-sharing agreement between Arts and Sciences (A&S) and Engineering. In sum, Arts and Sciences receives a percentage of Engineering revenue based on its share of total Engineering program expenses. The detailed calculation is detailed below.

Cross-Teaching Revenue Share Calculation

1 Calculate Full Cost of Instruction for Each Section

Three factors examined:
- Direct Teaching Costs
- Divisional Overhead
- University Overhead

2 Sum Costs of A&S Sections That Engineering Students Completed

3 Calculate Percent of Engineering Instruction Costs Provided by A&S

$$\left(\frac{\text{Cost of All A\&S Sections Engineering Students Completed}}{\text{Cost of All Sections Engineering Students Completed in Any Faculty}}\right) =$$

A&S bears **X%** of total Engineering costs

4 Reset Revenue Share

A&S receives **X%** of total Engineering revenue

Year 1 Results

Greater Course Access

- Increased priority seats available to Engineering students in A&S electives
- Seats added to A&S courses in high-demand by Engineering students
- Additional A&S evening course sections opened to accommodate Engineering college timetables

Increased Full-Time Faculty Hires

Full-time faculty hired to teach Engineering program core requirements such as math and physics

First, executives calculate a rough cost of each section, factoring in instructor costs, plus division and university overhead. Next, they sum the costs of all Arts and Sciences sections that enrolled Engineering students, including Engineering core curriculum requirements as well as electives. Third, they divide that number by the full cost of all sections across campus with Engineering students, which represents the percentage of Engineering teaching costs borne by Arts and Sciences. Ultimately, that percentage becomes the new revenue share between the faculties. After revenue is allocated to Engineering based 100% on majors, Engineering will then pass on the calculated percentage of revenue to Arts and Sciences.

In just one year, the revenue sharing agreement successfully recalibrated incentives. First, Arts and Sciences increased course access for Engineering students with priority seats and additional night courses. Second, with the additional revenue, Arts and Sciences hired more full-time faculty, ensuring Engineering meets accreditation requirements. The University of Toronto tentatively plans to replicate this agreement between Arts and Sciences and five other academic units.

Source: University of Toronto, Toronto, ON; Business Affairs Forum interviews and analysis.

3 Should we use enrollment smoothing to allocate tuition revenue?

Decision Point in Brief

Importance to Budget Model

The number of years of enrollment data used to determine revenue allocations impacts stability of unit budgets and how quickly allocations increase to reflect growth—and therefore the strength of financial incentives.

Observed Options

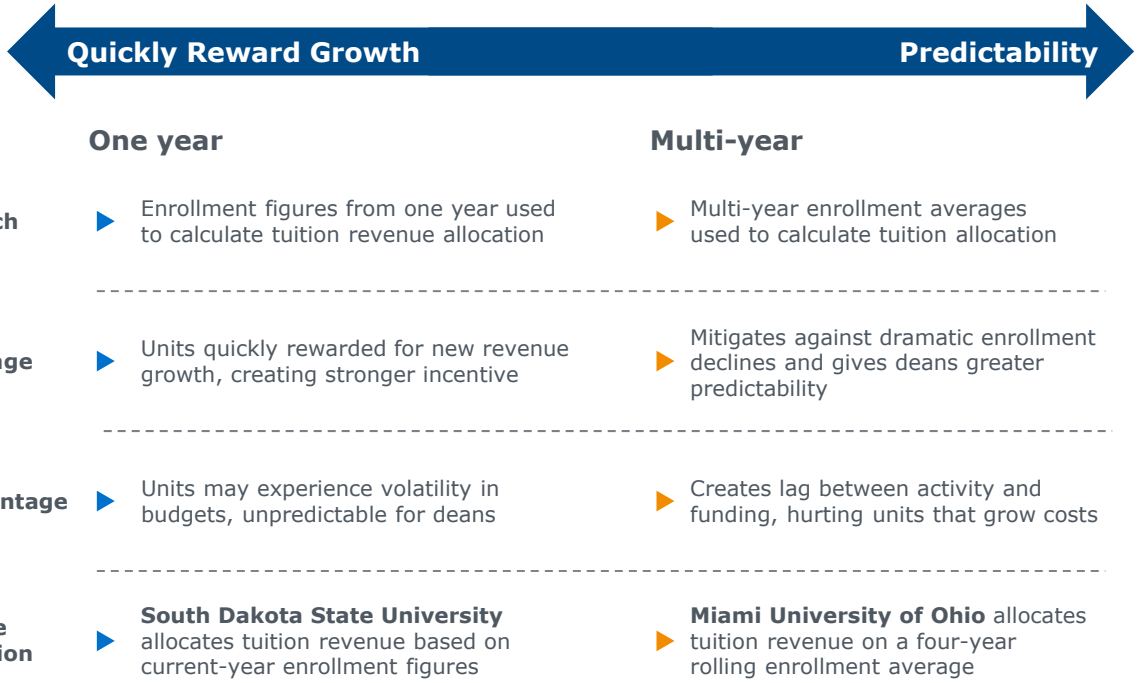
Institutions typically take one of two competing approaches to determine tuition revenue allocations for academic units. The more common approach is to base tuition allocations on one year of enrollment, either prior year or current-year projections. This approach rewards academic unit growth with immediate increases in next year's allocations but may create volatility in unit budgets and impede deans' ability to plan. Alternatively, some institutions have opted for a multi-year averaging approach known as enrollment smoothing, where tuition revenue allocations are based on two to four years of enrollments. This method creates more stability and provides deans adequate time to adjust to enrollment declines, but creates a lag between enrollment growth and funding—potentially weakening the incentive for growth.

EAB Guidance

Institutions can achieve the benefits of both approaches by **basing tuition-revenue allocations on one year of enrollment and establishing a central loan pool to support units with sudden enrollment declines.** This creates strong incentives by quickly rewarding units that achieve growth while providing a safety net for units facing unexpected declines.

Quickly Rewarding Growth Versus Predictability

Institutions typically take one of two approaches when allocating tuition revenue to academic units and colleges, as shown below. The more common approach is to base tuition revenue allocations on one year of enrollment, either prior year or current-year projections. This approach quickly rewards colleges for enrollment growth, immediately increasing revenue allocations the next year and ensuring they receive the necessary resources to offset potentially higher costs associated with that growth. However, this method may create volatility in unit budgets and impede deans' ability to plan. One year of severe enrollment declines could send a college into crisis mode, leaving it without sufficient resources to fund operations or potentially triggering damaging cuts.



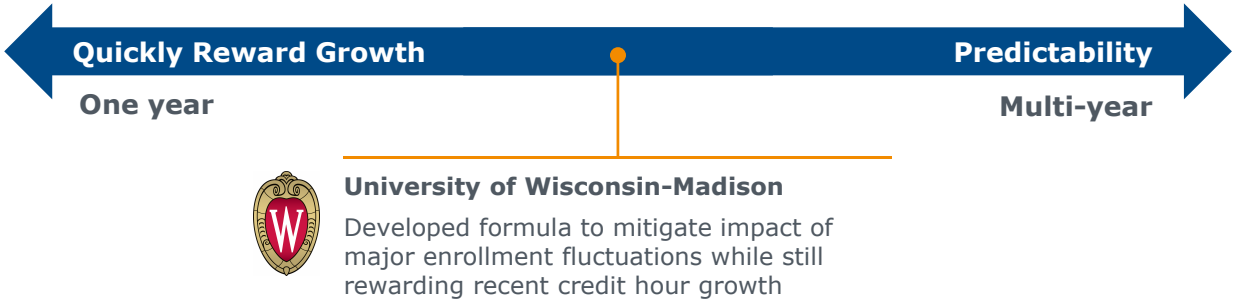
To combat budget volatility, some institutions have opted to base tuition revenue allocations on multi-year averages, an approach commonly known as enrollment smoothing. Institutions that use enrollment smoothing base tuition revenue allocations on two to four years of enrollment, which creates stability and provides deans adequate time to adjust to enrollment declines by spreading losses over multiple years. However, this approach creates a lag between enrollment growth and corresponding funding, which can weaken the incentive for growth and leave units without adequate resources to pay additional costs borne to pursue that growth (e.g., faculty lines for a new program launch).

Source: Miami University, Oxford, OH; South Dakota State University, Brookings, SD; Business Affairs Forum interviews and analysis.

Seeking the Middle Way

UW-Madison's Two-Year Average Weights Most Recent Year More Heavily

Seeking to strike the balance between predictability and quickly rewarding growth, the University of Wisconsin-Madison developed the formula below as a compromise approach. The simple formula averages the past two years of enrollments, but weights the most recent year double. The two-year average mitigates the impact of enrollment declines, while the emphasis on last year's enrollment still strongly rewards colleges for recent credit-hour activity.



$$\text{Adjusted Enrollment for Allocation} = \left(\frac{2 \times (\text{Prior-Year Enrollment}) + \text{Prior-Prior-Year Enrollment}}{3} \right)$$

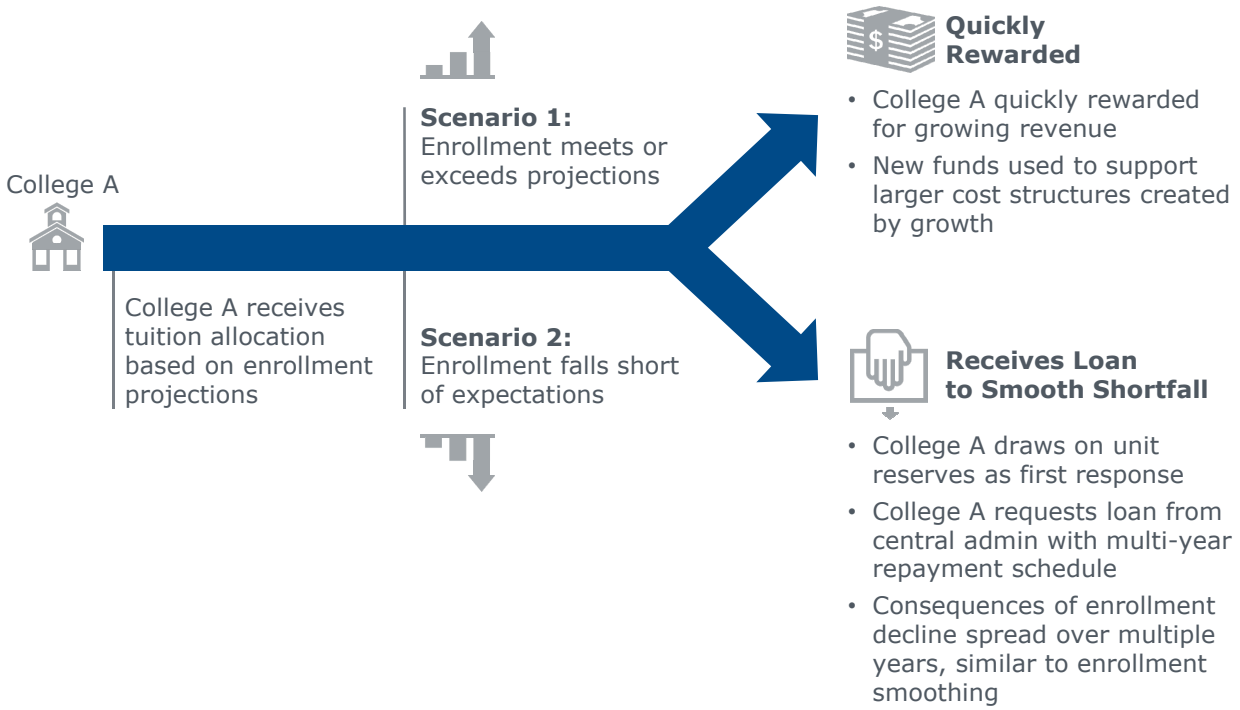
Source: University of Wisconsin-Madison, Madison, WI; Business Affairs Forum interviews and analysis..

The Best of Both Worlds

Complement Revenue Allocation with Loan Pool

For a more complicated but potentially more impactful approach, EAB recommends that institutions base tuition revenue allocations on one year of enrollment projections and establish a central loan pool to support units with sudden or unexpected enrollment declines. This approach captures the advantages of the two traditional approaches. It creates a strong incentive for enrollment growth by quickly rewarding units with increased allocations. At the same time, units with sudden drops in enrollment receive central funds they must pay back over time, effectively spreading losses over multiple years and giving deans time to adjust and plan.

Case Western Reserve University "Loan Pool"



As shown above, Case Western University bases revenue allocations on current-year projections and offers loans to help colleges experiencing unforeseen declines, as needed. In the top scenario, College A's enrollment meets or exceeds expectations, so the college is immediately rewarded with additional revenue the next year. On the bottom, College A's enrollments does not meet projections, so they receive less revenue the next year. Rather than absorbing the entire loss in one year, College A may request a loan from central administration and pay it back over several years.

South Dakota State University utilizes a similar central loan pool structure. To request a loan, units must submit a detailed form, including justification for the loan, corrective action they plan to take, and a repayment schedule. A full version of South Dakota State's request form is available on the following page.

Source: Case Western Reserve University, Cleveland, OH; South Dakota State University, Brookings, SD; Business Affairs Forum interviews and analysis.

South Dakota State University's Risk Management Request Form

Risk Management Request Form

Unit Requesting Risk Management:

Requested Amount:

Request Date:

Explanation of Unforeseen External Shock Causing the Need for Risk Management Assistance:

(Provide Response Here)

Corrective Action Taken for Next Fiscal Year to Adjust Budget in Response to External Shock:

(Provide Response Here)

Explanation of Expenditure Reductions or Revenue Increases used to Generate Loan Repayment:

(Provide Response Here)

Repayment Terms:

Amount: _____

Years (1 to 3): ____

Repayment Schedule:

Year	Amount
Year 1 (FYXX)	
Year 2 (FYXX)	
Year 3 (FYXX)	
Total	

Signatures:

_____

Unit Leader

_____ _____

Provost/VP Academic Affairs VP Finance & Business

ATTEST:

_____ _____

President Chair of Faculty Budget Committee

Source: South Dakota State University, Brookings, SD.

4 Should we allocate any forms of differential tuition revenue?

Decision Point in Brief

Importance to Budget Model

Allocating or not allocating differential tuition revenue directly to the academic units impacts the budget model's level of transparency and can alter model incentives or create unintended new incentives.

Observed Options

Institutions either allocate out-of-state tuition and financial aid differentials directly to the academic units, or instead allocate an average rate per student regardless of student. Direct allocation of non-resident tuition or financial aid costs may create perverse incentives to focus recruitment efforts on particular types of students. While less common, some institutions' models artificially weight credit hours to allocate more resources to colleges with higher costs of instruction.

EAB Guidance

Aside from rare exceptions, institutions should **not use weighted credit hours or directly allocate out-of-state tuition or financial aid differentials. Rather, institutions should average or "wash out" differential tuition** to avoid perverse incentives, keep units focused on growth activities, and maintain model transparency.

Balancing Accuracy with Perverse Incentives

Three Types of Differential Tuition Warrant Executive Attention

The fourth decision point centers on whether to allocate three different forms of differential tuition depicted below. The first type is out-of-state tuition. Public institutions must consider whether to allocate non-resident tuition differentials directly to the colleges or instead allocate average tuition rates regardless of residency. Similarly, institutions can either allocate tuition revenue minus each unit's share of financial aid or allocate a flat financial aid rate to all units. Lastly, some institutions artificially weight the tuition revenue allocation formula to provide more resources to colleges with higher instructional costs. The next several pages provide further details on each type of differential tuition.

Out-of-State Tuition

Tension between recruiting brightest and highest paying students across the nation without creating incentive for disproportionate recruitment of non-resident students

Financial Aid

Allocating financial aid directly to colleges results in differential tuition based on the type of students enrolled, and may create disincentive to enroll students with greater financial need

Weighted Credit Hours

Institutions artificially weight the tuition revenue allocation formula to recognize the differential teaching costs between colleges

Source: Business Affairs Forum interviews and analysis.

Obscuring Out-Of-State Revenue Differential

Lack of Unit Control and Inherent Political Danger Often Stop Allocation

The first kind of differential tuition is out-of-state tuition. In general, EAB recommends that most institutions "wash out" the non-resident tuition differential by averaging tuition into a single per-student rate**.** This way, units will receive the same amount of revenue for in-state and out-of-state students. Two primary reasons are detailed on the left. First, units typically have little control over the enrollment mix, which is often part of the larger institutional enrollment strategy. Units should focus their energies improving P+L, not trying to alter enrollment mix at the margins. Second, as legislatures increasingly scrutinize the mix of in-state and out-of-state students, there is political danger for institutions to incent disproportionate recruitment of non-residents.

Most Wash It Out…

Lack of Unit Control

- Enrollment management and senior leaders outside the units typically decide the optimal number of out-of-state students to enroll
- Units should focus time and energy on growth activities

Political Danger

- Institutions do not want units disproportionately targeting non-residents, especially in states with enrollment caps
- The **University of Virginia** washes out out-of-state tuition due to a commitment to the state to limit non-resident enrollments

…But Some Don't

Rewarding Prestige

- **Miami of Ohio** passes on the out-of-state tuition differential to colleges to reward nationally recognized prestige
- Business and Engineering colleges reap benefits of high-quality programs that attract many out-of-state students

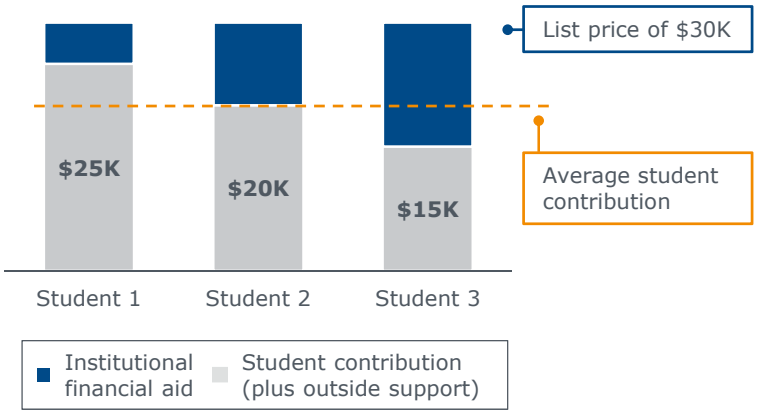
The one exception to the rule is shown on the right. A few institutions seeking to promote prestigious programs nationwide choose to allocate out-of-state differentials to units to reward those programs. As an example, the Business and Engineering schools at Miami of Ohio attract many non-residents, and differential tuition revenue has further enabled their growth. If rewarding prestige is a top priority, institutions can consider passing on non-resident tuition to units. Otherwise, most institutions should average out the difference to avoid perverse incentives and political danger.

Source: Miami University, Oxford, OH; University of Virginia, Charlottesville, VA; Business Affairs Forum interviews and analysis.

Most Should Wash Out Financial Aid Differentials

The second form of differential tuition revenue is financial aid. While typically viewed as a cost, institutions that allocate financial aid to the units effectively allocate discounted tuition. As shown on the graph below, colleges that enroll students with greater financial need receive less tuition revenue when financial aid costs are borne by the units.

