Minutes[*]

Senate Committee on Finance and Planning
Tuesday, October 1, 1996
3:15 - 5:00
Room 238 Morrill Hall

Present: Fred Morrison (chair), Jason Frick, Gerald Klement, Robert Kvavik, Gary Malzer, Patricia Ferrieri, Catherine French, Peter Robinson, Benjamin Senauer, Charles Speaks, James VanAlstine

Regrets: Richard Pfutzenreuter, Craig Swan

Absent: Bruce Bromberek, Thora Cartlidge, David Hamilton, Roger Paschke

Guests: Liz Eull (Budget and Finance), Susan Nemitz (Academic Affairs)

[In these minutes: Responsibility Center Management

Professor Morrison convened the meeting at 3:25 and welcomed Associate Vice President Kvavik to the meeting. He noted that Responsibility Center Management (RCM) has been a big topic for the last 18 months and that it has gone through a number of permutations; Dr. Kvavik will present the most recent version of the proposal, along with Mss. Eull and Nemitz.

Dr. Kvavik handed out a set of materials. He began by commenting that the University, in comparison with other institutions, was already farther along with using this kind of approach than many, even before formal discussions about RCM started, because it already has in place parts of it: arrangements with the college to keep tuition income, decentralization of fringe benefits, and carrying forward balances. They have rejected the RCM complexity that some schools have, where complex mechanisms have been put in place that have no incentives and where departments have no control over behavior.

The present plan focuses on four areas: tuition, allocation of the state subsidy, space, and indirect cost recovery (ICR) funds. They felt the University could benefit from analysis and incentives in each area, regardless of whether RCM is accepted or rejected as part of an alternative approach to budgeting.

The biennial request is premised on managed growth; there needs to be incentives in place so the University can fulfill its obligations under the biennial budget.

There are four purposes to the initiative: to grow to financial stability, to implement an incentive structure that encourages revenue-generating activities while controlling costs, to decentralize decision-making (put the dollars where the decisions are made, rather than collect them centrally and redistribute

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

them), and to clarify the current maze of cross-subsidies and make choices clear (to identify true costs, set priorities for state funds, and be sure those priorities are clear).

There are two units of analysis: college/academic, tuition-generating units, and support units, which do not generate tuition. One question is the extent to which the Graduate School should receive tuition income, rather than the departments; is it a mailbox or an active player? It is an active player, Dr. Kvavik said, when it provides funds for interdisciplinary centers across colleges. One could say the Graduate School does not need tuition revenue, and that it should use state funds to the extent the administration and governance structure agree is appropriate.

The assumptions for this initiative are as follows:

-- This is not "every tub on its own bottom," because units will be subsidized with state funds. There will always be state funds in every unit.

-- The initial transition will be revenue-neutral.

-- Historical inequities will be addressed through the University budget process. RCM or an alternative should not be held hostage to these inequities, and the budget and capital process should be used to correct them.

-- University leadership will retain sufficient academic and fiscal leverage to facilitate achievement of institutional goals. There are collective interests that supercede college interests, and the University must guard against sub-optimization.

Historical inequities have not been addressed through the budget process in the past, one Committee member observed; what ensures that they will be in the future? As units gain more control over their budgets, Dr. Kvavik said, they can earn the dollars they need and will have a smaller piece of their budget from the state. Some units have too much space, and some have too little; as the capital budgeting process takes place, one should constantly ask if the space a unit has is adequate. Units will have funding for space, and they can sell the space.

This is not making a statement about the budget process, Ms. Jackson said, and does not determine things for all time. Adjustments will have to be made as inequities are identified. This initiative will CLARIFY the inequities, with tuition removed from the equation. Just because RCM is adopted does not mean all else will stay the same.

This process will uncover the profoundly small amount of state dollars that goes to CLA, observed one Committee member; the amount will look like peanuts. The CLA budget looks big, but tuition is a part of its direct costs; without tuition, CLA is almost self-sustaining. So is the Law School. The budget review process next year will be different, Ms. Jackson responded, forcing different questions to be asked.

