Minutes*

Senate Committee on Finance and Planning
Tuesday, September 11, 2012
2:00 – 4:00
238A Morrill Hall

Present: Will Durfee (chair), Gary Cohen, Dan Feeney, Catherine Fitch, Susan Hupp, Kara Kersteter, Russell Luepker, Fred Morrison, Terry Roe, Michael Rollefson, Ann Sather, Arturo Schultz, S. Charles Schulz, Kyle Smyth, Pamela Wheelock

Absent: Lincoln Kallsen, Ruth Lane, Paul Olin, Richard Pfutzenreuter, Gwen Rudney, Thomas Stinson, Michael Volna, Aks Zaheer

Guests: Julie Tonneson (Office of Budget and Finance); Vice President Aaron Friedman, Associate Vice President Terry Bock, Beth Nunnally (Academic Health Center)

[In these minutes: (1) welcome, introductions, review of charge, and issues pending; (2) tutorial on the budget model; (3) administrative costs in the Academic Health Center (closed)]

1. Welcome, Introductions, Review of Charge, and Issues Pending

Professor Durfee convened the meeting at 2:00 and called for a round of introductions. He then reviewed the Committee's charge, commenting that what is key is consulting with and advising senior administrators. The Committee has no power but administrators appear to value what the Committee says, in part because of the diverse views that are represented through the Committee's members. In theory the Committee could take up anything because everything has to do with dollars, but it needs to bear in mind that there are other committees at which administrators discuss issues and there is a need to avoid duplication.

Professor Durfee briefly reviewed the list of issues pending, what it is proposed the Committee will do this year, and he emphasized that the list is not fixed.

Professor Morrison said that one thing that has happened twice during his long history with the Committee (which dates back to the 1970s), and that could happen a third time, is the need to deal with the financing of education in the health sciences, and particular medical education. Is there a plan? With all the uncertainties in financing, is there a plan to be sure that the University is in a good position and that it is financing a sustainable enterprise? If not, what should be done? Twice in his experience the enterprise of health sciences education was not sustainable and the University had to put substantial funding into it. It is not doing so now, but if it has to, where will the money come from? He suggested that the Committee take up the issue later in the year, after the elections and the report of the external advisors on the Academic Health Center (AHC) has been released.

Professor Schulz agreed that there are issues to be addressed. Can departments in the AHC meet their goals in getting grants and being good teachers—or is the funding at present sustainable because people are spending more time in clinics?

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* These minutes reflect discussion and debate at a meeting of a committee of the University of Minnesota Senate; none of the comments, conclusions, or actions reported in these minutes represents the views of, nor are they binding on, the Senate, the Administration, or the Board of Regents.

Professor Durfee concurred that this is an all-University issue because the AHC and the rest of the University "are joined at the hip."

Professor Luepker said he was glad Professor Morrison brought up the issue. Those who are in the AHC are looking forward to the report of the external advisers. He was in one group discussion with them and heard it said that any medical school dean needed to control the hospital and/or the practice plan to succeed.

Another issue is the fiscal cliff in January, Mr. Rollefson said. He also asked if the Committee would offer advice on any decision about the University's golf course. Professor Durfee said he was reserving judgment on the latter but that the Committee would, as appropriate, take up the former.

Professor Cohen suggested the Committee review the financing of intercollegiate athletics. Given the size of programs in the Big Ten Conference, including Minnesota, and the size of the physical plant for which the department is responsible, the University can be vulnerable to losing control—an issue that has arisen at other institutions around the country, including Penn State. He suggested the Committee ask how the institution maintains its oversight and supports the facilities.

Professor Hupp asked what the responsible way to look at continued state funding for the University, even assuming that Congress addresses the fiscal cliff.

Professor Durfee urged Committee members to review the list of issues pending, to highlight those they believe important, and to make suggestions; he will try to arrange the Committee's schedule in light of the comments. What is the Committee's capacity, Professor Roe inquired? That it will learn as it goes along, Professor Durfee replied.

2. Tutorial on the Budget Model

Professor Durfee now welcomed Ms. Tonneson from the Office of Budget and Finance to provide a tutorial and overview of the University's budget model.

Ms. Tonneson began by noting that she would discuss, at a 30,000-foot-level, the biennial budget process and the annual budget process and the budget model (the operating budget), not the capital budget process or debt management and investments. She noted the financial management organization of the University, where the President, the Associate Vice President and Director of Audits Gail Klatt, and the Treasurer Richard Pfutzenreuter report directly to the Board of Regents. Mr. Pfutzenreuter, as Vice President and Chief Financial Officer, reports to the President, and has reporting to him the Associate Vice President and Controller (Mr. Volna), University Budget and Finance, and a few other offices.