Miami of Ohio's Methodology for Financial Aid



1. Calculate flat rate per FTE. In this example, average student contribution is $20K.
2. Allocate flat rate uniformly to colleges as direct expense. In this example, each college is charged $10K per student for financial aid.

> "Our undergraduate discounting method is an important component of our overall enrollment strategy, so we want to keep the amount of aid awarded as a central strategic decision."
>
> *David Ellis, Associate VP for Budgeting and Analysis*
> *Miami University*

Like out-of-state tuition, EAB recommends for most institutions to wash out financial aid, allocating revenue based on an average student contribution rate. As shown in the example above, revenue allocations are based on a $20K per student average, regardless of individual students' level of financial need. Similar to out-of-state tuition, institutions primarily wash out financial aid because units cannot easily inflect this cost. Central administration typically awards financial aid as part of the larger strategic enrollment strategy, so institutions do not want to penalize units for a decision outside of their control.

Source: Miami University, Oxford, OH; Business Affairs Forum interviews and analysis.

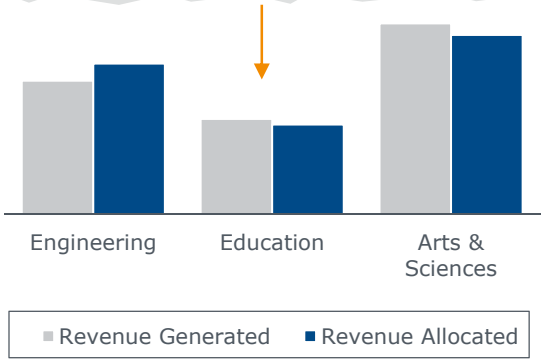
Avoiding Artificial Weighted Credit Hours

Weighted SCHs Distort P+L, Create Perverse Incentives and Disparities

The last form of differential tuition is weighted credit hours. This methodology is distinct from extra program fees such as lab fees or differing tuition rates charged up front by colleges (institutions nearly always pass on these forms of differential tuition to colleges). Instead, some institutions artificially weight credit hours to recognize different costs of instruction. As illustrated here, students pay the same tuition rate, but Engineering credits count 20% extra in the internal budget model formula. Therefore, the College of Engineering receives a higher allocation while Education and Arts and Sciences receive lower allocations than they would have under equal credit hour weighting.

Conceptual Illustration of Artificial Weighted Credit Hours

College	Credit Hour Weighting
Engineering	120%
Education	100%
Arts and Sciences	100%



Three Unintended Consequences of Weighted Credit Hours

1 Distorts College P+L

- Deans forced to make decisions based on skewed financial assumptions that do not reflect actual impact on the institution
- Obscures transparency of actual cost and revenue flows, undercuts unit financial accountability

2 Creates Perverse Incentives

- Units or departments may game the system to better capture higher credit hour weightings

3 Creates Accounting Problems

- Can cause disparity between actual generated revenue and revenue promised to units
- Significant time investment needed to calculate adjusted allocations each year

While sound in theory, this practice is not recommended for the three reasons listed on the right. EAB believes that first, weighting credit hours distorts unit P+L and obscures the link between revenue generated and allocations received. This ultimately undercuts the incentives the budget model is designed to create. Second, weighting credit hours may create perverse incentives for units or departments to game the system. At one institution, faculty deliberately re-listed existing courses from lower-weighted departments to higher-weighted ones to capture a greater share of revenue. Last, determining the appropriate weighting is time-consuming and complicated, requiring recalibration every year or two.

Rather than weight credit hours, institutions should rely on the subvention methodology (discussed in Section 2 of this publication) to allocate additional resources to units with higher instructional costs.

Source: Business Affairs Forum interviews and analysis.

5 Should we allocate unrestricted state appropriations?

Decision Point in Brief

Importance to Budget Model

The approach public institutions take to allocate unrestricted state appropriations primarily impacts the amount of flexible funds central leadership can deploy outside the activity-based allocation formula. This decision also has a strong downstream impact on other important budget model elements such as subvention and strategic reserves.

Observed Options

Historically, most public institutions combined tuition and state dollars into a single pool of revenue to allocate to the units. The other option is to allocate tuition revenue through the activity-based formula, but hold state appropriations centrally to fund subvention or strategic reserves. While less common in the past, more institutions are adopting this approach to shield deans from volatile state funds, decrease unit reliance on state funds, and provide central administration with more flexible dollars.

EAB Guidance

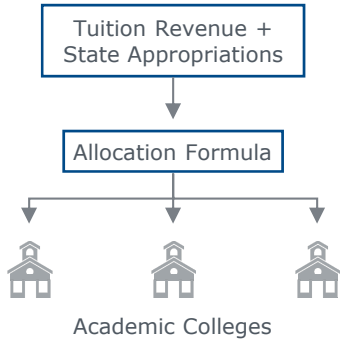
Though public institutions increasingly hold state appropriations centrally for subvention and strategic allocation, **either approach is acceptable. The key is for leaders to decide early in the budget model design process,** as this decision influences the structure of other important budget model elements such as subvention and strategic reserves.

A Philosophical Divide

Public Institutions Trending Toward Holding State Funds Centrally for Allocation

The final revenue decision point centers on unrestricted state appropriations. Although volatile in recent years, state appropriations still represent a significant source of revenue for most public institutions. Generally, institutions can take one of two approaches to allocate unrestricted state dollars. Historically, most public institutions combined tuition and state dollars into a single pool of revenue to allocate to the units, shown below on the left. The other increasingly popular option is to allocate tuition revenue through the activity-based formula, but hold state appropriations centrally to fund subvention or strategic reserves.

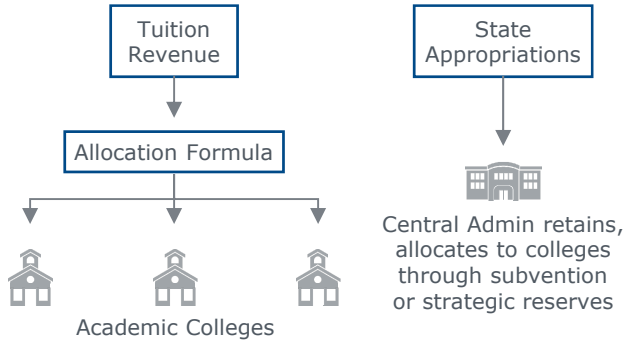
Supplements Tuition



KENT STATE UNIVERSITY

Allocates state appropriations to colleges to supplement tuition based on course and degree completions

Retained at the Center



Most Shifting Toward Retaining State Dollars Centrally

- Institutions increasingly retain state money centrally as states divest from higher education
- Holding state appropriations centrally increases central spending discretion and shields colleges from state funding volatility

There are three reasons more institutions are adopting this approach. First, institutions seek to shield units from increasing volatility in state funds. Second, this approach educates units on the reality of increased tuition-dependency in higher education and encourages them to become profitable without relying on state funds. Third, as more institutions adopt models with formulaic resource allocation, this approach also provides central administration with more flexible dollars. State funds are still ultimately passed down to the units, but unlike revenue subject to the allocation formula, central administration can strategically allocate state dollars based on subvention or strategic priorities. Importantly, institutions must be wary of state government scrutiny, as state officials may mistakenly believe state appropriations are funding central administration.

Though public institutions increasingly hold state appropriations centrally for subvention and/or strategic allocation, either approach is acceptable. The key is for leaders to decide early in the budget model design process, as this decision influences the structure of other important budget model elements such as subvention and strategic reserves.

Source: Kent State University, Kent, OH; Business Affairs Forum interviews and analysis.

6 How do we allocate overhead costs to maximize incentives and maintain buy-in?

Decision Point in Brief

Importance to Budget Model

Institutions must incorporate overhead cost allocation into the budget model for three primary reasons. First and most obviously, as institutions allocate a greater portion of revenue to the academic units, they must necessarily allocate indirect costs to fund institutional overhead. Second, cost allocation creates P+L accuracy and transparency, and educates units on the full cost of business operations. Lastly, cost allocation can create meaningful incentives to reduce spending.

Observed Options

Institutions take differing approaches to cost allocation, leaning toward either simplicity or precision. Institutions that prioritize simplicity combine overhead costs into one or two cost pools for allocation. However, overly simplistic models are often inaccurate and may not create incentives to reduce costs. Conversely, institutions that desire a very precise methodology allocate dozens of distinct costs. However, charging for costs that units cannot control dilutes incentives and spreads their attention too thin.

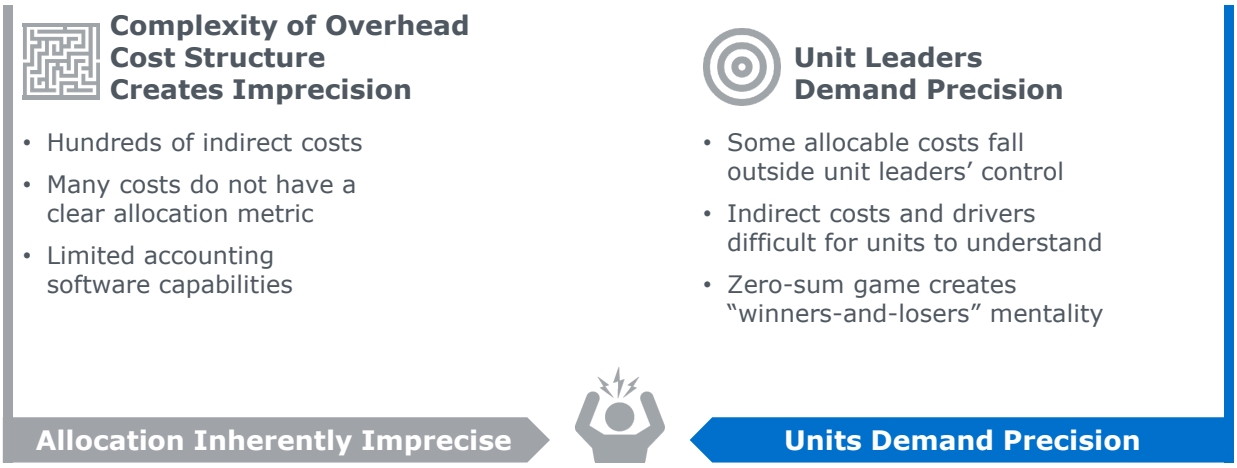
EAB Guidance

To create meaningful incentives to reduce unit consumption of institutional overhead, institutions must strike the right balance between precision and simplicity. **Institutions should aim to charge four to six cost pools with one to two cost drivers per pool to achieve an optimal balance.** In particular, institutions should break out costs that are easy to measure and within units' ability to control, and incorporate remaining costs into a general university overhead pool. However, it is crucial for executives to be flexible and tweak the model as necessary to maintain stakeholder buy-in for cost allocation. For example, institutions may need to break out additional costs (e.g., costs not attributable to every unit) to help academic leaders understand the reason behind general overhead cost increases.

A Tricky Balancing Act

Institutions Struggle to Maintain Simplicity Amid Calls for Precision

Cost allocation is often one of the most contentious aspects of a budget model change or redesign. In fact, arguments about cost allocation have derailed model transitions at several institutions. This tension arises from the difficulty in balancing simplicity and precision in the cost allocation methodology. On one hand, institutions have hundreds of indirect costs, many of which lack a clear allocation metric. To simplify the model, many institutions group costs together for allocation. On the other hand, simplicity makes the model less accurate—which creates pushback from units that demand precision and resent paying more than their "fair share." Since institutions have a set amount of overhead, cost allocation becomes a zero-sum game that creates a "winners-and-losers" mentality and can turn colleges against each other.



To help executives strike the right balance between simplicity and precision, this decision point will focus on how to best structure cost allocation to create impactful cost-control incentives as well as proven change management tactics to win stakeholder buy-in for the cost allocation methodology.

Source: Kent State University, Kent, OH; Business Affairs Forum interviews and analysis.

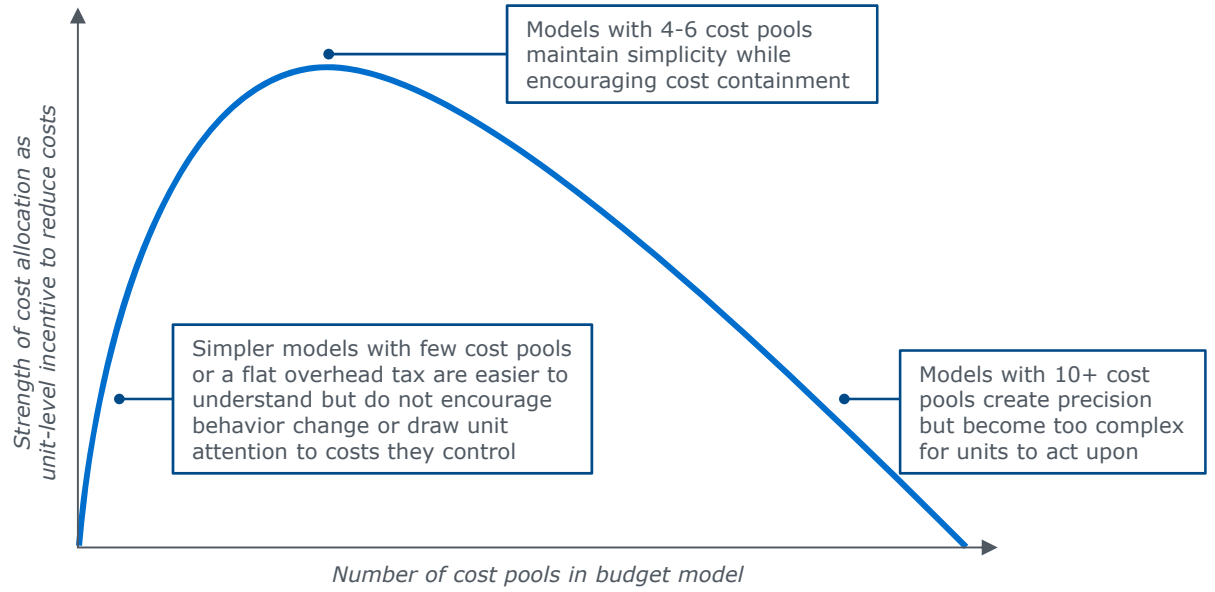
A False Dichotomy?

Balancing Simplicity and Precision to Incent Better Consumption Behaviors

When designing cost allocation, executives must first determine the number of cost pools to allocate to academic units. To clarify, institutions should allocate all indirect costs to create unit accountability and maintain P+L transparency. However, the number of distinct cost pools used to allocate indirect costs impacts the strength of P+L incentives.

The graph below depicts the relationship between the number of cost pools and likelihood to inflect unit behavior. On one hand, utilizing only one or two cost pools is often too simplistic. Units cannot see individual costs or the impact on allocations, so they have no incentive to change behavior. On the other hand, incenting units against dozens of costs outside of their control dilutes the incentives and spreads their attention too thin.

Relationship Between Number of Cost Pools and Potential to Inflect Behavior Change



EAB recommends that institutions allocate between four and six costs pools to create the most impactful incentives. This range represents a manageable number of pools for units to focus their efforts on while maintaining a level of precision to win stakeholder buy-in.

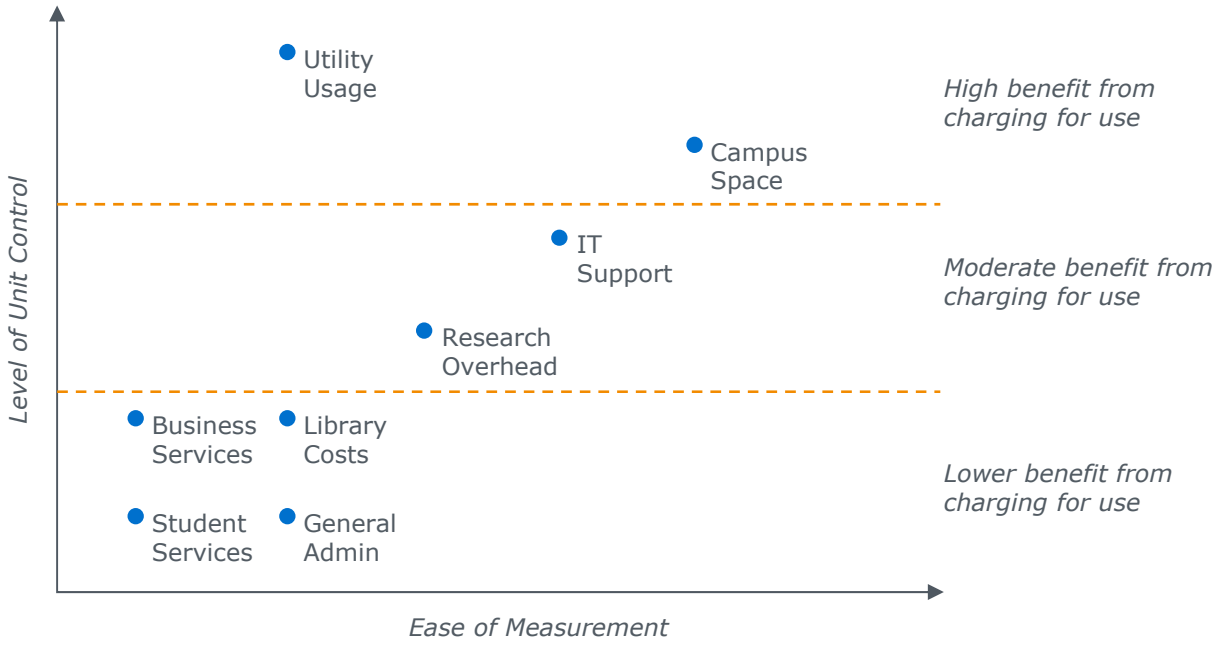
Source: Business Affairs Forum interviews and analysis.

To Charge or Not to Charge?

Break Out Easily Measured, Controllable Costs to Inflect Behavior Change

In determining which four to six cost pools will create the most impactful incentives, executives should focus on costs that are both easy to measure and within units' ability to control. The graph below plots potential cost buckets by these two considerations. For example, many institutions break space usage into a distinct cost. On the other hand, measuring unit consumption of costs such as business services or the library is difficult, and incenting departments and colleges to reduce use of these services may actually be counterproductive. Therefore, most institutions combine these costs into a larger general administration bucket.

Potential Cost Pools by Ease of Measurement and Unit Control



Source: Business Affairs Forum interviews and analysis.

Keeping It Simple

Select One or Two Cost Drivers per Cost Pool

The final step in cost allocation design is to assign drivers or metrics to each cost pool that determine unit allocations. The table below summarizes appropriate drivers for each pool. Within these options, the actual metric used to allocate each cost pool will not significantly change outcomes—executives should ultimately choose the metrics that win buy-in from campus stakeholders. More importantly, EAB advises executives to prioritize simplicity, assigning only one or two cost drivers to each pool so that units can easily understand and respond to incentives.

Suggested Allocation Approaches for Overhead Cost Pools

Expense	Revenue Tax	Expense Tax	Faculty FTE	Staff FTE	Student FTE	SCH	Other
G&A	✓	✓	✓	✓	✓		
Business Services	✓	✓	✓	✓			
Academic Affairs	✓	✓			✓	✓	Majors, Degrees
Library	✓		✓		✓	✓	
IT	✓		✓	✓	✓		Fee-for service
Facilities				✓			Asgn. Sq.Ft, Quality Asgn Sq.Ft
Research	✓	✓	✓				ICR, ICR Tax

Source: Business Affairs Forum interviews and analysis.