1. TUITION

Ms. Eull then reported that she had been the project leader on tuition attribution, a subject on which her group had worked for over a year and put a lot of thought into. The first major decision was that

tuition would be attributed exclusively to colleges, and none would be directed to support units. The colleges generate the money, so they should keep and control it.

The next question was attribution of tuition to colleges for teaching a course versus the college of enrollment of the student. Colleges recruit and retain students, so there needed to be incentives for the college of enrollment as the "caregiver" to the student. They knew ANY recommendation would be somewhat arbitrary, Ms. Eull explained, because they had no hard evidence or facts upon which to base the allocation of tuition between the teaching and enrollment colleges. They are recommending that 25% of tuition income be attributed to the college of the student's enrollment and 75% to the college teaching the course.

What part of tuition should be attributed? A student can obtain a number of discounts, so the University does not receive the full amount. Examples are residency (discounted from non-resident rates), reciprocity, waivers, American Indian students at Morris, and so on. This is another way that RCM leads to clarity, because the discounts obtained by students in each unit are identified. It is also then possible to see that institutional policies affect the colleges very differently. In the case of reciprocity students, for example, Pharmacy and Law students are paying VERY low rates, compared to Minnesota students. They want to be able to tell colleges what they could receive and what they are not receiving, and the net tuition income they will have. (This will not be possible until the new student systems are in place, but they did not want to limit the plans by the systems currently available.)

One Committee member said that over time, the University will want to eliminate, or fund, discounts that have a disproportionate impact on units. For example, the discount for high ability minority students falls across the University. Ms. Eull said that if there are institutional waivers or discounts that are believed to be good for the University, but that affect units disproportionately, the discounts should be funded with state dollars.

Dr. Kvavik pointed out that the waiver for American Indian Students at Morris is required by law, but money should be made available to Morris as a result. He speculated that waivers (e.g., the differentiation between resident and non-resident) may disappear in the professional schools, and those units may price to the market.

Will there not be an incentive to increase the number of non-resident undergraduate students, asked one Committee member? There could be, Dr. Kvavik agreed. With most graduate students, there is no difference in tuition rate; the University collects very little non-resident graduate tuition. At the undergraduate level, the state will continue to subsidize education and will doubtless pressure the University to keep the Minnesota contingent larger than that of non-residents. Dr. Kvavik reported that nearly 40% of the freshman class are non-residents (most of whom are from reciprocity states, whom the law says must be treated as residents); 23% of the freshmen are from Wisconsin.

Does the University lose money on these students, asked one Committee member? The University loses money, but the state makes tax money; the reciprocity agreement is part of a larger and more complex package of agreements between Minnesota and Wisconsin with respect to taxes, residents, and so on. The agreement does NOT net out for the University, but it does for the state. When everyone sees how things are working, there could be a housecleaning.

Apropos the division of tuition revenue 75/25 between the teaching and the enrolling college, Dr. Kvavik said the professional schools want 100% of the revenue; they see CLA as the big winner because it will receive 25% of the revenue but not provide 25% worth of services. His view is that students will know where the money is going; that will create expectations about levels of service. There will also likely be more freshman-admitting colleges, because the incentives will be there, which might be better for students and lead them to colleges with a lower faculty-student ratio.

Ms. Jackson cautioned that there will be a need for an oversight mechanism, when a college wants to offer a class in order to receive the instructional revenue. Any new system will cause cultural and other changes, some of which might not be to the advantage of the University.

There are two areas that need regulation, Dr. Kvavik said: who can teach what, and how support units price their goods and services. ANY system requires regulatory mechanisms, he said; there will need to be a new set of checks on behavior if these tuition mechanisms are put in place.

2. ICR FUNDS

Discussion turned next to ICR funds. The proposal should not be controversial, Dr. Kvavik commented; it reflects largely what is now being done: 49% of the money goes to the administration and 51% to the units that generated it. That allocation is based on the funding of elements that are the foundation of the indirect costs.