The FY2012-13 operating budget totals $3,321,730,446, of which about $2.7 billion is current non-sponsored expenditures and mandatory transfers and about $617 million is in sponsored expenditures. The latter come primarily from the federal government but also industry and other units of government. The sponsored funds carry with them a lot of rules and bureaucratic reports.

The total projected non-sponsored revenues for 2012-13 total $2.9 billion (or about $200 million more than the budget—spending—projections, because the budget does not take into account balances carried forward, transfers, and other transactions). Of that $2.9 billion in non-sponsored funds, $2.9 billion, $1.6 billion is centrally allocated and attributed (state Operations and Maintenance (O&M) money, state special appropriations, tuition, indirect cost revenues, and central reserves). The Board of Regents spends the most time on these funds; while the Board must approve expenditures in both categories—sponsored and non-sponsored funds—it is with the non-sponsored funds that the Board makes decisions. The state O&M funds are still a large amount, even though they have declined in recent years; Ms. Tonneson said she did not know why they are called Operations and Maintenance funds, although that is how they are labeled in statute. The central reserves funds are earnings on invested cash (Board of Regents' policy requires the University to hold a certain amount of cash for emergencies).

The other $1.3 billion in non-sponsored funds are revenues generated by local units ($254 million in auxiliary operations, such as bookstores, parking, food, etc., units selling to the public and students, $240 million in internal sales, departments selling to departments, and $807 million in clinical income, grants and contracts, business and industry sales and service, student fees, endowment income, etc.) The $1.3 billion goes directly into department accounts.

Ms. Tonneson provided a pie chart of the revenue sources for FY12-13.

14%	O&M state appropriation
2	state special appropriations
24	tuition
4	indirect cost recovery
7	auxiliary enterprises
7	internal sales
12	misc income, sales, fees
12	restricted gifts, endowments
18	sponsored funds

Professor Cohen asked the size of the central reserves; about $12 million, Ms. Tonneson reported.

What do the state revenues at other Big Ten schools look like, Professor Schultz asked? Ms. Tonneson reported that Penn State receives about 2-3% of its budget from the state; Michigan receives about $300 million, compared to about $543 million for Minnesota.

Ms. Tonneson also noted the general fund budget for the State of Minnesota and where the money goes.

42%	K-12 education
31	health and human services
8	property tax aids and credits
5	public safety
8	higher education
3	state government
3	debt and other

So 73% of the state budget goes for K-12 education and health and human services, Ms. Tonneson noted. Higher education constituted about 9% of the budget for many years; the University and MnSCU receive about the same amount and about $100 million goes into the state grant program.

Ms. Tonneson next provided a graph indicating the sources of funds for the coordinate campuses and each of the colleges on the Twin Cities campus. The Medical School is the largest, at $539 million; all other units have notably smaller revenues, down to $11 million at Rochester. The mix of revenues for each of the colleges and campuses (among state funds, tuition, indirect costs, gifts, endowments, fees and sales, and grants and contracts) varies widely. Some care a great deal about tuition levels and increases but, for example, the Medical School does not, as much. So depending on what changes in revenues one is talking about, there are different impacts on different units.

Ms. Tonneson reviewed the non-sponsored fund expenditures for FY2011-12 by object of expenditure and by function. By object of expenditure:

62%	salaries and fringe benefits
8	student aid
11	supplies and services
8	utilities
2	repairs and maintenance
4	consultants/purchased personnel
5	all other

By function (these codes are the ones used by all U.S. institutions of higher education):

13	operation and maintenance of plant
8	scholarships and fellowships
25	instruction
8	research
5	public service
19	academic support and student services
13	institutional support
9	all other

The University is a highly people-oriented place, she pointed out, and the portion dedicated to salaries and fringe benefits has declined from about 66% in the past. What are the growth areas, Professor Cohen asked? The growth is spread throughout a number of the other categories, with the most significant growth being in student aid, Ms. Tonneson said.

Ms. Tonneson review an organizational chart depicting the accounting and reporting structure, with the primary organizational unit (academic or support, such as a college), the Resource Responsibility Centers or RRCs, of which there are 51. Beneath them are secondary organizational units, such as departments, of which there are 419, and below them are activities with department IDs, of which there are 2,075. Within the last there are various funds and a total of about 85,500 unique account strings that track transactions in the different funds. The RRC is the level at which the University holds units accountable for finances.

There are two operating budget processes, Ms. Tonneson related, the biennial budget request to the state, prepared every two years, and the annual budget process, which is conducted every year. She reviewed briefly the state revenue outlook for 2014-16, which includes a $4.6 billion deficit if fixing the school shift is included. But much can happen; there are 11 months left in the current biennium and 35 months to the end of the next biennium (6/30/15).