Starting Where You Must

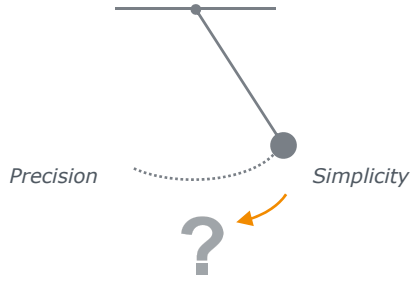
Allow for Some Complexity, Move Toward Simplicity Over Time

In sum, EAB recommends that institutions allocate four to six cost pools with one or two cost drivers each to most effectively balance simplicity and precision in cost allocation. However, given the high tension surrounding cost allocation, it is crucial for executives to be flexible and tweak the model as necessary to maintain stakeholder buy-in for the model.

Institutions Moved to Simpler Cost Methodologies Later on…

Institution	Initial Number of Pools	Revised Number of Pools
Penn	20+	6
USC University of Southern California	100+	4
University of Delaware	7	2

…But Old Arguments May Resurface Over Time



> "Every five years or so, a new group of deans will want to move in the opposite direction on the spectrum between simplicity and precision. The pendulum swings back and forth."
>
> *Stephen Golding, CBO*
> *Ohio University*

For example, to appease unit demands for precision, many institutions must implement a more complex model initially and slowly migrate to a simpler model over time. Three examples of institutions that moved from complex to simpler models are shown in the table on the left. Additionally, some institutions periodically tweak the cost allocation model as deans turnover and alternate between calls for simplicity and precision.

Source: Ohio University, Athens, OH ; University of Delaware, Newark, DE; University of Pennsylvania, Philadelphia, PA; University of Southern California, Los Angeles, CA; Business Affairs Forum interviews and analysis.

Evolving Cost Allocation with Campus Concerns

Two Types of Overhead Costs May Require Breakout as Model Matures

While the goal is to move toward a simpler model over time, there are two instances where it may be prudent to break out additional cost pools to maintain stakeholder buy-in. First, some costs are not attributable to every unit—for instance, the graduate school clearly does not utilize undergraduate advising services. In general, EAB recommends that institutions adopt Temple University's approach, where all units share in all costs in the name of supporting the greater good. This also ensures simplicity and equity in cost allocation.

However, there may be some occasions that warrant breaking out select costs to promote goodwill among stakeholders. For example, Rutgers University breaks out Student Services into its own cost pool to recognize that research centers do not enroll students. Ultimately, executives must determine which situations require breaking out additional cost pools.

1 Costs Not Attributable to All Units

- Units that do not generate certain overhead charges resist paying for those charges
- Institutional approaches vary; choose breakout that best fits institution-specific model principles

Temple University

Does not discriminate among units when allocating costs, instead allocates on basis of the "common good"

Rutgers University

Breaks out Student Services into its own cost pool because research centers resist paying student-driven charges

2 Costs That Become More or Less Significant Over Time

Break out or pool costs as their overall materiality changes to better communicate year-over-year cost changes and maintain buy-in

University of Pennsylvania

Initially rolled development costs into general overhead pool but broke costs out separately when launching major capital campaign

Barnes University[1]

Set a materiality threshold to dictate which cost categories were significant enough to warrant their own cost pools

The second potential instance to break out additional costs is if some costs become more significant over time. For instance, the University of Pennsylvania initially included Advancement within the General Overhead cost pool, but broke it out as a separate charge during a major campaign. Although deans could not control advancement costs, creating a separate pool communicated the reason behind general overhead cost increases. Similarly, Barnes University is considering establishing a materiality threshold upfront that will automatically break out costs that reach a certain level.

Provided that institutions remain close to the ideal four to six range, adding one or two cost pools for the sake of buy-in will not drastically weaken incentives.

1) Pseudonym.

Source: Rutgers University, New Brunswick, NJ; Temple University, Philadelphia, PA; University of Alabama, Birmingham, AL; University of Pennsylvania, Philadelphia, PA; Business Affairs Forum interviews and analysis.

Incorporate Remaining Costs into a Single Pool

Weighing the Advantages of Using Revenues or Expenditures as a Driver

After building out four to six cost pools, executives should incorporate the remaining costs into a general overhead pool for allocation. Common expenses pooled as general overhead are listed on the left. Broadly, general overhead costs are not easily tied to unit activity and are therefore outside of dean control.

Typical Expenses Pooled as General Overhead

- President's Office
- General Counsel
- Budget and Finance
- Board of Trustees
- University Relations
- Compliance
- Risk Management

Relative Advantages of Two Common Drivers

Type of Charge	Advantages	Disadvantages	Example
Share of Overall Revenue	More stable	Risks dis-incentivizing revenue growth	THE UNIVERSITY of NORTH CAROLINA at CHAPEL HILL
Share of Overall Direct Expenditures	Promotes reduced cost consumption	More volatile; units likely to ask for exemptions	UF UNIVERSITY of FLORIDA

Institutions typically allocate general overhead in one of two ways—either by unit share of total revenue or by unit share of total direct expenditures. The table on the right lists the relative advantages and disadvantages of these two approaches. While unit revenues are typically more stable, allocating general overhead by share of revenue does not incent any behavior change. In comparison, allocating general overhead on expenditures provides further encouragement for units to reduce spending, but expenditures are more volatile year-to-year. In particular, an expenditure-based tax penalizes colleges and departments for large, one-time costs such as research equipment purchases. Though executives can grant exceptions for large purchases, this creates complexity and builds uncertainty into the cost model. For this reason, most institutions view a revenue-based general overhead tax as the safer option.

Source: University of Florida, Gainesville, FL; University of North Carolina, Chapel Hill, NC; Business Affairs Forum interviews and analysis.

Addressing Common Concerns

Tactics to Safeguard Deans from Volatility and Prevent Service Duplication

To further assist institutions in cost allocation methodology design, the table below summarizes proven change management tactics that address common academic unit concerns with cost allocation. For example, units may become more vocal about administrative unit performance after they perceive they are "paying" for those services, or may resist the interdependencies between colleges that cost allocation creates. Solutions to such challenges are detailed below.

Model Characteristic	Academic Unit Concern	Suggested Tactic
Central Service Charges	"The charge for central HR is too high. I can have someone in-house do it cheaper."	Encourage units to provide input into Service Level Agreements and annual service unit budgets
	"My overhead cost charge spiked this year. I blame the growth of administrators."	Provide unit leaders with line-item breakouts of cost pools that explain notable year-over-year variances
Volatility of Overhead Expenses	"Overhead charges are volatile, so I can't plan for my expense charges."	Allocate particularly volatile expenses (e.g., utilities) or expenses with volatile drivers (e.g., direct expenditures, fundraising receipts) across 2-4 year rolling averages
	"My cost charges are dependent on other colleges. I get charged more when another college cuts costs or loses enrollments."	Set caps and floors on how much a unit's share of a given expense can increase or decrease year-over-year

Source: Business Affairs Forum interviews and analysis.

7 How do we regulate unit spending to protect institution finances and strategic goals?

Decision Point in Brief

Importance to Budget Model

While all institutions seek to ensure academic units make smart spending decisions, regulating unit investments is even more important in activity-based models. Growth incentives encourage units to take risks, so central leadership must implement safeguards to ensure college investments are sustainable long-term and align with institutional priorities.

Observed Options

Most institutions regulate unit spending through a standard set of oversight mechanisms. For example, central administration vets new program proposals, the provost approves new faculty lines, and a curricular review committee monitors course offerings and quality.

EAB Guidance

Institutions should **supplement standard oversight mechanisms with ongoing central resource planning** to ensure unit alignment with institutional finances and strategic goals.

Ensuring Smarter Unit-Level Spending Decisions

Set of Proven Practices Address Majority of Concerns

Beyond allocating indirect costs, the final decision point in this section focuses on regulating unit-level spending or direct costs. While all institutions seek to ensure academic units make smart spending decisions, regulating unit investments is even more important in activity-based models. Growth incentives encourage units to take risks, so central leadership must implement safeguards to ensure college investments are sustainable long-term and align with institutional priorities.

Fortunately, institutions have already found proven solutions to the majority of concerns regarding unchecked unit spend. For example, a common concern with activity-based models is that colleges will launch unprofitable programs—but most institutions have a central committee that vets all program proposals to determine viability. Another worry is that colleges will hire too many faculty, creating inflexible, long-term salary costs. However, the provost typically approves all faculty hires, even at very decentralized institutions.

Common Concern	Proven Solution
Colleges will launch unprofitable new programs	Central administration vets and approves all new program proposals
Colleges will make unnecessary investments in new faculty or staff	Provost retains power to approve all new full-time faculty and staff hires
Colleges will create low quality courses to poach students from other units	Curricular Review Committee or Faculty Senate monitors course quality
Colleges will create duplicate courses to generate more revenue from their majors	Curricular Review Committee or Faculty Senate monitors course offerings for unwanted duplication
Colleges will make investments that deviate from institution-level strategic vision	Provost authorizes or denies dean reappointments

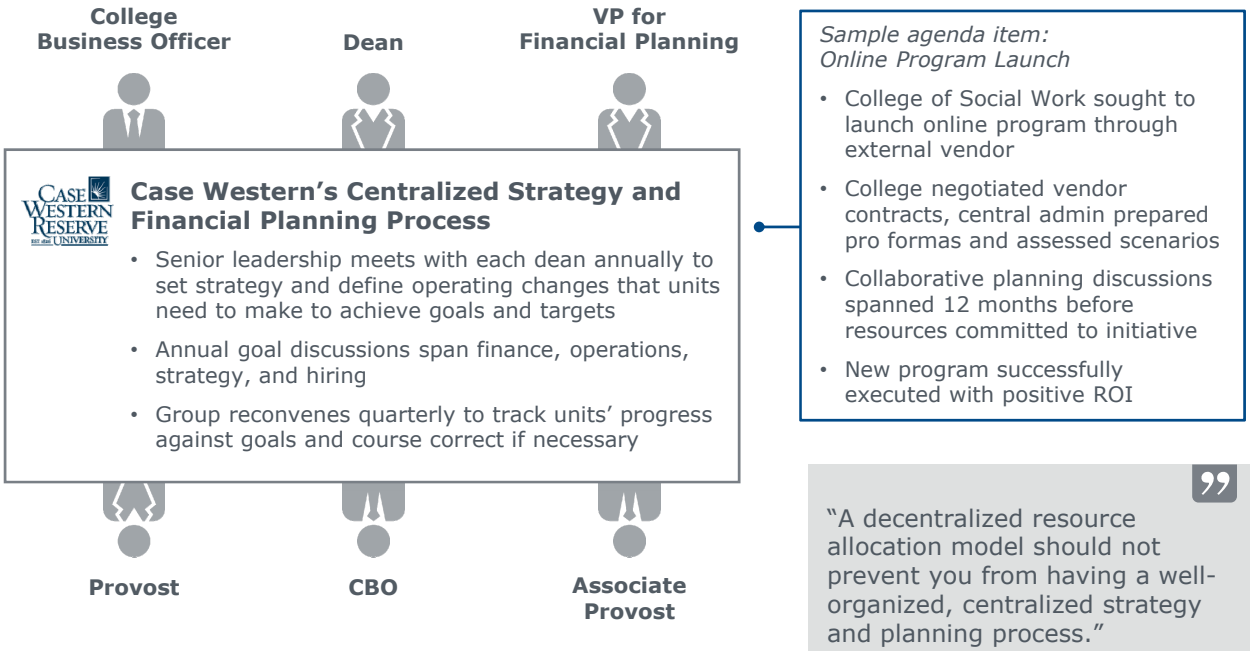
Source: Business Affairs Forum interviews and analysis.

Taking a More Holistic Approach to Oversight

Case Western Quarterly Strategy Meetings Guide Unit Spending

Beyond this standard oversight playbook, Case Western Reserve University (CWRU) takes a more holistic approach to regulate direct costs as part of central planning. Each year, the CBO, provost, and several other central leaders meet with each dean and college business officer to collaboratively set unit goals—including finances, operations, strategy, and hiring. This group also reconvenes quarterly to discuss units' progress on goals and plan next steps. The intent of these meetings is to ensure the viability of unit spending decisions as well as unit alignment with institutional strategy.

Representative CWRU Strategy Meeting



"A decentralized resource allocation model should not prevent you from having a well-organized, centralized strategy and planning process."

John Sideras, CBO
Case Western Reserve University

Although Case Western's budget model is heavily decentralized, these strategy meetings enable leaders to maintain a strong centralized planning process. As an example outcome, central finance staff helped the College of Social Work negotiate a better deal with an external vendor to launch an online Master's program. Without the involvement of central administration, the college likely would have created a less profitable program.

Source: Case Western Reserve University, Cleveland, OH; Business Affairs Forum interviews and analysis.

Preserving Mission-Critical Activities Through Subvention and Strategic Reserves

SECTION 2

- **Decision Point 8**: How do we ensure sufficient central reserves for strategic investments?
- **Decision Point 9**: How overt or hidden should subvention be?
- **Decision Point 10**: How do we motivate units receiving subvention to still make financial improvement?

Controlling the Impact of Allocation Incentives

Two Challenges Necessitate Central Reserves and Subvention

Incorporating decentralized elements into the budget model creates meaningful revenue and cost incentives, but can create two new challenges. First, allocating the majority of revenue to the academic units can leave central administration starved for resources. The cost allocation methodology ensures enough funding for day-to-day business operations, but activity-based models often leave the center without sufficient funds for large, strategic, or cross-campus investments. Second, making resource allocation contingent upon performance exposes units to enrollment declines or revenue shortfalls that could threaten operations.

Center Starved for Resources

Allocating majority of resources to units can leave the center with too few funds for important strategic priorities or cross-unit investments

Units Financially Isolated

Sole reliance on allocation formula for funding leaves units exposed to market fluctuations, potentially experiencing short-term losses and making drastic cuts

To address these challenges, institutions must build well-resourced, centrally controlled strategic investment and subvention funds, but do so without undermining the financial incentives created by revenue and cost allocation. This section details three executive-level decision points for structuring subvention and strategic reserves in the budget model. These decisions points will help executives balance the decentralized financial incentives described in Section 1 of this publication with centralized elements that safeguard institution mission and brand. The first decision point offers guidance on ensuring sufficient central strategic reserves, while the latter two decision points address how to best structure subvention to safeguard units and maintain financial accountability.

Source: Business Affairs Forum interviews and analysis.

8 How do we ensure sufficient central reserves for strategic investments?

Decision Point in Brief

Importance to Budget Model

Ensuring the budget model provides some central funding for institutional priorities is critical to achieving strategic goals. Moreover, the structure used to secure and deploy strategic funds can impact stakeholder buy-in for the model.

Observed Options

Some institutions fail to create a dedicated mechanism to fund central reserves, which leaves central administration unable to fund cross-campus strategic investments. However, this was more common in decades past. Most institutions that have changed models in the last 5-10 years have created a separate tax on all revenue to ensure sufficient central reserves. Some institutions combine subvention and strategic reserves into one fund, while others establish distinct pools funded through separate taxes.

EAB Guidance

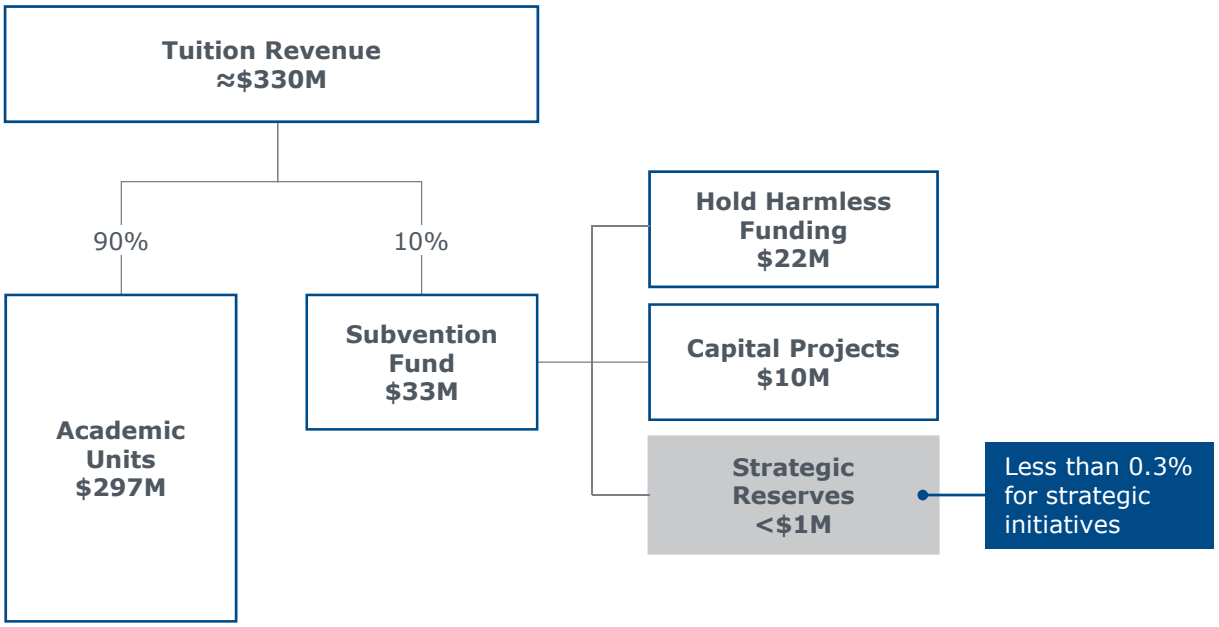
Institutions should **create a separate 3-5% tax on all revenue to fund central strategic reserves,** either set aside before allocations or collected from units after allocations. Institutions designing new budget models should establish this tax from the outset. Institutions introducing a new tax within an existing budget model should anticipate push-back from campus stakeholders. Proven tactics to secure campus buy-in for a strategic reserve tax include slowly increasing the tax percentage over several years to avoid disruptive change and promising to return a portion of funds to the units through strategic investments.

‘The Limbs Thrive While the Body Dies’

Decentralized Budget Models May Leave the Center Without Sufficient Resources

The next executive-level decision point focuses on how to ensure central administration has sufficient resources for cross-campus strategic investments. The most cited challenge of RCM or similarly decentralized models is a lack of fungible resources available for central administration. The graphic below depicts one institution’s revenue allocation model in their its year under RCM, though this is representative of many institutions with decentralized models. Academic units receive 90% of tuition revenue through allocations, while 10% flows into a combined subvention and strategic fund. However, after capital projects and hold-harmless funding, less than $1M—just 0.3% of tuition revenue—remains for central strategic reserves. This problem is particularly difficult to solve after a model goes live, as allocations cannot be radically altered from one year to the next.