The assumptions with respect to ICR are:

-- The portion of ICR revenue attributable to unit level administrative costs (about 51%) will be returned to the unit from which they were generated.

-- Units will only receive the amount of ICR revenue they actually generated.

-- Allocations will be based on an average of prior year activity.

-- Adjustments will be made to correct estimates to actual.

If a sponsoring organization pays a lower ICR rate, or provides no ICR funding, the University will not figure out what it should have been and provide the corresponding amounts.

Dr. Kvavik said, in response to a question, that he did not believe the distribution of ICR funds have been uneven or capricious. There are funds taken off the top to pay for ORTTA, animal care, the libraries, and so on, which are expenses and facilities for the whole. The rest of the money goes to the units on a formula basis. There is a myth, it was said, that the Medical School is short-changed on ICR funds, and that the money does not go back proportionately to the units that generate them. The problem is not only that the Medical School does not receive the correct amount of ICR funds, Dr. Kvavik commented, but that it benefits greatly from tuition cross-subsidies from CLA. RCM begins to clean that up; units keep the funds they earn and those cross-subsidies do not exist.

One Committee member noted that "unit" must be defined with respect to ICR. There are grants

funneled through one college but which include much research done in another college. The "unit" should not necessarily be the college that administers a grant. Dr. Kvavik said this should not be a problem, and that who will receive credit for the ICR funds can be stipulated; no one will enter into such a grant without that clarity, he observed. It is also the case that some administrative units generate ICR funds; the point, it was said, is that there be APPROPRIATE allocation.

What happens with units that do a lot of research for the state, asked one Committee member? Dr. Kvavik said one alternative is to direct charge as much as possible. The provost or dean may also recognize that the work is important, and underwrite the indirect costs with state funds. At some point, he said, the University may have to challenge the state on its failure to provide ICR funds. There was no argument in the past, but now that the state is making the University pay one-third of the debt service on new buildings, and has provided no new funds for operating buildings for a long time, the rationale for not providing ICR funds has disappeared.

3. FACILITIES

With respect to facilities, Dr. Kvavik said, the incentive is to use space more wisely. His favorite example is that he took a walk through a building on the East Bank, and discovered 20 offices that were being used to store old furniture--at the same time the provost was spending $500,000 to rent space off-campus. The department chair no doubt believed that if he gave up the space, he would never get it back, that maybe good days would return and he would need the space for faculty members, and that nobody would pay for the cost of removing the junk that was being stored.

The initial goal was to identify space costs, but that got to be too complicated. Now the plan is that regardless of where a unit has space, it will be charged $5 per square foot, and will be provided $5 per square foot from the Facilities Management budget to pay for it. If the units can do with less space, they can keep the money and use it elsewhere; if they need more space, they will have to find the money to pay for it.

There are rules about getting rid of space, Dr. Kvavik said. There must be a buyer for it (the space cannot be abandoned). The administration will not buy back all the closets; there must be a rationale for getting rid of the space. There will be incentives built into the capital budget for departments to get rid of space, if possible. In some cases, they may be granted priority (such as proposing to move from Nicholson to the space being vacated by the Carlson School of Management).

Asked if there was any formula for counting usable space, Dr. Kvavik said there is. Corridors will not count. As for space that is now useless, but unavoidable (an example was given in Folwell), the departments will receive the money for the square feet initially, so will not be harmed financially by having the space. Departments will only "win" or "lose" if the chose to contract or expand. The point is to get people to think about the use of space, Ms. Jackson said, and to think about NOT using it--units that cannot change certain spaces will not be penalized.

In addition to the charging mechanism, units will be provided all the information about the actual costs of their space, Dr. Kvavik said.