The biennial budget timeline begins in July, with development of the conceptual framework and receipt of the state's preliminary budget instructions. The process includes development of the proposal and presentation to the Regents in September for review and in October for approval; the Governor makes decisions about recommendations in November/December. The president has chosen to emphasize reforming how education is funded, how the state invests in its future, and how students and families pay for higher education. (Ms. Tonneson provided more detail about these three emphases but did not discuss them; she also provided a brief summary of the 2013-15 biennial request, which will seek about an 8% increase in state support.)

Ms. Tonneson reviewed the trend in state funding (in unadjusted dollars) for the University since 1997; the peak year was $708.8 million in 2008. The current year funding is $569.8 million, or about the level the funding was at in the late 1990s. In constant dollars the level would be considerably lower than the 1990s. She also reviewed the trends in state funding and tuition revenues; in 2010 the University faced a new paradigm because tuition revenues exceeded state funding. Most Big Ten schools reached that point earlier; Minnesota was the last one to do so.

Ms. Tonneson turned to the annual budget process and began by identifying the players, who include the president, the budget committee (the provost, the senior vice president for system academic administration, the vice presidents for the health sciences, research, and finance, and her), the chancellors, deans, and other vice presidents, and departments. She noted the role that each plays in the development of the budget. At the end of the process, the Board of Regents reviews and approves the annual budget submitted by the president. This process is just beginning for FY2014 for the support units; the instructions to academic units go out in January and final budget recommendations for academic and support units are prepared in April.

The roles:

The president: Sets broad goals, strategies, principles; Directs and delegates the overall process; Receives and acts on recommendations from Budget Committee and Delivers Final Recommended Budget to the Board

The budget committee: Manages the overall budget development process; Interfaces with each unit of the University; Develops recommendations to the President on unit allocations and budget balancing tactics

The chancellors, deans, and vice presidents: Provide input into broad goals and strategies; Develop unit level goals and strategies; Respond to compact/budget instructions; Request funding from Central; Implement final decisions

Departments: Respond to RRC level direction regarding development of departmental goals and strategies; Request funding from RRC; Respond to internal budget instructions; Implement final decisions

Ms. Tonneson reviewed for the Committee the history of budget development activities and the reasons behind the changes, beginning with the "pre-IMG" phase, up to 1997, the traditional model, when all funds flowed centrally and were allocated to the colleges/units. The University moved to Incentives for Managed Growth (IMG) and used it up to 2005. In 2006 the current budget model was adopted, the "earned income and full cost" model. The first move in attributing revenues and costs to units began in 1998, and the IMG model was largely successful, but there were problems in dealing with facilities costs (a facilities charge was developed and dropped), the internal revenue sharing program had to be adopted because while all the revenues were attributed to the units, not all the costs were, and when state funds were inadequate to cover all the support and overhead costs, the units had to be taxed. The University Fee also was imposed to cover support services and overhead costs. The IMG model also needed more transparency, simplicity, and accountability, and less internal assessment and less of a "base plus/minus" methodology. So the University moved to its current budget model, attributing all revenues and allocating all costs, with the latter determined by different formulae. The state appropriation is used only for academic units, in a manner decided by the president.

There are nine primary cost allocation pools, including facilities operations and maintenance, utilities, debts and leases, information technology, support service units, libraries, student services, general purpose classrooms, and research. The allocation methods used to charge the academic units for the cost pools are consumption based (e.g., utilities, and there is a direct incentive for desirable behavior), cost driver based (a proxy is used, such as number of students, and there is no direct incentive for any particular behavior), or common good based (cost based on a variable accepted as reasonable (e.g., size of the unit budget, and there is no direct connection to incentives, it is just a reasonable way to share the costs). Most operations fall in the second category; the third category is the administrative cost pool and includes such things as the president's office, the Board of Regents' office, etc.

Ms. Tonneson laid out the schedule for making budget decisions and the issues raised, with service units coming in the fall. The service units must deal with compensation, strategic priorities, and infrastructure costs; the available resources are from internal reallocation, additional earned income, or an expense added to the cost pool. The approved cost pool budgets are then used with academic unit budget decisions, which also must deal with compensation, strategic priorities, and infrastructure costs as well as the cost pool charges. The academic units can rely on increased state appropriations, reallocated state funding, additional earned revenue (e.g., tuition, indirect cost funds, gifts), or unit internal reallocation.

Professor Durfee thanked Ms. Tonneson for the presentation.

3. Administrative Costs in the Academic Health Center

Professor Durfee welcomed Vice President Friedman, Mr. Bock, and Ms. Nunnally to the meeting to follow up the presentation last spring on administrative costs in the Academic Health Center (AHC). He accepted a motion to close the meeting, which received unanimous support. He also extended a special welcome to Vice President Wheelock, who joined the meeting at this time, her first meeting with the Committee.

The Committee discussed with Vice President Friedman his colleagues the costs of various units in the AHC. At the end of the discussion, Professor Durfee thanked the guests and adjourned the meeting at 4:00.

-- Gary Engstrand

University of Minnesota