Representative Activity-Based Tuition Revenue Allocation Model

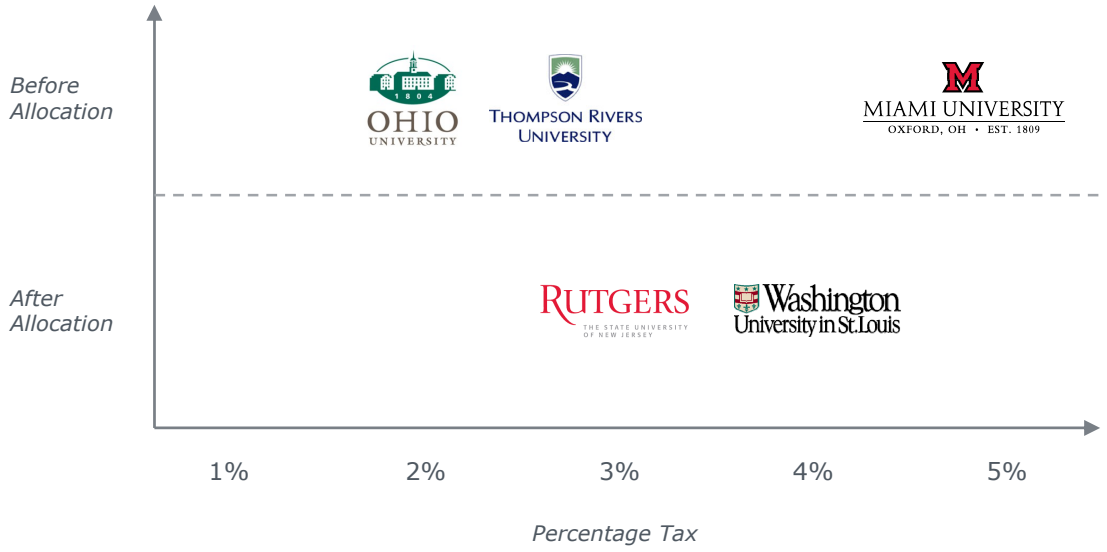


Source: Business Affairs Forum interviews and analysis.

Finding an Appropriate Tax Rate for Central Fund

To ensure sufficient central strategic dollars, most institutions that have changed models in the last 5-10 years have created a separate strategic reserve tax on all revenue. Examples of institutions' strategic tax percentage are shown below, separated by institutions that take funds off-the-top before unit allocations and those that tax on the back end after unit allocations. As discussed in Decision Point 1 (i.e., tuition revenue allocation percentage), both approaches have advantages for funding strategic reserves. Differences in tax and allocation structures across institutions with varying budget models makes determining a single benchmark almost impossible. That said, the ideal range for a strategic reserve tax appears to be between 3-5% of all revenue.

Examples of Tax Rates to Fund Central Strategic Reserves

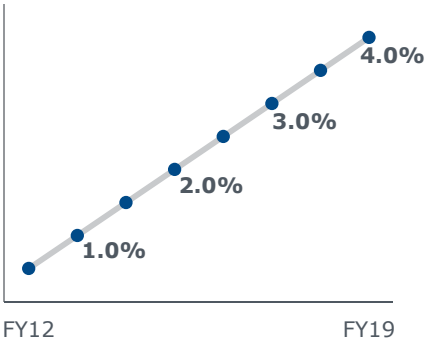


Source: Miami University, Oxford, OH; Ohio University, Athens, OH; Rutgers University, New Brunswick, NJ; Thompson Rivers University, Kamloops, BC; Washington University in St. Louis, St. Louis, MO; Business Affairs Forum interviews and analysis.

Options for Gaining Academic Leader Buy-In

While finding the right tax percentage is relatively straightforward, securing buy-in for a strategic reserve tax can be more complicated. Institutions designing new budget models can often create a strategic reserve tax from the outset with minimal pushback, since the larger-scale budget changes will occupy stakeholders' attention. On the other hand, institutions introducing a tax within an existing budget model should expect stakeholder push back, as faculty and academic leaders will likely be wary of budget allocation changes. Two tactics to win stakeholder buy-in for a strategic reserve tax are detailed below.

Incrementing Up Tax Rate Over Several Years



Washington University in St. Louis

- Provost Fund financed through tax on traditional undergraduate net tuition
- In FY14, tax generated $3M
- In FY19, tax will generate $9M

Earmarking Portion of Strategic Funds for Faculty Priorities

Faculty Equity Fund

$1M of central dollars earmarked for a **Faculty Equity Fund**, used to help the institution become nationally competitive in the marketplace and improve faculty retention

Prairie View A&M University

New Academic Program Fund

Approximately 20% of central dollars are earmarked for an **Academic Program Fund**, used to develop new academic programs at the university

Ohio University

First, some institutions gradually increase the central reserve tax over time to avoid disruptive change. For example, Washington University in St. Louis plans to increase its new tax half a percent each year until it reaches the desired 4%.

The second tactic to secure stakeholder buy-in for a strategic tax is to promise to return a portion of reserves back to the units. In particular, several institutions have created dedicated pools of funds to selectively invest in faculty projects with central dollars. Faculty at these institutions were less resistant to the introduction of the tax because they had the chance to win back an even larger share of funds. To ensure best use of resources, institutions should only earmark dollars for categories of projects that reinforce larger institutional priorities, such as a faculty equity fund or new academic program fund.

To learn more executive tactics for securing funding for central reserves and winning buy-in for strategic priorities, members can access our publication *Increasing Central Fungible Dollars* on eab.com.

Source: Miami University, Oxford, OH; Prairie View A&M University, Prairie View, TX; Washington University in St. Louis, St. Louis, MO; Business Affairs Forum interviews and analysis.

9 How overt or hidden should subvention be?

Decision Point in Brief

Importance to Budget Model

The subvention methodology impacts the transparency of the budget model, the amount of executive control over subvention allocations, and the level of criticism from campus stakeholders.

Observed Options

Institutions utilizing an overt subvention methodology directly tax units for subvention, and redistribute the funds to support units with deficits or mission-critical units unable to generate a profit. Alternatively, institutions attempt to hide or partially hide subvention to avoid political battles or build simplicity and fairness into the model. These institutions use a variety of methods to hide subvention, including weighted credit hours, cross-subsidies hidden within historical base-budgets, or cost allocation that favors some units over others.

EAB Guidance

Though logical in theory, hidden subvention often leads to negative outcomes—including perverse incentives, a lack of control over allocations, and increased stakeholder criticism. To avoid these problems, **institutions should make subvention as overt as possible through an explicit unit tax.** Both hidden and overt subvention will generate some criticism from stakeholders, but overt subvention maintains transparency in the budget model critical to creating unit-level financial accountability. Moreover, executives can minimize stakeholder pushback of an explicit subvention tax by proactively explaining the important role subvention plays in the advancement of institutional goals and mission.

The Appeal of Hidden Subvention

Institutions Hide Subvention to Allay Concerns and Automate Subsidies

The next two executive-level decision points focus on preserving mission-critical activities through subvention. Subvention is typically defined as any subsidy central administration provides to a unit in addition to its standard revenue allocation, including direct subsidies and hold-harmless funding. Institutions utilizing an overt subvention methodology directly tax units for subvention, and then redistribute the funds to support units in deficits or mission-critical units unable to generate a profit. Institutions that take a hidden approach to subvention deliberately distort the revenue allocation formula to covertly subsidize specific units. Three common types of hidden subvention are detailed below.

Examples of Hidden Subvention

Historical Base Budgets
The Ohio State University applies the revenue allocation formula only to new revenues, so units continue to receive historical base budgets with inherent cross-subsidies.

Cost Allocation Formula
One university charges the same tax rate for all types of space in order to subsidize research, which occurs in significantly more expensive spaces.

Weighted Credit Hours
University of New Hampshire reviews SCH weighting annually and makes adjustments every 2-3 years to ensure units are not disadvantaged.

Three Considerations Driving Hidden Subvention

1 **Avoid Political Battles**
Leaders believe explicit subsidies create a hostile culture of winners and losers, undercutting support for units that are mission-critical but financially dependent.

2 **Simplify Transfer of Funds to Units**
Funds flow directly to units through the allocation formula rather than adding another central calculation and allocation step.

3 **Recognize Differences in Cost of Instruction**
Weighted credit hours reflect legitimate differences in cost of instruction, inability to raise differential tuition.

Generally, institutions choose hidden rather than overt subvention for three major reasons listed above. Most obviously, institutions use hidden subvention in an attempt to avoid political battles created when academic leaders can clearly see which units subsidize others. Second, institutions use hidden subvention to simplify the transfer of funds between units. Rather than adding another round of allocations, hidden subvention embeds subsidies into the initial allocation. Last, institutions choose hidden subvention to build fairness into the model by recognizing legitimate differences in costs of instruction.

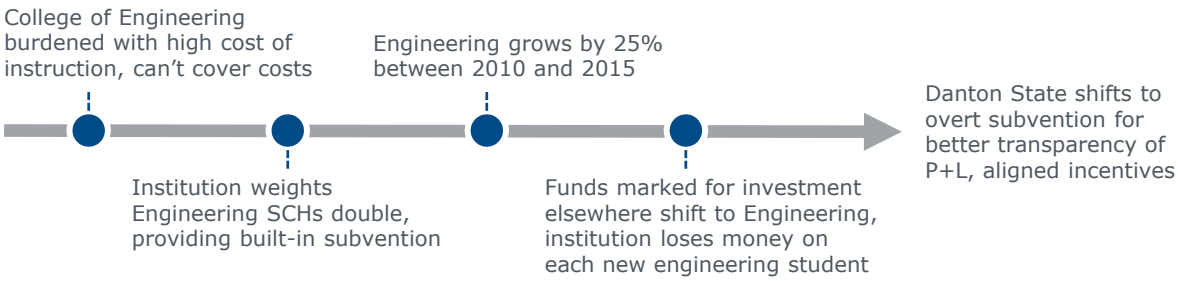
Source: The Ohio State University, Columbus, OH; University of New Hampshire, Durham, NH; Business Affairs Forum interviews and analysis.

Resisting the Siren's Call

Hidden Subvention Brings Perverse Incentives, Units See Through Ploy

Though logical in theory, hidden subvention often leads to negative outcomes. As an example, Danton State University[1] began weighting Engineering credit hours double in order to provide additional resources for high instructional costs. Unexpectedly, the Engineering college grew by 25% across the next five years, forcing the institution to use central reserves to cover the expensive hidden subsidy. Eventually, Danton State abandoned weighted credit hours in favor of an overt subvention tax.

Danton State University[1] Walks Away from Hidden Subvention



Hidden Subvention Increases Political Tension

"Weighting credit hours is great for subvention in theory, but in reality it doesn't work well because it's confusing and people argue over the right weighting. **They can see through the ploy…we should have instead had a productive conversation about how much we value our unprofitable colleges.**"

CBO, Public Research University

Institutions deploying hidden subvention typically face three distinct problems.

- First, hidden subvention creates perverse incentives. Danton State, profiled above, inadvertently created an incentive for Engineering to grow, even though each new student was a net loss for the institution.
- Second, executives have little control over subsidies embedded within an allocation formula. Many institutions must adjust weighted credit hour formulas each year to ensure units receive the amount of subvention leaders intend.
- Last, institutions that hide subvention will still receive push-back from campus stakeholders. Instead of avoiding political battles as intended, most academic leaders will see through the ploy of hidden subvention, leading to more political battles and criticism of the lack of transparency.

1) Pseudonym.

Source: Business Affairs Forum interviews and analysis.

Biting the Bullet

Overt Subvention Typically Funded Through an Explicit Tax

To avoid the perverse outcomes of hidden subvention, EAB encourages institutions to make subvention as overt as possible through an explicit unit tax. Unlike hidden subvention, overt subvention maintains transparency in the budget model critical to creating unit-level financial accountability. Three institutions' subvention tax rates are shown below.

Admittedly, implementing an explicit subvention tax may be politically difficult, and executives should expect pushback from campus stakeholders. However, institutions that maintain transparency around subvention and address the tough conversations head on typically move past the political battles quicker than those that attempt to hide subvention. Moreover, executives that choose an open conversation about subvention can proactively explain its important role in advancing institutional goals and mission, allowing all parties to find common ground.

Observed Tax Rates to Fund Subvention Pool

Queen's University

- 4.25% tax rate on operating revenue complemented with nearly equal funding from investment income, auxiliary contributions, etc.
- Charging a higher tax for subvention would drive additional colleges into subvention

McMaster University

- 8% tax rate
- University Fund supports both subvention and strategic initiatives

Penn — University of Pennsylvania

- 20% tax on tuition revenue and 10.5% tax on grant overhead
- Approximately 75% of fund for subvention, 25% for strategic funds

Source: McMaster University, Hamilton, ON; Queen's University, Kingston, ON; University of Pennsylvania, Philadelphia, PA; Business Affairs Forum interviews and analysis.

10 How do we motivate units receiving subvention to still make financial improvement?

Decision Point in Brief

Importance to Budget Model

Ensuring units are still motivated to improve unit P+L while receiving subvention is critical to maintain the financial accountability incentives created by the budget model.

Observed Options

Institutions provide two types of subvention to academic units. Bridge subvention is short-term financial support to help units avoid disruptive change. Though bridge subvention is typically provided to units when a new model goes live, institutions may offer bridge subvention any time a unit experiences temporary deficits. Many institutions motivate units on bridge subvention by slowly scaling back funds over time, commonly known as hold harmless. The second type of subvention is mission-critical subvention, long-term subsidization for unprofitable units critical to the university mission. Generally, most institutions provide long-term subvention funds "no questions asked," without considering how to continually motivate units to improve. This leads to unit dependency of central funds and undercuts budget model incentives.

EAB Guidance

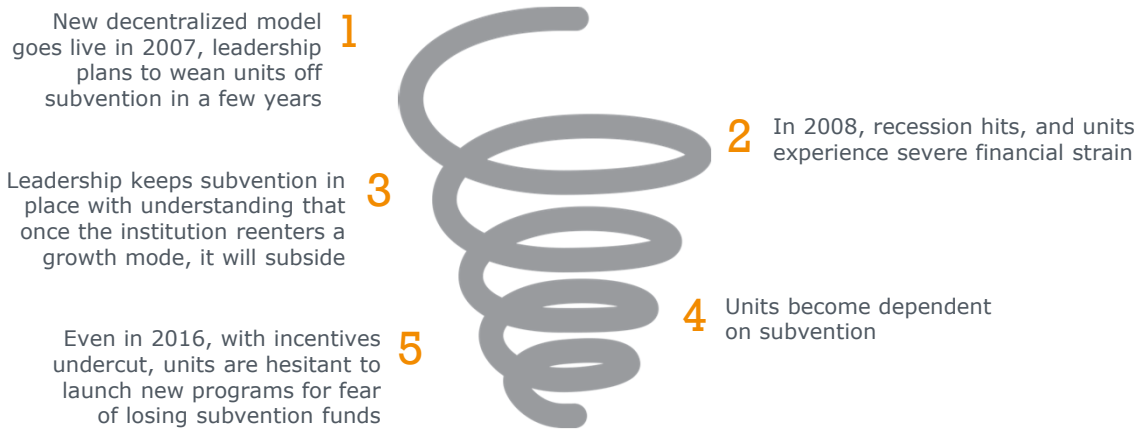
Institutions must first distinguish between two forms of subvention, as the strategies to motivate units differ by subvention type. To motivate units receiving **bridge subvention, leaders must set a clear end date for subvention funds. For units on mission-critical subvention, central administration should place conditions on subvention funds and require spending plans to drive financial improvements.**

Creating an Entitlement Culture

Units Become Dependent on Central Support at One University

The next decision point centers on counteracting the major risk associated with subvention—that subsidization will undermine the budget model incentives as units become dependent on central support. The example below depicts one institution's experience with this problem. This institution transitioned budget models in 2007 and planned to wean units off subvention over several years.

Subvention Dependency at One Institution



> "The units became completely reliant on the subvention funds, and we couldn't take it away. It's like reducing someone's salary."
>
> *CBO, Private Research University*

> "Making units whole with subvention when they should be in a deficit is the same thing as incremental budgeting."
>
> *CBO, Canadian Research University*

When the recession hit, leaders decided to maintain subvention levels until the institution reentered a more stable business environment. However, units quickly became dependent on subvention, and the guaranteed subsidy undermined incentives for growth. In fact, many units deliberately avoided new program launches fearing unit growth would lead to subvention reductions. Nine years after model implementation, subvention levels remain unchanged. Worse yet, leaders are unsure how to scale back subvention because units rely so heavily on subsidization to maintain their operations. To help institutions avoid this scenario, the next several pages detail strategies to preserve financial incentives while providing subvention where needed.

Source: Business Affairs Forum interviews and analysis.

Distinguishing Temporary from Long-Term Support

Different Tactics for Motivating Under Bridge, Mission-Critical Subvention

The first critical step is to distinguish between two forms of subvention, as the strategies to motivate units differ by subvention type. The first type is bridge subvention, temporary resources for units that can achieve financial independence but require short-term support to restructure or adjust to significant change. The most common form of bridge subvention is hold-harmless funding provided when a new model goes live, though institutions may provide bridge subvention any time a unit experiences temporary declines. The second type of subvention is mission-critical subvention, long-term funding for unprofitable units important to institutional mission. Of course, institutions should not indefinitely support every unprofitable unit. Rather, leaders must distinguish between truly mission-critical units and those that can be restructured, downsized, or collapsed into other areas.

	Bridge Subvention	**Mission-Critical Subvention**
	• Temporary subvention for colleges that require financial support while acting on new revenue and cost-saving incentives • Allows colleges to focus on growth, spreads impact of a major financial disruption	• Long-term subvention for colleges unlikely to reach financial independence but important to the institution's mission • Allows colleges to continue contributing to the institution while making incremental financial progress
Miami University Set up-front expectations for subvention during model transition by identifying colleges to receive bridge subvention and mission-critical subvention	• Leaders identify that College of Engineering has growth potential • Received subvention for first two years, next year will not receive any subvention	• College of Creative Arts unlikely to become financially independent in near future • Will continue to receive subvention

The above table shows which colleges leaders at Miami of Ohio determined would receive bridge and mission-critical subvention during their model transition. In most cases, it should be clear which units can eventually generate a profit and which will require ongoing support. Where there is less certainty, institutions should default to bridge subvention and readjust down the road if necessary.

The remainder of this decision point offers strategies for institutions to motivate units to improve P+L while providing each type of subvention.

Source: Miami University, Oxford, OH; Business Affairs Forum interviews and analysis.

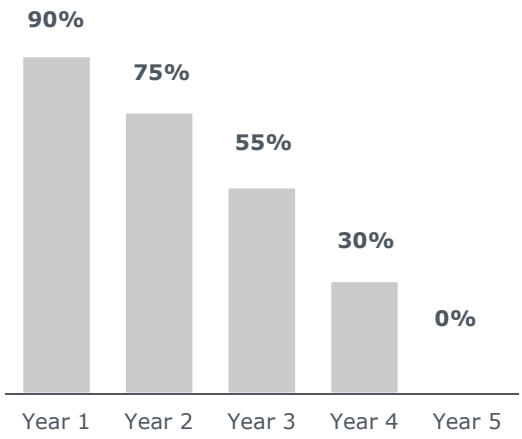
Setting a Clear End Date

Phasing Out Subvention Acclimates Units, Spurs Change

The best tactic to motivate units on bridge subvention is to communicate a clear end date. Setting clear expectations for when subsidization will cease motivates units to prepare for financial independence. As shown on the left, many institutions also attenuate the amount of subvention each year to provide further motivation to improve. Leaders at Queen's University scaled back the percentage of guaranteed funds each year to help units prepare for complete independence by year five of the budget model.