The actual cost per square foot, on average for the University, is $9.40; the use of the $5 figure is a

temporary solution, until actual costs can be charged. There is no way, now, to tell actual costs without getting into big arguments, so the RCM committee gave up on the idea. Departments will be charged $5, and the administration will make up the difference between the $5 and the actual costs. In the short run, there will be an incentive to close space; over the long term, the system will move to actual costs (with appropriate budget adjustments, increases in revenue, and costs adjusted to actual expenses).

The University now pays $74 million for facilities, Ms. Jackson pointed out; it costs $9.40 per square foot to run the University. Now the $5 figure will be used, but in the future, as units might demand more services, they must be willing to pay for them--and must know what their options are. This will be true beyond facilities, she said.

Discussion returned to facilities later in the meeting as well. One Committee member asked about the $5 charge and provision of $5 to units. Professor Morrison explained that Facilities Management spends $74 million, of which $50 million will come from the units; the rest will come from state and funds, so the Senior Vice President for Finance and Operations will have an incentive to control the total costs of Facilities Management--because she must allocate part of her state subsidy to Facilities Management. Until Facilities Management is fully covered by operating charges, there is probably less incentive to control costs. This is not a mechanism by which the colleges can control Facilities Management expenditures, but it gives the senior officer a vested interest in controlling them.

Ms. Nemitz observed that the University does not have the capability to adopt a more complex model, and said that as responsibilities shift, so will funds. Ms. Jackson emphasized the latter point; now the system is out of joint, she said. She receives all the O&M money for facilities and has all the responsibility. But that is not really true; she cannot shut down a building nor can she force people to turn off the lights. If she gives the $74 million to the colleges, can they make different decisions? Not really, because, for example, they cannot buy power from a different source. Colleges cannot be held responsible for costs they cannot control. So the idea is to move costs and benefits to the same level, to the advantage of the University.

One concern in all of this, Professor Morrison observed, is whether the colleges have the staff with training to control custodial costs. Will there have to be a custodial supervisor in each college? That might not be wise.

One Committee member said that while this discussion is about colleges, these changes will be carried to the department level. The colleges will charge departments for space. Ms. Jackson expressed doubt, saying it was extremely complex even to do this at the college level; it is doubtful the colleges would have the expertise to charge departments for space. It would be formula-driven, not on a spreadsheet, said another Committee member. If one department has 16 office and 8 faculty, and another department has eight offices and eight faculty, it may be that the college will do something.

4. THE STATE SUBSIDY

The transition year will be neutral with respect to revenues for units. Dr. Kvavik explained how the operating subsidy will be determined.

He also emphasized that the process will be evolutionary. At one institution, there are cost

algorithms for everything; departments are charged for a portion of their presidents' and regents' offices. The University will not do that.

One Committee member inquired about use of state funds to support programs that grow because they are worth a lot, and the possibility of taxing some units. Dr. Kvavik said a tax is not in the plan. Originally, there had been a proposal to charge a "franchise fee" of 1-2% on ALL revenues, which would generate about $50 - 60 million that could be used as a strategic investment pool for the University.

The Committee discussed the phases that would occur during the transition year (1997-98). Dr. Kvavik said that some units will be questioned, and agreed that there could be justification emerging for closing programs. He observed that there will always be programs that cost a lot of money but that the University will never close. The recommendation simply makes people realize the costs.

Would this not make it easier to go the legislature to request funding? Ms. Jackson agreed that the University could identify needs and point out that it cannot take funds from other programs. It is hard to believe, she said, that any program will generate SO much money that the University would say it could not invest the money in new faculty or facilities or programs.

His personal view, Dr. Kvavik said, is that if there is a VERY successful program, one that everyone wants to get into and that is making a lot of money, and someone were to say that his program does not need the state subsidy funding any more, he would argue that to remove the state funding would be contrary to the incentives that the proposal is intended to create (one of which is to generate revenues). Contrary to what members of the Board of Regents and others may say, the University cannot cut itself to health; it must generate new money and keep the people and facilities it needs for a world-class university. Ms. Jackson agreed, and said she did not know which programs need to grow, which could be growing, and which are costing more than they should.