Variations of bridge subvention are listed on the right along with typical timeframes.

Percentage of Guaranteed Pre-RCM Base Budget at Queen's University



Type of Hold Harmless and Typical Length	Capsule Description	Representative Institution
Learning Year (1 year)	One-year data-sharing period to familiarize units with new allocation formula before changing budgets	University of Delaware
Phased Implementation (4-5 years)	Increase amount of funds subject to formula in predetermined increments	University of Wisconsin–Madison
Stop-Loss (4-5 years)	Set limit on how much funding individual units can lose in a single year	The University of New Mexico

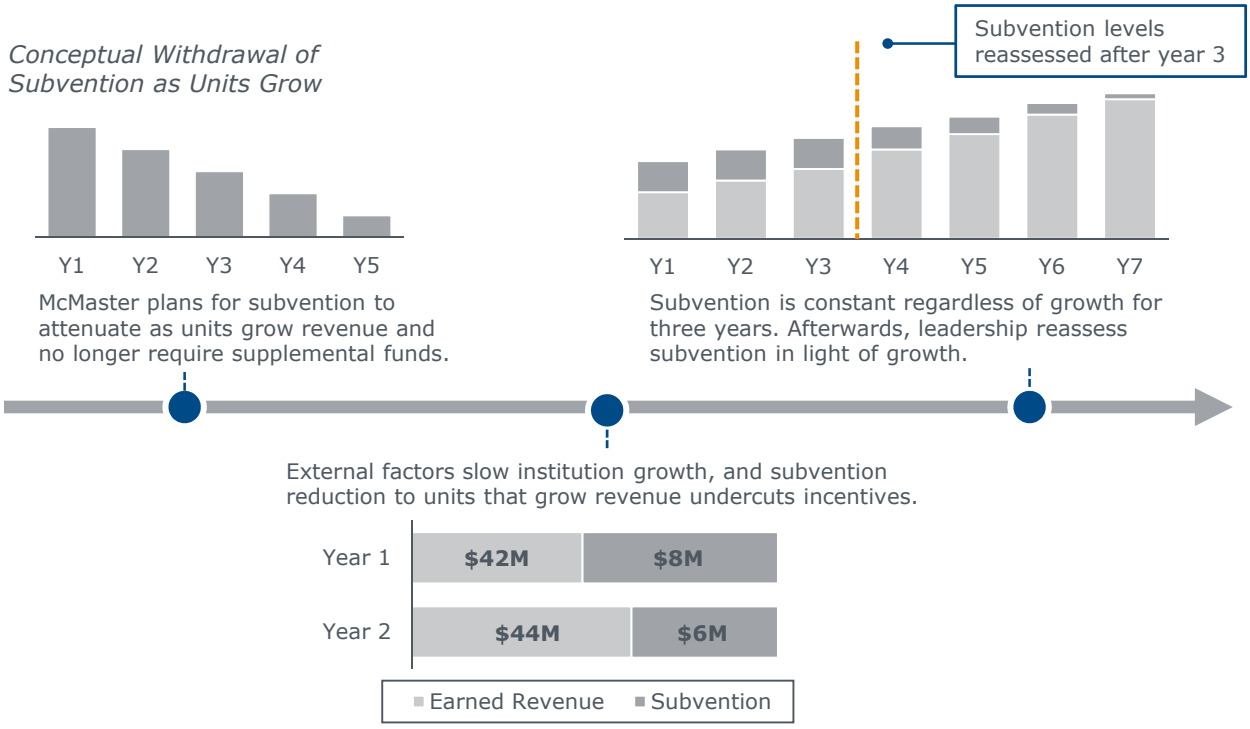
Source: Queen's University, Kingston, ON; University of Delaware, Newark, DE; "University of New Mexico—Main Campus Responsibility Center Management and Performance Based Budgeting," available at http://www.unm.edu/~acadaffr/documents/unm-rcm-pbb-white-paper.pdf; University of Wisconsin, Madison, WI; Business Affairs Forum interviews and analysis.

Extending the Attenuating Hold Harmless Runway

McMaster Responds to Market Conditions and Preserves Growth Incentives

In recent tough budget climates, many institutions' original subvention end date became unviable. Leaders facing financial challenges should lock in a fixed amount of subvention for several years to help units weather the storm while preserving growth incentives. Then, leaders can set a new end date for subvention.

The example below shows how McMaster University dealt with this situation. On the left, McMaster changed models in 2010 and planned to phase out hold-harmless by year five. However, when the institution encountered a period of stagnant growth, many units could not become financially independent as quickly as planned. McMaster first opted to extend subvention while scaling back funds in proportion to unit growth. Meaning, a unit that grew by $2 million would receive $2 million less in subvention. This provided no incentive to improve and undermined growth efforts.



In response, McMaster recalibrated the subvention plan shown on the right. Units received a fixed level of subvention for three years, which preserved the models' growth incentives as they could still earn additional funding with increased activity. After three years, McMaster restarted the original attenuating subvention plan with a clear end date.

Source: McMaster University, Hamilton, ON; Business Affairs Forum interviews and analysis.

Subvention with Strings Attached

Incenting Some Incremental Growth in Financially Dependent Units

The second type of subvention is mission-critical subvention for financially dependent units that require long-term support. Common mission-critical loss-leaders are on the left. These units often lose money on paper, but offer less quantifiable contributions to institution mission, community engagement, or student recruitment. To motivate forward progress in these units, institutions should place stipulations on subvention funds. Unlike the typical "no-questions-asked" approach, subvention funds with strings attached give central administration some leverage to drive financial improvements.

Common Mission-Critical "Loss Leaders"


College of Music


College of Nursing


College of Education


College of Social Work

For the Love of Subvention

"Units love subvention because they can use the funds however they want—the center doesn't have any leverage."

CBO, Private Research University

Mimicking the IMF

"Providing subvention should be like the IMF giving a loan. We're providing stability, but we also want to ensure units make some structural changes."

CBO, Canadian Research University

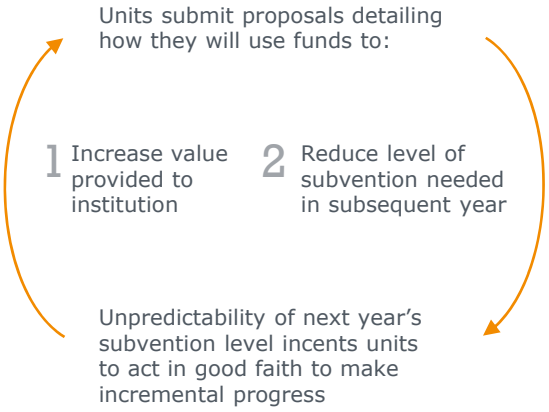
Source: Business Affairs Forum interviews and analysis.

Keeping Units on Their Toes

Wilfrid Laurier Annually Assesses Subvention Need, Unit-Level Strategy

To motivate units receiving long-term subvention, Wilfrid Laurier University requires units to formally request subvention funds each year. Units submit proposals detailing either how they will increase their contribution to institutional mission or how they will reduce the amount of subvention needed next year. A group of senior leaders then evaluates proposals and determines funding for each unit. Of course, Wilfrid Laurier would never completely eliminate subvention for mission-critical units. However, subvention levels do fluctuate based on the review, so units are incented to make meaningful improvements.

Annual Subvention Process Through Strategic Funds



Faculty of Music Launches Revenue-Generating, Mission-Supporting Venture

- Elite Faculty of Music teaches 100 students, has high cost of instruction
- New annual justification for subvention makes unit more cost-conscious
- Faculty launches revenue-generating conservatory for K-12 students who pay for instruction
- New conservatory also supports mission; faculty will identify top young talent to recruit to their programs

For example, the annual justification process spurred the College of Music to launch a new revenue-generating conservatory for K-12 students. In addition to serving as an enrollment pipeline, the conservatory brings additional funds to the College and reduces the level of subvention central must provide.

Source: Wilfrid Laurier University, Waterloo, ON; Business Affairs Forum interviews and analysis.

A Sleight of Hand

Gallagher University[1] Shifts Subvention Dollars into Strategic Fund

Notably, another institution was able to drive improvements in mission-critical units without creating a new review structure. Rather than attaching new conditions to subvention funds, leaders at Gallagher University simply combined the $50M subvention fund and $20M strategic fund into one $70M strategic pot. As with the old strategic fund, units must apply to the new strategic fund and leaders place conditions on fund use. Though units receive approximately the same amount of subvention as in the past, central administration now has more direct authority over how units use subvention funds.

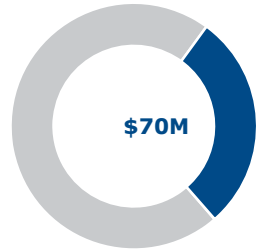
Two Previously Separate Funds…

Subvention Fund *Strategic Fund*

- Subvention funds allocated formulaically to keep units whole
- Strategic funds allocated to vetted initiatives that align with institution priorities
- Units apply for strategic funds, and leadership adds conditions on how funds are used

…Combined into Single Fund to Give Central Greater Oversight

New Strategic Fund



- Rather than putting new conditions on the subvention fund, university leaders at Gallagher University shifted subvention funds into the strategic fund
- Units will still receive the same approximate level of subvention as in the past, but now they must apply for funds and there is more central authority over how funds are used

1) Pseudonym.

Source: Business Affairs Forum interviews and analysis.

Incorporating Institutional Strategic Goals into the Model

SECTION 3

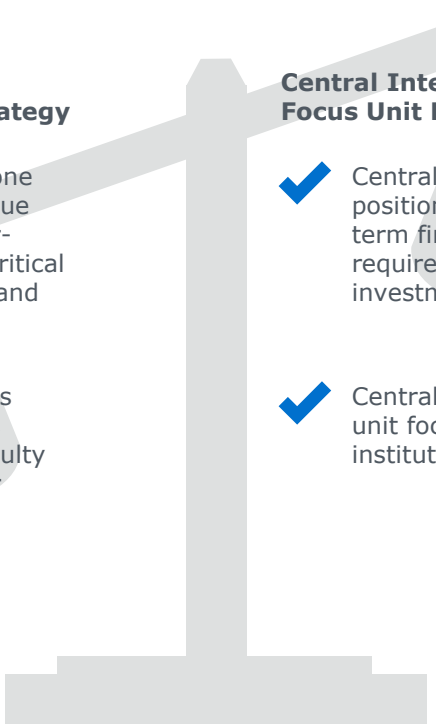
- **Decision Point 11:** How do we incent student success goals through the budget model?
- **Decision Point 12**: How do we incent research growth through the budget model?
- **Decision Point 13**: How do we incent targeted new program launches through the budget model?

Rebalancing the Scales

Ensure Financial Accountability Does Not Distract from Central Priorities

The last category of decision points focuses on incorporating institutional priorities into the budget model. While creating meaningful revenue and cost incentives promotes financial accountability, it can also increase the risk of units becoming independent actors focused solely on P+L management. This could distract from campus-wide goals or even create counter incentives. For example, units may divest from research activities to grow SCH revenue or cancel low-registration sections of courses important to institutional completion goals.

To prevent this scenario, institutions must establish incentives and policies that reward progress on institutional strategic goals in addition to P+L objectives.



Sole Unit Focus on P+L Risks Derailment of Long-Term Strategy

- ✗ Academic departments at one institution reacted to revenue incentives by cutting under-enrolled summer courses critical to student time-to-degree and completion goals
- ✗ At another institution, funds allocated to academic units specifically for research faculty hires were instead used for discretionary needs

Central Intervention Necessary to Focus Unit Effort on Campus Goals

- ✓ Centrally defined strategic goals position the institution for long-term financial success, but require unit-level focus and investment
- ✓ Central incentives and policies align unit focus on P+L management with institution-wide priorities

Source: Business Affairs Forum interviews and analysis.

Aligning Local Decisions with Central Strategy

Framework to Advance Strategic Goals Through College-Level Investments

Institutions can incorporate any strategic, campus-wide goal into the budget model using the following three-part framework. First, build unit-level incentives for units to advance the most important outcomes or metrics. Second, institutions should direct seed funding to initiatives that support strategic goals. These first two steps form a virtuous cycle, as units receive funds to make targeted changes and then are rewarded for improvement. Lastly, institutions must monitor and correct for unintended consequences or perverse incentives in the model.

1	2	3
Incent Outcome Measures	**Direct Seed Funding**	**Correct Perverse Incentives**
Determine metrics that track progress toward strategic goals and use performance funding to incentivize units to advance those metrics	Award seed funding to units that propose resource-intensive investments in initiatives that advance institutional strategic goals	Implement oversight and policies to correct unintended consequences or perverse incentives of new model

Three Common Strategic Goals

- Advancing Student Success
- Growing Research
- Launching Targeted New Programs

To illustrate how to apply this framework, the last three decision points center on incorporating three common strategic goals into the budget model—advancing student success, growing research, and launching targeted new programs.

Source: Business Affairs Forum interviews and analysis.

11 How do we incent student success goals through the budget model?

Decision Point in Brief

Importance to Budget Model

Without direct incentives or central policies, units and departments may undermine student success goals by concentrating solely on P+L accountability and SCH generation.

Observed Options

Most institutions focus on achieving student success goals outside of the budget model, though a handful of institutions have begun to utilize performance funding to reward student success goals.

EAB Guidance

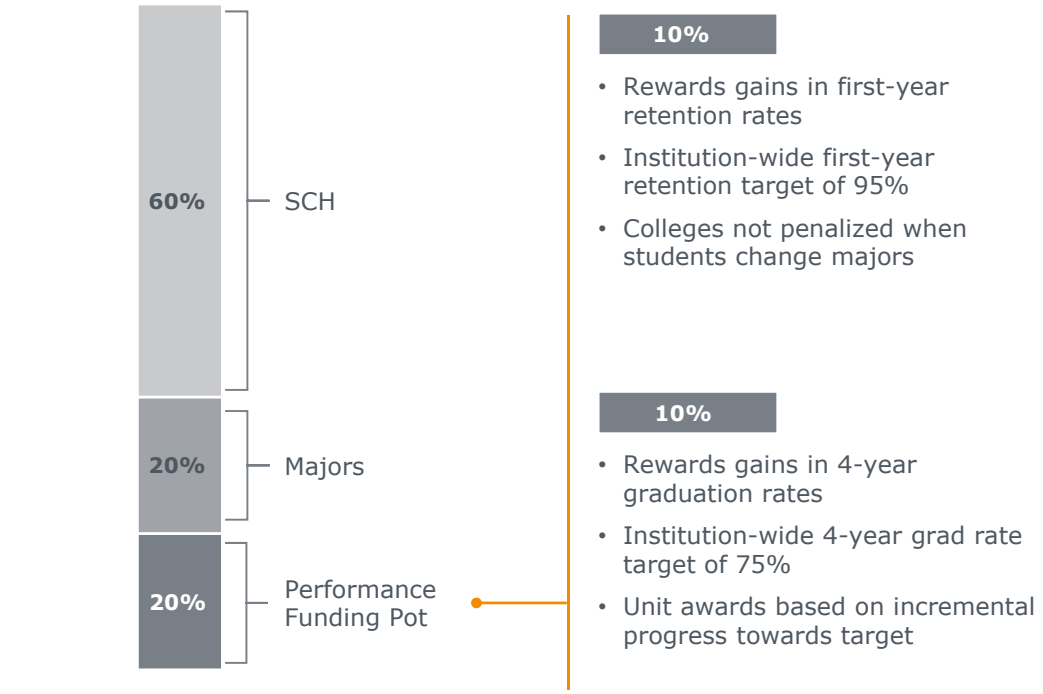
If student success is a top strategic priority, institutions should use **budget model incentives and seed funding to promote success goals,** such as rewarding improved student retention and graduation rates with performance funds**.** Institutions should **monitor and correct for perverse budget model incentives that may impede student success.**

Moving Beyond Credit Hours and Majors

UC Riverside Builds Student Success Metrics into Tuition Allocation Method

The first piece of the three-part framework for incenting student success in the budget model is incenting key metrics or outcomes. As an example, UC Riverside incorporates student success metrics into its tuition revenue allocation formula shown below. The first two parts of the formula represent the typical allocation by student credit hours and majors that reward instruction and enrollment. However, the remaining 20% of the formula rewards two student success metrics.

UC Riverside's Tuition Revenue Allocation Formula



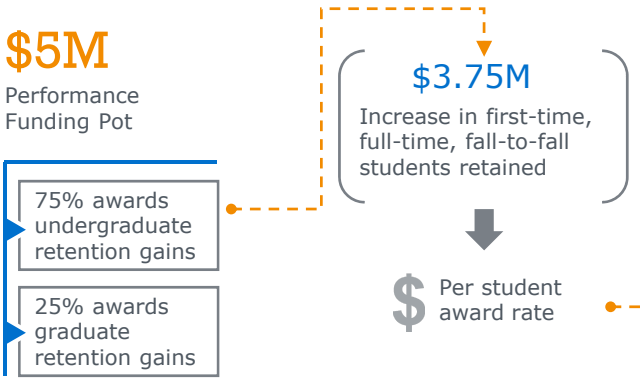
The first 10% of performance funding is tied to improvements in first-year retention rates from the previous year. Allocations are based on retention rate improvements rather than raw figures in order to create a level playing field—units with low rates can still earn meaningful dollars, and units with high rates are still motivated to improve further. The second 10% of performance funding rewards 4-year graduation rates, also based on units' year-to-year improvement.

Source: University of California, Riverside, Riverside, CA; Business Affairs Forum interviews and analysis.

UK's Performance Pot Incents Improved Retention

Similarly, the University of Kentucky also allocates performance funding to reward student success. Its $5M performance pot is split 75/25 to reward improvements in undergraduate and graduate student retention, respectively. To determine allocations, Kentucky calculates a per-student award rate and allocates funds to colleges for each additional student they retain compared to the previous year.

Kentucky's Performance Funding Award Allocation



College	YOY Increase in Students Retained	Award Rate Per Student	Total Award
A	20	$7.5K	$150k
B	250	$7.5K	$1.875M
C	70	$7.5K	$525k
D	160	$7.5K	$1.2M

Year One Results

10/11

Of UK's undergraduate colleges improved retention, received funding awards

32.6%

Percentage increase in number of students retained by College of Business and Economics, largest award recipient

One college focused on SCH production to "game" RCM revenue allocation, did not receive funding

Although the $5M represents a small portion of Kentucky's total budget, the results demonstrate the potential impact of even small financial incentives. In the first year, 10 of 11 undergraduate colleges at Kentucky increased retention rates and received funding awards. Interestingly, the one college that did not improve retention rates acknowledged it was too focused on adding electives and increasing SCH production to capture increased revenue, and plans to course correct next year.

Source: University of Kentucky, Lexington, KY; Business Affairs Forum interviews and analysis.

Lowering the Barrier to Entry

University of Maryland System Seed Funding Facilitates Course Redesign

The second part of the framework is directing seed funding toward initiatives that support student success. As an example, the University of Maryland System (UMD) sought to improve student outcomes and reduce drop-fail-withdrawal (DFW) rates through course redesigns. To support this effort, UMD used strategic reserves to offer matching funds up to $20K for each redesign—which faculty used to flip classrooms, collapse course sections, and create active-learning modules.

Strategic goal of improving student outcomes through course redesign

Administrators sought three key benefits from course redesigns:

- Decrease DFW rate of low completion courses
- Reduce long-term instructional costs
- Free up faculty time and adjunct funds for higher-return activities

Seed funding provided on matching basis

- UMD system provided matching funds to institutions up to $20K
- Institutions used funds to redesign courses by collapsing sections, flipping classes, and planning active learning modules

7%	100%	$1.8M
Average drop in DFW rate (e.g., from 20% to 13%)	Efforts sustained past 2-3 year design and implementation period	Total cost savings and avoidance across 57 courses

This incentive yielded significant long-term, sustainable improvements for UMD. The DFW rate declined by 7%, and 100% of course redesigns were sustained past the pilot phase. Moreover, the system achieved $1.8M in savings, mostly by collapsing course sections and freeing up costly adjunct dollars.

Source: University of Maryland, College Park, MD; Business Affairs Forum interviews and analysis.

Not Sacrificing Throughput for Efficiency's Sake

UC Davis Intervenes to Safeguard Access to Critical Summer Courses

The last part of the framework is correcting for unintended consequences in the budget model. At UC Davis, units reacted to revenue incentives in the new budget model by eliminating low-enrollment summer courses to reduce costs. However, many of these summer courses were critical for student time-to-degree and completion goals. To counteract this perverse incentive, the Provost offered backfill funding to close the revenue gap between target and actual enrollments for 300 graduation-critical courses. This incents colleges to continue to offer important summer courses without fear of any becoming a net loss. More information on the Provost's Instructional Need Funding is detailed below.

Institution places programmatic emphasis on summer courses to accelerate student time-to-degree

Budget model monitoring reveals departments are cutting under-enrolled summer courses to control costs

Provost incents college to offer graduation-critical summer courses with additional funds

Provost Instructional Needs Funding

- Time-to-degree critical courses guaranteed revenue allocation based on course enrollment targets, regardless of actual enrollments
- 300 out of 700 summer courses deemed critical and eligible for backfill funding
- Eligible courses include:
  - ✓ 100-level courses that are prerequisites for staying on-track in major
  - ✓ 100-level courses required of a large number of students
  - ✓ Upper division writing courses required of a large number of students

Source: University of California, Davis, Davis, CA; Business Affairs Forum interviews and analysis.

Keeping a Watchful Eye

UC Riverside Integrates KPI Monitoring into Annual Budget Process

UC Riverside continuously monitors for any unintended consequences of the budget model that may undermine student success goals. To prevent units from sacrificing academic quality in pursuit of revenue gains, deans at Riverside complete an annual budget template that includes several student success key performance indicators (KPIs) including average class size, student-to-advisor ratios, and first-year retention rates. If a unit demonstrates a three-year negative trend in any KPI, the provost intervenes and works with the dean to diagnose the problem and course correct.

Units Complete Standard Budget Template

- Units submit annual budget templates with P+L data
- Templates force units to report key performance indicators of central interest

Reported Student Success KPIs

- Average class sizes
- % of classes taught by adjuncts
- Number of faculty course releases
- Student:advisor ratio
- First-year retention rate
- 4- and 6-year graduation rates

Center Monitors KPIs for Unintended Consequences

- Center tracks KPI data by college for inverse relationships that indicate units are sacrificing quality for revenue gains
- Provost intervenes and course corrects as necessary, reviewing 3-year KPI trends

> "We want to make it clear that student success is a priority for UCR. We track it and built it into our revenue allocation model."
>
> *Maria Anguiano, CBO*
> *University of California, Riverside*

Source: University of California, Riverside, Riverside, CA; Business Affairs Forum interviews and analysis.

12 How do we incent research growth through the budget model?

Decision Point in Brief

Importance to Budget Model

Without direct incentives or central oversight, units and departments focused solely on P+L accountability may devalue or even divest from research goals in favor of more profitable activities.

Observed Options

Most institutions seeking to grow the research enterprise already allocate the majority of indirect cost recovery (ICR) to the originating college or to the VP of Research. Some institutions are beginning to experiment with performance funds to reward research growth.

EAB Guidance

If research growth is a top strategic priority, institutions should use **budget model incentives and seed funding to encourage units to achieve research goals, such as allocations based on grant funding.** Institutions should also **monitor and correct for perverse budget model incentives that may impede research growth.**

Unintentionally Devaluing Research

Activity-Based Models Can Divert Attention and Funding from Research Goals

The next decision point centers on incenting research growth through the budget model. As shown in the examples on the left, growing research is a top priority for many institutions. However, because research is typically a net expense, units and departments focused on P+L accountability may devalue research goals or even divest from some research in favor of more profitable activities. To counteract these pressures, this decision point applies the three-part framework to help institutions incorporate research growth into the budget model.

Big Bets Abound…

THE UNIVERSITY of NORTH CAROLINA at CHAPEL HILL

Aims to double research expenditures and become top-5 public research university across next decade

FIU FLORIDA INTERNATIONAL UNIVERSITY

Seeks to increase research expenditures by 54% and become an R1 by 2020

UT DALLAS

Plans to double tenure-track faculty ranks and more than double research expenditures by 2022

…But Activity-Based Models Challenge Research Growth Goals

1 Distracting Incentives

- Activity-based models reward tuition growth and cost cutting over low-ROI research investments
- Indirect cost recovery from grants is typically insufficient to cover all research costs

2 Perverse Incentives

- Transparent models demonstrate that research is a cost driver and incent units to slow cost growth
- Units may divest from research activities in order to free up resources for more lucrative initiatives

> "Activity-based budget models are set up to reward butts in seats, not research. How do you make an activity-based model work in a research university?"
>
> *CBO, Private Research University*

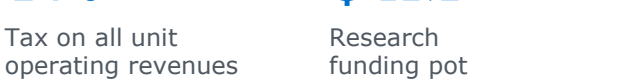
Source: "FIUBeyondPossible2020," http://stratplan.fiu.edu/docs/Strategic%20Plan.pdf; "Strategic Plan for the University of Texas at Dallas," https://www.utdallas.edu/strategicplan/index.php?id=a; University of North Carolina, Chapel Hill, NC; Business Affairs Forum interviews and analysis.

Rewarding Research Outputs

Queen's Redistributes 1% of Revenues Based on Share of Grant Funding

The first part of the framework is incenting key research outcomes. Most institutions seeking to grow research already allocate the majority of indirect cost recovery (ICR) to the originating college or to the VP of Research. For more detailed information about allocating ICR, see *Optimizing Institutional Budget Models* available at eab.com. Beyond that standard practice, some institutions have implemented more innovative incentives to encourage research growth.

Illustrative Example of Queen's University's Research Funding Model



Faculty	Proportional Share of Grant Funding	Research Pot Allocation
A	40%	$1.6M
B	27%	$1.08M
C	23%	$920K
D	10%	$400K

The first example is Queen's University, who created a separate research funding pool with a 1% tax on unit revenue. Queen's rewards research output by reallocating those funds back to the units based on their share of grant funding. Leaders at Queen's deliberately chose an explicit research tax after budget allocations to motivate units to grow research grants and to distinguish research as a top institutional priority.

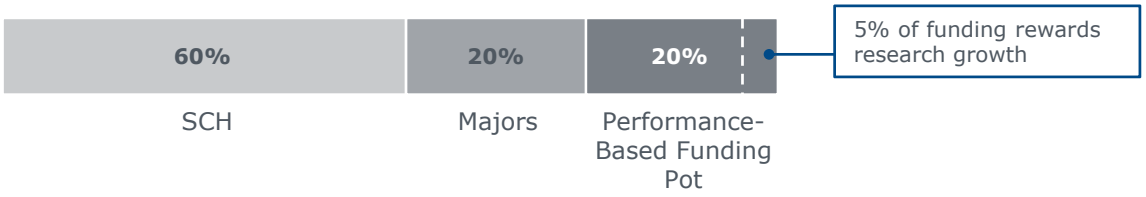
Source: Queen's University, Kingston, ON; Business Affairs Forum interviews and analysis.

Incentivizing Momentous Research Growth

Performance Funds Reward Year-Over-Year Research Gains

Rather than creating a separate funding pool through a tax, a few institutions are incorporating research incentives into the tuition revenue allocation formula to reward research. While Queen's incents total research activity, the institution below is specifically incenting new research growth. This model allocates 20% of tuition revenue to a performance pot, with 5% rewarding gains in research. Two potential metrics to reward unit research gains through performance funding are detailed at the bottom.

Representative Tuition Revenue Allocation Formula



Two Potential Metrics for Assessing and Rewarding Unit Research Gains

Research Expenditure Growth Rate Targets

Units receive performance-based funds for meeting or exceeding centrally set target growth rates

Proportionate Share of Institutional Research Growth

Units receive performance funding awards for their contribution to overall research expenditure growth relative to other units

Source: University of North Carolina, Chapel Hill, NC; Business Affairs Forum interviews and analysis.

Seeding Interdisciplinary Research Growth

Riverside Uses Central Funding to Incent Cluster Hiring in Strategic Areas

The second part of the framework is using central seed funding to fuel interdisciplinary research growth. For example, UC Riverside uses strategic funds for research faculty cluster hires across six research themes, such as Energy Efficiency and Sustainable Development. Departments must submit proposals for cross-disciplinary faculty positions, and the Provost will fund the new faculty lines as well as additional start-up costs through the strategic investment fund.

UC Riverside's Process for Growing Interdisciplinary Research Faculty

1 Identify Strategic Research Areas

Strategic Action Plan calls for programmatic cluster hiring in 33 areas across 6 overarching research themes by 2020

2 Vet New Faculty Proposals for Impact and Strategic Alignment

- Departments prepare cross-disciplinary proposals for new faculty positions
- Rigorous peer review process vets proposals for grant potential and strategic alignment

3 Award Seed Funding to Promising Proposals

Provost considers peer review reports, funds new faculty lines and other start-up hiring expenses

Sample Strategic Research Themes

- Science, cultivation, and production of plants and food
- Next generation technologies: new materials, phenomena, and devices
- Energy efficiency and sustainable development

140	Faculty positions to be funded through Strategic Investment Fund
$110M	Additional start-up funding available for faculty recruitment and hiring
81	Interdisciplinary faculty positions currently in recruitment based on approved proposals

Source: University of California , Riverside, Riverside, CA; Business Affairs Forum interviews and analysis.

Correcting Perverse Incentives in Faculty Hiring

SUNY Buffalo Takes Back Central Control of Earmarked Funds

The third part of the framework is correcting unintended consequences created by the budget model that may impede research growth. In the example below, SUNY Buffalo opted to allocate new tuition revenue from enrollment growth and state-approved tuition increases to the units specifically for research faculty hires. However, because senior leaders did not include an enforcement mechanism, many units utilized funds for discretionary needs rather than investing in new faculty.

100%

New Tuition Revenue

- Allocated to units on basis of tuition rate increases and modest enrollment growth above tuition revenue target
- Center instructs units to use funds to hire new tenure-track faculty
- However, center discovers units retaining funds for discretionary spend or unfunded mandates, not investing in new faculty

50%

New Tuition Revenue

- Allocated to units on basis of proposals focused on academic quality initiatives
- Units must submit spending plans to center outlining plans to invest funds in new faculty hires

50%

New Tuition Revenue

- Retained centrally in Provost's Strategic Investment Fund
- Units can submit proposals for additional funding for initiatives that focus on academic quality, student experience, or interdisciplinary programs

In response, leaders at SUNY Buffalo adjusted the model to regain some central authority over use of new tuition revenue. As shown above, 50% of new revenue flows to the academic units, but only after they create spending plans demonstrating their intentions to invest in new faculty hires. The remaining 50% flows into the Provost's Strategic Investment Fund for strategic initiatives.

Source: The State University of New York at Buffalo, Buffalo, NY; Business Affairs Forum interviews and analysis.

13 How do we incent targeted new program launches through the budget model?

Decision Point in Brief

Importance to Budget Model

Without central intervention, units and departments focused on P+L management lack an incentive to launch mission-critical programs with low short-term revenue potential.

Observed Options

The most common approach to incenting new program launches is to reserve a portion of central strategic funds to seed targeted programs that advance key priorities. Some institutions build direct incentives into the budget model to encourage targeted program growth.

EAB Guidance

Institutions can use **direct seed funding and budget model incentives such as targeted revenue-sharing agreements to spur investment in strategically important programs.** Institutions should **monitor and correct for perverse budget model incentives that may impede new program launches.**

A Necessary Intervention

Encouraging Units to Look Beyond Profits to Long-Range Strategic Niches

The last decision point focuses on creating budget model incentives for units to launch targeted new programs. As shown below, there are four main reasons that institutions launch new programs. First and most obviously, new programs generate additional revenue, so deans will naturally explore these opportunities. Second, institutions create programs in high-demand fields to respond to local needs or serve the larger community. Third, institutions may launch a program to target new student segments such as online or adult learners with the goal of creating more segment-specific programs later. Lastly, institutions may launch new programs to enhance their market competitiveness.

Four Reasons Institutions Launch New Programs

Reason	Description
Grow Revenues	Lucrative graduate and non-degree programs create profits that help offset the costs of programs with structural deficits
Respond to Local Needs	Programs in high-need fields advance institutional mission to serve state and local communities
Target New Student Segments	Programs targeted at online, off-site, or non-traditional learners offset demographic changes that limit the growth of traditional student enrollments
Enhance Market Competitiveness	High-demand programs attract students in target market and hedge against competition

Activity-based budgets incent units to launch lucrative new programs

Central intervention may need to spur unit investment in other strategic programs

While these goals are not necessarily mutually exclusive, new programs centered on reasons two through four do not always yield a positive ROI, at least not in the short term. Even if these programs align with institutional priorities, units lack an incentive to launch programs with low-revenue potential. Therefore, central intervention is often necessary to spur unit investment in strategically important programs.

Expanding Beyond the Borders

GW Uses Revenue Incentives to Spur New Off-Site and Online Programs

The first type of central intervention is to build direct incentives into the budget model to encourage targeted program growth. For example, George Washington University utilizes budget model incentives to promote new programs for particular types of students. In addition to its space-constrained urban location, GW faces a city-mandated cap on its enrollment within Washington, DC. This has led GW to pursue two alternative forms of growth—creating online programs and off-site programs at its Virginia campuses.

George Washington University's Main Campus

Goal to Incentivize Two Alternative Forms of Graduate Program Growth

1 Online Programs

2 Off-site Programs

Spurring Strategic Growth through Differential Revenue Allocations

Type of Grad Program	Revenue Retained
On-Campus	70%
Off-Site	80%
Online	85%

"The model was built in collaboration with the Provost, Deans, and central administration. We built incentives into the methodology to increase the autonomy of the schools, giving them more control of their own destinies."

Ann McCorvey
Deputy EVP and Treasurer, GW

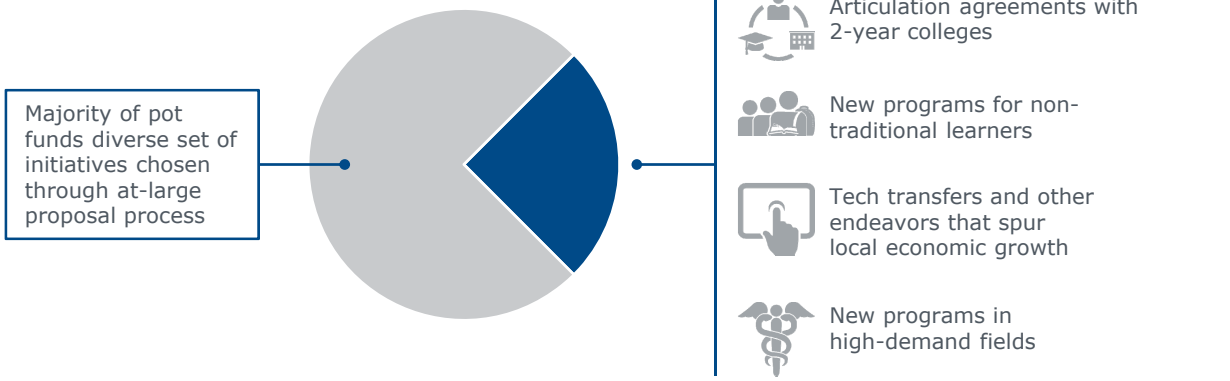
To incent focus on these alternative programs, GW tweaked the budget model allocations so units retain a higher portion of revenue for off-site and online programs. While the allocation for on-campus programs is 70% of revenue, units receive 80% of revenue for off-site programs and 85% for online programs. Though the model is still new, early enrollment projections indicate that it has successfully incented units to focus on alternative program growth.

Cultivating Strategic Growth

Reserving a Portion of Central Fund for Targeted Initiatives

The most common approach to incenting new program launches is to reserve a portion of central strategic funds to seed targeted programs that advance key priorities. For additional resources on evaluating and vetting new program launches, including sample business case templates, please see *Increasing Central Fungible Dollars* available at eab.com.

Example Strategic Reserve Fund



Source: Business Affairs Forum interviews and analysis.

Advisors to Our Work

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Assistant Vice President, Budget & Finance

Morgan Olsen
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Financial Analyst

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Vice President, Resources & Operations

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Wilfrid Laurier University
Vice President, Finance & Administration

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EAB

2445 M Street NW, Washington DC 20037
P 202.266.6400 | **F** 202.266.5700 | **eab.com**

Financial Challenges Facing the Academic Enterprise and the Drive-to-25

Dan Bernardo

Preface: While there has been discussion of "re-budgeting" the university for several years, little progress has been made. In 2015, a budget task force was commissioned that worked diligently and thoughtfully to create a report, *Administering the WSU Budget: Future Principles and Processes.* While a useful starting point to initiate a budget discussion, this report has not been vetted to date. The thoughts in this white paper are my own; they are not intended to be critical of any individuals or office, but they are intended to initiate serious thought about our long-term budget model. In an attempt to contribute to the solution (as opposed to simply presenting problems) I have attempted to offer recommendations throughout the paper.

While recent explanations of WSU's fiscal situation have focused on the last five years, the genesis of issue goes back much farther. At a minimum, one must look back to the Great Recession and the removal of over 50 percent of the University's state allocation over two biennia to put the current situation in proper perspective. This loss of state funding resulted in significant and immediate changes in how WSU did business, including immediate increases in undergraduate enrollment, significant increases in tuition, faculty staff reductions, and administrative restructuring. Dollars were captured from whatever sources possible to plug budget holes created by the exodus of state funds. The situation did not avail itself to strategic budget decision making, and many of the budget decisions and allocations made during that difficult period have never been revisited. More recently, we have unveiled the Drive-to-25, an ambitious initiative that will require significant improvement and disciplined strategic allocation of financial resources.

According to WSU's most recent Comprehensive Annual Financial Report, over the past decade the size and scope of the university has grown in just about every dimension. Total revenue has increased 37 percent; expenditures outstripped revenue, increasing 43 percent; enrollment has increased 30 percent, and research and development expenditures have increased 28 percent. However, we have operated under a patchwork of budget allocations and processes that most would agree are neither sustainable nor meet the needs of a growing university with ambitious academic goals. President Schulz has implemented some important budget processes that are an important first step, but these must be followed by a complete and holistic revision of our university budget model.