One Committee member inquired whether the University's approach should be based on philosophy rather than dollars; Ms. Jackson responded that the two should be married. There have to be conscious decisions.

And when there are decisions, Dr. Kvavik added, people will know what the financial ramifications are. The program to recruit high-ability minority students, for example, has grown very fast; there is now $8-10 million in foregone revenue, and there is no cap on the program. Is that what is wanted? The current system does not put that question on the table; this would. It all comes down to making informed decisions, Ms. Jackson emphasized.

In terms of a unit making a lot of money, Dr. Kvavik said, he would rather impose a tax than remove the state subsidy.

Dr. Kvavik stressed that they want to try to solve the big problems in the first phase of the transition to RCM. When they did the classroom study, they discovered the campus was carrying 434 classrooms that were used 25% of the time; if the rooms were used 65%, then the number can be reduced from 464 to 312, and the dollars saved can be used to increase the quality of space. The difference is about $2 million per year.

This proposal is in many ways attractive, said one Committee member; is this proposal at the level of discussion or action? It is being brought to the Executive Council and the colleges for discussion; it will have to be approved in November in order for budget instructions to be prepared. Dr. Kvavik said they want an informed discussion and want reactions to what is good and what is bad; it will be up to the Executive Council to judge whether or not to go forward.

Professor Morrison said the Committee would take action on the proposal at its meeting next week. There are two issues that need to be addressed, he said: sub-optimization and the 75/25 ratio in the allocation of tuition revenues.

Ms. Jackson said she hoped everyone would view this as evolutionary, not revolutionary, and that they would realize it would not solve all problems overnight, and that it would not change the political system in which the University operates. There are no losers, said one Committee member; everyone breaks even. Instead of a unit receiving an allocation of $X million, the amount will be broken into its sources; tuition can change, units will have some control over facilities, and they will negotiate with the provosts only over the state subsidy, not their entire budget.

This will get central administration out of a lot of department business, Dr. Kvavik added; if deans do things right, they will have greater control over a larger portion of their budget. At some schools, the deans failed, financially, and built deficits, so they were replaced with deans who could manage and allow the school to grow back to health.

One has seen that around the University, commented one Committee member. Some are forgiven, some are subsidized. Those deans who face accidental or uncontrollable circumstances must be allowed to recover; those who overspend must find other employment. And there must be some control, so colleges don't decide to enter the movie business or some such activity, in order to generate money.

At the undergraduate level, students should have a lot of choice and be able to take advantage of a lot of programs; the colleges must NOT design curricula so that it is difficult for students to take courses outside the college, Dr. Kvavik said. There will have to be professional judgment about what a high-quality education is, "RCM be damned." One hopes that everyone will be professional enough to not accept behavior that undermines that quality.

The theory behind the Graduate School, at least in the past, was that it would maintain uniform standards across the University. Who maintains those standards in research and undergraduate education? There must be standards across the University, concluded one Committee member.

If the recommendations are adopted, the deans must be trained in financial management, one Committee member said; they will need to be more sophisticated than they have been. Dr. Kvavik agreed; he noted that they will also have to have better data. The new systems being purchased should provide sophisticated enough data so that the colleges can succeed. With this shifting down of responsibility and revenues, observed another Committee member, the tuition shortfalls will be in the colleges, central administration; the deans will have to clearly understand they are responsible for revenues and creating incentives. That may also require regulatory bodies and standards.

Other institutions have not suffered from the poor behavior one speculates may arise, Dr. Kvavik

said. There is much one can worry about that has not emerged as problems at other institutions.

To some extent, it was said, the incentives have been wrong under the present system as well; there are duplicative departments that should perhaps be merged. It must make sense under RCM for one college to buy a service from another, rather than build its own infrastructure.

Dr. Kvavik said he would welcome suggestions for improvements in the proposal. Professor Morrison thanked Dr. Kvavik and Mss. Eull and Nemitz, and adjourned the meeting at 5:00.

-- Gary Engstrand

University of Minnesota