What is our budget model?

During budget deliberations over the past year, a fundamental question posed by several deans was, "What is our budget model at WSU?" At face value, that seems like a reasonable question, and one that should be fairly easy to answer. Unfortunately, I cannot provide a coherent or concise response to this question, and I would surmise that no one else in senior leadership can either.

Some historical reflection provides important context for to this dilemma. Under President Floyd's administration, we functioned under what some have described as a "benevolent dictatorship" leadership model. This leadership style extended to budget decisions, where, at least from my

observation, budget allocations were largely made piecemeal through the fiscal year, by fiat from the president. These decisions were primarily comprised of additional expenditures or programmatic decisions that resulted in future allocations (e.g., Student Information System, School of Global Animal Health, and ESF College of Medicine). With the notable exception of the Academic Affairs Program Prioritization (A2P2) process, there was no systematic or strategic budget planning conducted during the past decade.

Some would say that WSU has operated under an "incremental budgeting" model, and that is generally true, at least in terms of how annual budgets have been developed annually. Over the past decade, areas started basically with their previous year's allocation and were given any "plus ups" provided by the legislature or bestowed from the president. This work was largely completed with little transparency or input from senior leadership. Similarly, decrements were assigned, usually based upon some across-the-board manner to cover university-wide obligations.

I would propose the term "residual budgeting" to best represent the university's budget model, at least within the realm of academic affairs. "Residual budgeting" can be described as follows. Revenues come into the university from a variety of sources (e.g., tuition, grants and contracts, service fees). Outflows are diverted from these revenue streams for various purposes, with any residual hitting the central budget. For the most part, these outflows are based upon formulas or "special deals" negotiated on a case-by-case basis that have been in place for several years. For example, for a couple of high-profile professional programs, tuition comes to the university, 89 percent is allocated to the academic college, and the residual 11 percent hits the central budget. Similarly, and consistent with most universities, funding associated with research grants comes into the university, direct expenses are diverted to the academic units, a portion of F&A is allocated to the department and college, a fraction is peeled off to unit such as the Office of Research and Libraries, and the balance (remaining F&A) hits the central budget.

The attached flow diagram is a schematic representation of the budget model for the academic enterprise of the university and captures the essence of "residual budgeting." This flow diagram shows the eight major revenue streams generated by academic colleges: (1) undergraduate tuition, (2) F&A, (3) graduate tuition, (4) professional programs, (5) service center revenues, (6) INTO, (7) online education (Global Campus), and (8) gifts. Amounts "peeled off" from the revenue stream are shown as leaving the revenue stream, and the balance hits the central budget. These revenue streams account for over two-thirds of the total revenue generated by the university.

The Current Situation

A primary outcome of applying the above budget model for several years has been a drawdown of reserves and a lack of central funding to support strategic initiatives and address basic overhead costs. Quite simply, there is not enough money hitting the central budget to cover the increasing demands for funding to cover increasing administrative and overhead costs paid out of the central budget. It is also clear that additional stress has been placed on the central budget due to large investment in strategic initiatives (e.g., ESFCOM, the Spark, WSU-Everett), as well as other unplanned large expenditures (e.g., Felicia, Moore vs HCA).

An equally debilitating effect has been the rapidly declining financial health of the academic colleges. It is not coincidental or symptomatic of collective fiscal mismanagement by deans that 7 of 10 academic colleges carried negative carryforwards into FY-18. The fiscal state of academic colleges collectively can be attributed to a number of factors including:

- Continual permanent budget reductions to cover financial commitments that would be addressed at the university-level in a well-functioning fiscal enterprise (e.g., salary programs, 5% reallocation program);
- Several one time "claw-backs" of funds which have drained college financial reserves (e.g., Felicia, half-year of salary increases to bridge to a legislative allocation, Moore vs. HCA);
- Recent (total $6.4 million) and anticipated one-time expenditure reductions assigned to colleges;
- Long-term absence of new investment in the academic enterprise;
- A reduction in permanent faculty, the primary resource for generating new revenue to a college and the university; and
- Colleges' (particularly those involved in "Big Science") own investments in faculty and complementary resources to increase research output.

Due to the lack of reliable and accessible university data, it can be challenging to assemble the necessary data to quantify the effects of these factors; however, several recent analyses provide compelling evidence of the fiscal erosion of the academic enterprise, including:

- A recent analysis of payroll data completed by Institutional Research indicates that over the past 10 years, annual payroll months for tenure-track faculty have decreased 10 percent, non-tenure track faculty have increased 11 percent, and faculty administrative appointments have decreased 2 percent. Conversely the number of non-faculty administrative staff and administrative professional staff have increased 88 and 26 percent, respectively.
- A ten-year comparison of budget allocations by area that academic colleges increased 6 percent over the period, while all other areas increased more than three-fold that amount (21 percent).
- While data is yet available, recent discoveries of fiscal affairs at WSU-Spokane and WSU-Tri Cities seem to provide evidence of over-investment in administrative functions on those campuses, leaving less funding available for academic-related expenditures.

Thinking Through A Solution

Current expenditure reduction activities are a necessary first step in building a sustainable university budget; however, expenditure reductions are just that – a first step. Developing a budget that accommodates planned growth and the academic aspirations of the University will require completely revamping the budget model with which we operate. The current budget model will not appropriately allocate the resources necessary to achieve the Drive-to-25. Our focus must be on increasing revenue, while improving efficiencies to accommodate this growth without similar increases in expenditures. This goal can only be realized by placing the incentives in place to stimulate entrepreneurial, revenue-seeking behavior.

Concurrently, we must do everything possible to mitigate unnecessary or non-strategic uses of the central budget. Any new uses of university budget resources should receive serious scrutiny and assessed based upon their direct contribution to the Drive-to-25.

In the context of the flow diagram, the academic enterprise can contribute to a sustainable university budget by increasing net revenue (funds hitting the central budget at the center of the diagram). Net revenue can increase two ways: (1) increasing the flow of dollars entering the pipeline (represented by the large arrows), or (2) reducing the outflows from each pipeline (as represented by the smaller arrows). Increasing the flow of dollars (or total revenue) requires investment in revenue generating resources or incenting academic units to generate more revenue. Of course, in theory, outflows can be reduced or eliminated; however, achievement of these reductions is a complex balancing act. For example, the amount of undergraduate tuition hitting the central budget can be increased by decreasing waivers and/or decreasing the enrollment-based budget distributions. However, waivers are required to attract students, and their decrease could result in a decline in enrollment and commensurate reductions in total net tuition. Similarly, EBB distributions have been used to cover instructional costs associated with enrollment growth over the past eight years, and their reduction or elimination could reduce course enrollments and further drive college carryforward balances down.

Revamping the university budget (at least the academic budget) to focus on revenue, accommodate growth, and fuel the academic achievement necessary to realize the Drive-to-25 aspiration will require assessment of every inflow and outflow represented in the flow diagram (and perhaps some that were inadvertently omitted). Policies which define the funding flows in the diagram are very interdependent and must be evaluated and reconfigured holistically. For example, changing incentives to faculty, departments, and colleges for online (Global Campus) activities without considering on-campus enrollment could inadvertently redirect resources away from on-campus instruction and have an adverse effect on mission delivery and/or financial return.

A holistic assessment of every inflow and outflow in the flow diagram first requires a complete understanding of the dollar amount associated with each. While existing financial data makes this task difficult, it is an imperative.

Revenue Streams from the Academic Enterprise

A brief look at some of the major revenue streams in the flow diagram can provide some specific insights into how to modify each one to contribute to a more sustainable budget.

Undergraduate tuition. Although enrollment growth has increased total net tuition over the past 10 years, several countervailing forces have also been at work, including an increase in tuition waivers, a 15 percent reduction in resident tuition, increased competition for both resident and non-resident students, and an increasing percentage of students pursuing high-cost programs. While at first blush one might assume that the backfill of tuition creates a neutral revenue situation, it does not. First, the backfill reduced the inflow shown in the flow diagram, and replaced it with a deposit in the central budget. Second, the backfill was calculated based upon a base enrollment at the time; so, any enrollment growth is now generating 85 percent of revenue relative to prior to the tuition reduction. Another interesting trend has been that our recent success in recruiting better prepared students to

WSU has increased waivers which are largely based upon merit. Similarly, recent enrollment trends have shown disproportionate increases in high-cost programs such as engineering and STEM fields.

Recommendation. Specific strategies to increase net revenue from undergraduate tuition include:

- Fundraise for central scholarships, thus allowing for substitution of 17A funds for waivers.
- Better utilize existing university, college, and departmental scholarships to reduce waivers.
- Continue to modify waiver/scholarship policies to realize recruitment goals, while controlling outlays for waivers.
- Increase non-resident undergraduate students.
- Increase resident new freshmen and transfer enrollment.
- Employ differential tuition or fees to better cover expenses of high-cost academic programs and/or courses.

F&A. The F&A revenue stream has generally been flat over the past five years, as federal research funding has become increasingly competitive. While WSU has more than held its own relative to the competition by maintaining its research expenditures, it is unlikely that this revenue source will contribute significantly to university revenue growth. Due to the absence of central funding and college resources, an increasingly necessary strategy has been allocation of F&A generated from the grants of incoming faculty transferring F&A bearing grants to pay for startups. This again, reduces availability of F&A funds to support infrastructure in the short-run, with goal that these faculty generate larger F&A inflows in the future.

Recommendation. Increasing the average F&A rate actually collected from research grants could provide some additional revenue. Reallocating the utilization of F&A to strictly cover research infrastructure and administration, has been discussed for years. Such a strategy would demonstrate the value of F&A to faculty and unit administrators, and thus provide more incentive to negotiate higher rates on individual grants.

Recommendation. The budget study, *Administering the WSU Budget: Future Principles and Processes,* has some very useful recommendations concerning F&A management (p 31-38). These suggestions should be assessed and implemented where appropriate.

Professional Programs. Traditional professional programs (e.g., DVM, PharmD) and programs directed toward working professionals (e.g., MBA, METM) offer significant potential for increasing revenue and have been used effectively by some entrepreneurial colleges as a revenue source to increase their academic enterprise. There is no better illustration of the impact of economic incentives in increasing revenue to the university than this area. For example, PharmD and MBA enrollment have increased 59 and 123 percent over the past five years, as a result of these incentives being in place.

Recommendation. The percentage of tuition returning to professional programs differs significantly across programs and includes several “special deals” made over the years. Some of these “special deals” return as much as 89 percent to the academic unit. All of these arrangements should be revisited, and a uniform structure implemented based upon the services provided to the program. Such a structure would allow differential rates, give all units equal access to revenue, and likely increase the proportion of tuition realized by the university.

INTO. INTO is a great example of a strategic enterprise designed to increase revenue flows to all participating areas (departments, colleges, and the university) and incent entrepreneurial behavior. Additional teaching loads from increases in undergraduate enrollment are covered through the normal EBB model, while incentives for taking on additional Master's students are provided through a separate model based upon AAFTE completed and number of degrees conferred.

Recommendation. Continue to increase opportunities for enrollment growth from INTO, particularly in programs and campuses with capacity. Invest in the INTO operation; added capacity and improved performance will generate additional revenue.

Global Campus. Global campus revenues include online courses/programs and summer school. For the past several years, online revenues have been allocated in a nuanced manner. Tuition from online enrollments during Fall and Spring Semesters is routed to the central budget, and instruction costs are covered using the EBB model. In the Summer Session, online and summer school tuition goes to AOI, with instructional costs allocated to colleges at a rate of $6,250 per AAFTE. Apparently, this revenue is used to operate AOI during the year. More recently, another model for distributing revenue was developed to address new academic programs developed under the Online Initiative.

Recommendation. Clearly, current arrangements represent a patchwork of policies developed over time that must be assessed and modified in a holistic manner to provide appropriate incentives, generate additional revenue, and expand online offerings.

Recommendation. Online learning opportunities must be better distributed across all campuses. An explicit goal of any online budget model must include incentives for participation of faculty on all campuses.

Other Areas Requiring Immediate Attention

Employee Benefits. A significant source of carryforward reduction has been a drawdown of the benefits pool. The current approach of centralized benefits provides little incentive for units to manage employee benefit expenditures.

Recommendation. An alternative approach would move a benefit allocation (let's say 90 percent of current benefit expenditures) to each unit and allow the unit to retain savings from reducing benefits below this level. This structure would incent units to reduce benefit costs and eliminate the negative balance in the central benefit pool.

Misallocation of Revenue Streams. As a consequence of large increases in state funding, earnings from alternative revenue streams were allocated to unrelated purposes, leading to inappropriate incentives and revenue misallocation. For example, late fees from tuition are used to fund various offices in Finance and Administration, so when we contemplated a payment plan for tuition, one of the key objections was that implementation of the plan would reduce late fees and reduce funding to key business offices. Similarly, the majority of the application fee charged to undergraduate students goes to the central budget and is not available for use to assist with burgeoning application numbers and recruiting resources.

Recommendation. Tie the use of revenue streams to their intended purpose.

Permanent Budget. The concept of PBL is antiquated and constraining. Some advocate for continuation of a "policy" where permanent employees are only paid from PBL sources. Given dramatic reductions in state funding, and hence PBL, adherence to such a rule will serve to further reduce faculty numbers. Colleges today are funded by a complex mix of revenues, and this portfolio will become increasingly diverse.

Recommendation. Eliminate PBL, or at a minimum, any requirement (explicit or implicit) that faculty positions need to be on permanent budget.

Most Importantly!

WSU has little chance of realizing the academic goals associated with the Drive-to-25 without a significant change in the prioritization of the use of its fiscal resources. The statistics cited above are disturbing and demoralizing. Quite simply, WSU's faculty is too small to generate the quantum leaps in research and development funding, federal funding, and doctoral students trained, while simultaneously improving student outcomes. Significant increases in resources allocated to the academic enterprise will be necessary, and recent trends indicate that we are moving in the wrong direction!

Include academic priorities in budget planning. Recent budget planning analyses (e.g., "Future Budget Flexibility" distributed following the last budget hearing) omit academic priorities and focus on "essential expenditures" such as ongoing Felicia costs, current M&O deficit, ERP, commitments to Athletics-University support). Academic needs are just as important as these and must be explicitly included in these analyses. The academic enterprise can no longer be regarded as the residual claimant to a non-existent future budget surplus; otherwise, academic expenditures will continue to shrink at the expense of administrative spending.

Increase the number of tenure-track faculty. The most important resource for achieving the Drive-to-25 is tenure-track faculty. WSU's tenure-track faculty is significantly smaller than even the bottom five of the current top-25 public universities. To accomplish this aim will require reallocation of resources within colleges, as well as investment of new resources into colleges.

Recommendation. Colleges must reallocate existing resources to hire additional tenure-track faculty. This action will require moving resources from other employee categories to tenure-track faculty.

Recommendation. When new revenue becomes available at the university level, allocate the lion's share to increasing the number of tenure-track faculty. This goal needs to be publicly stated and the administration needs to be accountable to it.

Recommendation. Non-Pullman campuses must contribute more significantly to Drive-to-25 metrics. Deans and chancellors need to reallocate resources to hiring tenure-track faculty on non-Pullman campuses.

Stop taxing academic units! Resources to colleges and academic departments have been continually eroded as a result of numerous one-time and permanent budget reductions. Much like the Roman Empire in the 3rd and 4th Centuries, the aggregate effect of these "taxes" has been a decline in the ability of the revenue generating regions (in this case the academic colleges and departments) to function effectively and more funds are allocated to an expanding administrative structure. Hopefully, WSU will fare differently!

Get the **Budget Model Machine** to work for **you**

The 13 Most Important Decision Points to Align Your Budget Model and Strategic Priorities

Seeking to boost unit-level accountability for revenue improvement and cost control, institutions across the country are tinkering with their budget models. But budget model changes involve hundreds of decisions and can lead to many unintended consequences.

Whether considering a wholesale model redesign or making targeted improvements, **focus on the 13 budget model design decisions below to align your model to your strategic goals**, ensuring that the remaining outstanding decisions fall into place.

Learn more with the Business Affairs Forum's full study, which contains specifics about each of these decisions as well as resources for implementation, available at: eab.com/baf/budgetdecisions.

Creating Unit-Level Financial Accountability

Preserving Mission-Critical Activities

Incorporating Institutional Strategic Goals

01 **Tuition Revenue Allocation Percentage**
Allocate bulk of revenue (70% or more) via an activity-based formula.

02 **Tuition Revenue Allocation Weighting**
Define a range for SCH versus major weighting between 85/15 and 70/30; let deans set final weighting.

03 **Enrollment Smoothing**
Allocate based on prior-year actual or current-year projected enrollment; a central loan pool smooths unit budget volatility.

04 **Differential Tuition Allocation**
Do not directly attribute out-of-state tuition or financial aid; avoid weighted credit hours.

05 **State Appropriation Allocation**
Either allocate formulaically or use for subvention/strategic funds; decide early which option to use.

06 **Overhead Cost Allocation**
Allocate 4–6 overhead cost pools most likely to incent behavior change, with 1–2 drivers per pool.

07 **Unit Spend Monitoring**
Integrate oversight of unit-level spending decisions with ongoing central resource planning.

08 **Strategic Reserves Funding**
Create a separate 3%–5% tax on all revenue to fund central strategic reserves.

09 **Subvention Methodology Transparency**
Make subvention as overt as possible to avoid perverse incentives.

10 **Effective Subvention Incentives**
Set a clear end date for units on bridge subvention and ensure long-term subvention is not a blank check.

Budget Model Boosters

Institutions can use budget model financial incentives and seed funding to reinforce—rather than undercut—strategic goals.

11 **Incenting Student Success**
Example: Include student retention and graduation improvement metrics in revenue allocation formula.

12 **Incenting Research Enterprise Growth**
Example: Include grant funding in revenue allocation formula.

13 **Incenting Targeted Program Launches**
Example: Implement targeted revenue-sharing agreements.

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To learn more about aligning your budget model to strategic goals, download the full study.
eab.com/baf/budgetdecisions

Washington State University
FY15 - FY17 Athletics Actual Revenue & Expenses

($ M)	Actuals		
	FY15	FY16	FY17
REVENUES:			
01 - Ticket Sales	6.8	5.5	7.7
02 - Direct State/Gov Support	-	-	-
03 - Student Fees	1.1	0.8	1.6
04 - Direct Inst. Support	3.7	3.7	3.3
05 - Less Xfer to Inst.	-	-	-
06 - Indirect Inst. Support	1.2	0.4	0.4
06A - Debt Service, Lease, Rentals	-	-	-
07 - Guarantee Revenue	0.4	0.3	0.3
08 - Contributions	6.4	7.6	8.1
09 - In-Kind	0.2	0.1	0.1
10 - 3rd Party Compensation	-	-	-
11 - Media Rights	17.0	17.9	18.8
12 - NCAA Distribution	1.3	1.3	3.2
13 - Conference Distribution	8.2	9.4	10.7
14 - Program/Concessions etc.	0.2	0.2	0.9
15 - Royalties/Advert. etc.	4.0	6.3	4.4
16 - Sport Camp Revenue	0.4	0.4	0.4
17 - Endowments	0.6	0.6	0.6
18 - Other Revenue	2.4	2.1	1.4
19 - Bowl Revenue	-	1.9	2.4
Total Revenue	54.1	58.8	64.3
EXPENSES:			
20 - Athletic Aid	9.7	11.0	10.7
21 - Guarantee Expense	1.3	1.7	1.6
22 - Coaches Comp: WSU	10.7	11.7	11.8
23 - Coaches Comp: 3rd Party	-	-	-
24 - Admin Comp: WSU	12.1	12.8	13.4
25 - Admin Comp: 3rd Party	-	-	-
26 - Severence	1.0	0.0	0.1
27 - Recruiting	1.2	1.1	1.2
28 - Team Travel	4.0	4.0	4.1
29 - Equipment	2.4	3.0	2.0
30 - Game Expenses	2.4	1.6	1.8
31 - Fund Raising/Marketing	1.9	2.4	2.2
32 - Sport Camp Expense	0.3	0.3	0.3
33 - Spirit Groups	0.2	0.2	0.2
34 - Facilities: Debt/Lease/Rental	11.5	9.7	9.3
35 - Direct Admin Expense	0.0	2.3	2.4
36 - Indirect Inst. Support	1.2	0.4	0.4
37 - Medical/Insurance	1.1	1.0	0.8
38 - Dues & Memberships	1.8	1.8	1.7
39 - Student-Athlete meals	-	0.8	1.0
40 - Other Expense	4.5	4.1	4.9
41 - Bowl Expenses	0.0	1.7	1.9
Total Expenses	67.4	71.7	71.8
Net Operating Income	(13.3)	(12.9)	(7.5)
Cumulative Deficit	(38.6)	(51.5)	(59.0)

Washington State University
FY19 through FY23 Athletics Budget

($ M)	Estimated	Budgets as of 5/25/18				
	FY18 Y-end	FY19	FY20	FY21	FY22	FY23
REVENUES:						
01 - Ticket Sales	8.5	9.5	8.6	10.3	10.4	11.5
02 - Direct State/Gov Support	-	-	-	-	-	-
03 - Student Fees	1.6	1.5	2.3	2.3	3.2	3.2
04 - Direct Inst. Support	3.5	3.4	3.5	3.6	3.7	3.8
05 - Less Xfer to Inst.	-	-	-	-	-	-
06 - Indirect Inst. Support	0.4	0.4	0.4	0.4	0.4	0.5
06A - Debt Service, Lease, Rentals	-	-	-	-	-	-
07 - Guarantee Revenue	0.0	0.3	-	0.2	-	0.3
08 - Contributions	8.2	7.7	8.7	9.6	9.9	10.7
09 - In-Kind	1.6	1.6	1.6	1.6	1.6	1.6
10 - 3rd Party Compensation	-	-	-	-	-	-
11 - Media Rights	19.6	20.6	21.6	22.8	23.9	25.2
12 - NCAA Distribution	1.3	1.3	1.3	1.4	1.4	1.5
13 - Conference Distribution	11.9	12.1	12.8	12.5	13.0	12.9
14 - Program/Concessions etc.	0.9	1.0	1.4	1.4	1.5	1.5
15 - Royalties/Advert. etc.	2.9	4.1	4.2	4.3	4.4	4.6
16 - Sport Camp Revenue	0.3	0.3	0.3	0.3	0.3	0.3
17 - Endowments	0.6	0.6	0.6	0.7	0.7	0.7
18 - Other Revenue	1.9	1.8	1.7	1.8	1.8	1.9
19 - Bowl Revenue	2.3	2.5	2.6	2.7	2.8	2.9
Total Revenue	65.6	68.6	71.7	75.9	79.1	83.0
EXPENSES:						
20 - Athletic Aid	10.5	11.4	11.6	11.9	12.2	12.5
21 - Guarantee Expense	1.7	1.7	1.8	1.3	1.8	1.4
22 - Coaches Comp: WSU	12.7	13.3	13.8	14.9	15.4	15.9
23 - Coaches Comp: 3rd Party	-	-	-	-	-	-
24 - Admin Comp: WSU	13.8	14.0	14.1	14.3	14.6	15.0
25 - Admin Comp: 3rd Party	-	-	-	-	-	-
26 - Severence	1.0	-	-	-	-	-
27 - Recruiting	1.5	1.5	1.5	1.6	1.6	1.6
28 - Team Travel	4.1	4.3	4.6	4.6	4.7	4.8
29 - Equipment	2.3	2.0	2.0	2.0	2.0	2.2
30 - Game Expenses	2.4	2.4	2.3	2.5	2.6	2.7
31 - Fund Raising/Marketing	2.2	2.1	2.2	2.2	2.3	2.3
32 - Sport Camp Expense	0.3	0.3	0.3	0.3	0.3	0.3
33 - Spirit Groups	0.2	0.2	0.2	0.2	0.2	0.2
34 - Facilities: Debt/Lease/Rental	9.2	9.2	9.2	9.2	9.2	9.2
35 - Direct Admin Expense	1.7	1.8	1.9	1.9	1.9	2.0
36 - Indirect Inst. Support	0.4	0.4	0.4	0.4	0.4	0.5
37 - Medical/Insurance	0.9	0.9	0.9	1.0	1.0	1.0
38 - Dues & Memberships	2.2	2.2	2.2	2.3	2.4	2.4
39 - Student-Athlete meals	1.0	0.9	1.0	1.0	1.0	1.0
40 - Other Expense	4.3	4.3	4.4	4.6	4.7	4.8
41 - Bowl Expenses	2.4	2.5	2.6	2.7	2.8	2.9
Total Expenses	74.7	75.3	77.0	78.8	81.1	82.9
Net Operating Income	(9.1)	(6.7)	(5.3)	(3.0)	(2.0)	0.2
Cumulative Deficit	(68.1)	(74.8)	(80.1)	(83.1)	(85.1)	(84.9)

CORE & OTHER FUNDS FY 2018 Year-End Projection based on May Actual				
CORE FUNDS	**FY 2017 as of 6/30/2017**	**FY 2018 Scenario 1**	**FY 2018 Scenario 2**	**FY 2018 Scenario 3**
Run Rate	(18,090,696)	(8,190,829)	(354,351)	(354,351)
OTHER FUNDS	**FY 2017 as of 6/30/2017**	**FY 2018 Scenario 1**	**FY 2018 Scenario 2**	**FY 2018 Scenario 3**
Run Rate	(4,196,202)	(4,196,202)	158,711	3,616,715
Total Run-Rate	**FY 2017 as of 6/30/2017**	**FY 2018 Scenario 1**	**FY 2018 Scenario 2**	**FY 2018 Scenario 3**
Total Run-Rate Area 1-59	(22,286,898)	(12,387,031)	(195,640)	3,262,364
Central Reserve Decline	(7,512,272)	(8,091,471)	(8,091,471)	(8,091,471)
Total Change in Reserves Area 1-59 + Central	(29,799,170)	(20,478,502)	(8,287,111)	(4,829,107)
Improvement over FY17		**9,320,668**	**21,512,059**	**24,970,063**
Timing & other differences		**10,000,000**		**(4,200,000)**
Revised projected improvement over FY17		**19,320,668**	**21,512,059**	**20,770,063**
Average improvement all three scenarios				**20,534,263**

Budget Office
6/8/2018

University Fiscal Health Advisory Council

June 2018

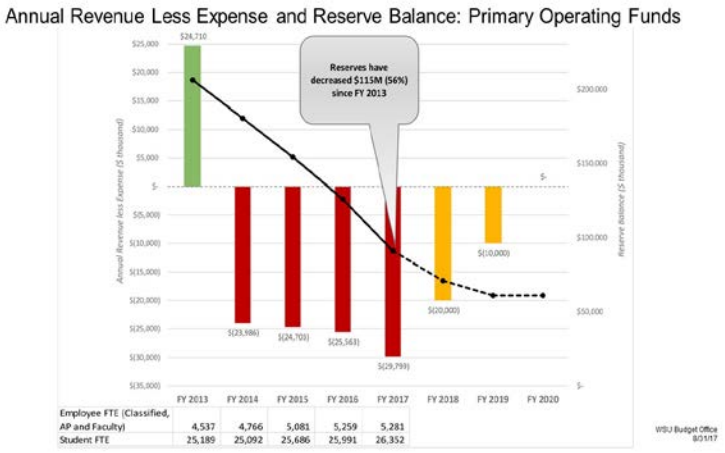
Great Recession of 2008

- State Appropriation declines significantly
- Meanwhile enrollments continue to increase
- Significant increases in tuition to offset large decline in appropriations
- Faculty and staff reductions
- Administrative restructuring

Significant changes to WSU over the past decade including

- Total revenue has increased by 37 percent
- Expenditures have increased even more, by 43 percent
- State "bought down" two years of tuition increases
- Enrollment has increased by 30 percent, but net tuition revenue has grown at a much slower pace and is starting to decline
- Research and development expenditures have increased by 28 percent

During this period of significant change, WSU lacked a comprehensive and strategic budget planning and allocation process



University reserves declined by $48.9 million in one fiscal year, due to internal loan write offs and spending in excess of revenues

Deficit spending has continued through the most recent fiscal year resulting in further depletion of reserves and creating serious financial instability

- Multiyear spending in excess of revenues and operating budget by some colleges, campuses and areas
- Large investment in facilities with insufficient new revenues for debt service and maintenance
- Medical school start up with minimal new operating revenues and an outdated financial startup plan (proforma vs. actual)
- Ongoing financial commitments without new revenues further depleting
- 5 percent Grand Challenge budget reallocation
- ***Lack of cohesive budget and financial planning policies and processes***

Revenue Enhancement programs are not consistently evaluated for ROI

- Inconsistent arrangements for allocating new revenues and incentivizing new revenue generating programs
- Program investments and expected outcomes mostly undocumented, or not shared with Budget and Finance offices.

Resulted in:

- Significant decline in reserves, both central and some areas
- Deficits in reserves require subsidization from central and areas with positive balances
- Ongoing commitments with no funding source depleting reserves by $9+ to $17M annually
- Approximately two months of operating reserves, extremely low

The Good News:

- Expenditure reductions are underway and appear to be succeeding
- Reports have been generated for monthly progress review
- Reviewing revenue allocation processes and means for growing central reserves
- Both revenue collection and expenditure policies are being reviewed and revised to prevent future unplanned spending
- Moving forward on a new financial and human resources system so that budgets, commitments and expenditures can be tracked in real time
- Creation of a fiscal health advisory committee to review and recommend longer term budget and finance policies and models.
- Some discussions and a little progress on optimizing IT, communications functions, program mergers and closure of small programs that are operating in deficit or without permanent funding, continuing review of other programs.

How do we turn this around?

- First, eliminate university deficit spending
- Monitor programs with large deficits to meet recovery goals
- Prioritize and fund the unfunded commitments list before funding new initiatives
- Build a central reserve for two purposes; funding of strategic initiatives for emergency purposes to cover emergencies.
- Review and evaluate current revenue streams and allocation methodologies and identify the problems created by "residual budgeting." Residual budgeting is described as follows:

  Revenues come into the university from a variety of sources (e.g., tuition, grants and contracts, service fees). Outflows are diverted from these revenue streams for various purposes, with any residual hitting the central budget. For the most part, these outflows are based upon formulas or "special deals" negotiated on a case-by-case basis that have been in place for several years. For example, for a couple of high-profile professional programs, tuition comes to the university, 89 percent is allocated to the academic college, and the residual 11 percent hits the central budget. Similarly, and consistent with most universities, funding associated with research grants comes into the university, direct expenses are diverted to the academic units, a portion of F&A is allocated to the department and college, a fraction is peeled off to unit such as the Office of Research and Libraries, and the balance (remaining F&A) hits the central budget. See Attachment I that shows eight major revenue streams generated by academic colleges: (1) undergraduate tuition, (2) F&A, (3) graduate tuition, (4) professional programs, (5) service center revenues, (6) INTO, (7) online education (Global Campus), and (8) gifts. Amounts "peeled off" from the revenue stream are shown as leaving the revenue stream,

and the balance hits the central budget. These revenue streams account for over two-thirds of the total revenue generated by the university. See Attachment I.

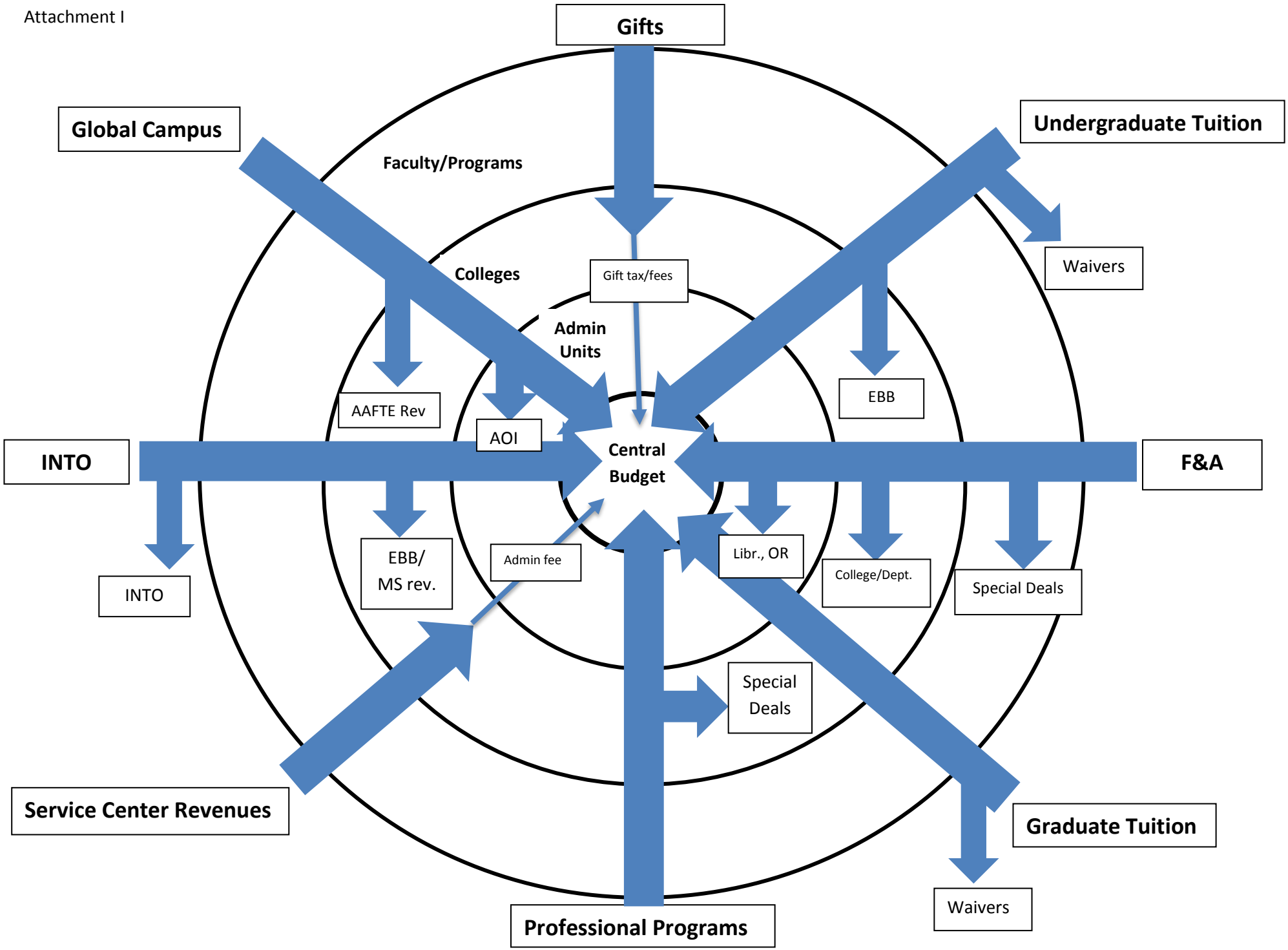
- Scope an analysis of administrative infrastructure and efficiencies with a goal of reducing administrative spending.
- Assess academic programs with the goal determining how to right size the structure so that appropriate investment can be made into the most mission critical programs and the academic programs and initiatives that support these programs.

What about a budget model?

Review current models and focus on a methodology that accommodates planned growth and provides funding for strategic initiatives and prevent unintended consequences to include:

- Increasing revenues
- Improving efficiencies to accommodate growth without a commensurate increase in expenditures.
- Identify incentives to stimulate and reward revenue growth, but that also provides regular funding for central reserves.
- Develop a process to vet new program approvals by requiring detailed analyses, metrics and process for revision or elimination of programs that are not meeting intended goals.
- Develop a process to both fund a central reserve and approve how strategic initiatives will be funded from this reserve. Ensure that the reserve is sufficient to cover unplanned expenditures and emergencies (like Felicia, HCA, etc.)
- Establish goals for faculty hiring and tenure commensurate to the academic and research goals.

Attachment I



Unfunded commitments

Description	Estimated amt	
ONGOING COMMITMENTS		
Unfunded M&O - Legacy		
2013-15: Vet Med Research Building	706,000	
2013-15: Riverpoint Biomedical Building	873,000	
2015-17: Clean Tech Lab, Prosser viticulture, Ag Tech	923,000	
Central already covering	2,502,000	
Unfunded M&O - New buildings **(Does not include programming costs)**		
2015-17 Troy (incremental new in 2017-19)	114,000	
2017-19: Art Museum	148,480	
2017-19: Digital Classroom	774,472	
2017-19: Multicultural Center	148,480	
Incremental new for 2017-19	1,185,432	
Centrally Funded with Annual allocations (no permanent funding source)		
Everett Administrative positions	527,372	
Government Relations positions	196,400	
CAHNRS Children's Center	200,000	
Blackboard application	371,000	
	1,294,772	
New Central Commitments FY18		
Library periodicals	500,000	
AVP, Diversity Salary & benefits estimate	250,000	
Tree fruit positions - ESF commit	299,500	
Vet med retention (Academy member)	150,000	
Research posn retention	88,200	
SB 5939 requirements/ Energy program unappropriated		*funded in s
Three Dean positions	700,000	*new*
Accessible Technology Manager	15,000	*new*
Downtown Art Museum (ongoing)		*new - amo
Benefit pool - insurance rate increases assumed funded with new tuition + benefit impact of MSI's	1,655,000	
	3,657,700	
Felicia on-going (currently being absorbed by IT)	1,300,000	
Total unfunded on-going commitments	**9,939,904**	
ONE_TIME SHORTFALLS		
Felicia one-time (absorbed by IT)	1,600,000	
CAS F&A deficit, covered by Central	3,287,189	
HPA deficit, covered by Central	949,000	
CIRC commitment (848K total over 4 yrs.)	848,000	
SB 5939 requirements/ Energy program unappropriated		*funded in s
Engineering Startup commitment	400,000	*new*
3 IREACH Startups	725,000	*new*
Endowed Chair -Vancouver	150,000	*new*
Downtown Art Museum	250,000	*new*
FICA tax retroactive adjustments	550,706	*new*
NWCCU bill	16,000	*new*
Total one-time commitments	**8,775,895**	