Minutes[*]

**Senate Committee on Finance and Planning**
**Tuesday, October 15, 2013**
**3:00 – 5:00**
**238A Morrill Hall**

Present: Russell Luepker (chair), Gary Cohen, Dan Feeney, Jennifer Gunn, Karen Ho, Samantha Jensen, Lincoln Kallsen, Jill Merriam, Fred Morrison, Gwen Rudney, Terry Roe, Michael Rollefson, Ann Sather, Aks Zaheer

Absent: Mahogany Ellis, David Fisher, Laura Kalambokidis, Kara Kersteter, Paul Olin, Richard Pfutzenreuter, Jahon Rafian, Arturo Schultz, S. Charles Schulz, Michael Volna, Pamela Wheelock

Guests: Associate Vice President Julie Tonneson (Office of Budget and Finance)

[In these minutes: (1) cost benchmarking (mission, mission support, and administration); (2) simplifying fringe benefit accounting; (3) the impact of mandatory salary increases; (4) committee business]

## 1. Cost Benchmarking (Mission, Mission Support, and Administration)

Professor Luepker convened the meeting at 3:00 and welcomed Ms. Tonneson to present an analysis of cost definition and benchmarking.

Ms. Tonneson began by noting that the information she was bringing to the Committee today was also presented to the Board of Regents last week; this is a second-year snapshot of cost definitions and benchmarks. She reviewed the goals set out in 2012 for the analysis:

-- Develop a shared understanding of University spending
-- Promote a broader dialogue of our cost structure – where the money goes
-- Identify gaps in processes, data and information
-- Improve the University's ability to set its own spending benchmarks
-- Establish a repeatable methodology to monitor changes or patterns in spending over time.

The idea is to look at University spending in new and different ways, Ms. Tonneson said, and is useful as a tool within the University, not across institutions. It is a way "to benchmark ourselves," but she noted that there are not many conclusions one can draw with only two years of data. She emphasized that this analysis does not address the COST of mission, it only allocates costs across the three categories defined in the analysis.

The analysis puts expenditures into three different categories, Ms. Tonneson said; they are Direct Mission Delivery, Mission Support and Facilities, and Leadership and Oversight. In brief, those are "expenses of the 'doers' of the mission," "expenses to 'support" the delivery of mission activities," and the "expenses for the 'leadership, direction, control and management' of the mission." She said that expenditures in the three categories occur throughout the University (i.e., not all leadership and

[*] 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.

management is in Morrill Hall) and they have multiple funding sources. Student aid is in its own category, she pointed out.

Ms. Tonneson explained the methodology behind the attribution of expenses to each of the three categories. In the case of Direct Mission Delivery, for personnel expenses (salaries and fringe benefits) they used the University's 600+ job codes. For non-personnel costs they used function codes (instruction, research, public service) and included all subcontract and participant expenses. For Mission Support and Facilities, they included ALL facilities costs and, as with Direct Mission Delivery, used job codes and function codes for both Mission Support and Facilities and Leadership and Oversight. (The last category includes, for example, deans, department heads, chancellors, vice presidents, supervisors, etc.).

Ms. Tonneson reviewed the expenditures in each of the three categories for FY13. Direct Mission Delivery was $1.518 billion, Mission Support and Facilities was $999 million, and Leadership and Organization was $272 million. Committee members and Ms. Tonneson discussed several of the numbers and what was included (or not) in each. The Committee also reviewed data on the sources of funds for each of the three categories of expenditures (O&M/State Specials, Sponsored, and Other Non-sponsored).

The summary of the results for FY13 was this:

-- Total Spend Was $3.1 Billion (up $88m or 3% from FY12)

-- Approved Budget for FY13 Followed Several Years of Salary Freezes and Cuts – First Year in Several that Didn't Include Planned Reallocations

-- Costs of Compensation Represent Half of the Growth in Expense Yr. to Yr.

-- Leadership & Oversight as % of Total Spend Remained Unchanged at 8.8%

-- Using This Analysis as a Tool to Gain an Understanding of "Normal" Expenditure Shifts and Spending Patterns, and Identify Areas for Further Investigation

Professor Luepker inquired whether there was an increase in the Leadership and Oversight budget, inasmuch as it remained at 8.8% of the total budget. There was, Mr. Kallsen said, because if there is a compensation increase, that makes it likely that all categories will grow. But the University has adopted a mandate to reduce administrative costs, Professor Luepker pointed out. Ms. Tonneson pointed out that the FY13 budget was set well before the goals of administrative cost reductions were set—it was nearly two years ago.

Professor Zaheer asked what the Board of Regents' view of the analysis is. Ms. Tonneson said the Board will see the analysis once per year and see what is occurring at the institution. The analyses will be more useful at the unit level, where they will be able to see trends as well as identify what is "good" growth and what is "bad" growth. There can be year-to-year analyses and identification of changes that need investigation. In the budget instructions, units will be asked to focus reallocation plans on the Mission Support and Leadership and Oversight categories; the president wants funds to move from those categories to Direct Mission Delivery.

Professor Luepker surmised that at the unit level, the changes will be more striking, so each dean will have to have explanations for significant changes. He asked if the Committee would have the opportunity to review the disaggregated data for the units; Ms. Tonneson said that it would. She also

said, in response to a query from Professor Roe, that the provost will have the unit data when the compact hearings take place, although, she noted again, there will only be two years' worth.

Mr. Kallsen next reviewed some of the notable findings in each of the three categories of expenditures after comparing FY13 to FY12. Direct Mission Delivery, $1.518 billion or about 49.3% of total expenditures, includes faculty members, extension educators, health science professionals, scientists and lab technicians, and students in TA, RA, or fellowship roles. The total expenditures in this category were up $33 million, of which compensation increases constituted $17 million. "In addition to the 2.5% general wage increase, compensation changed for promotional increases and changes in the number of personnel hours; sponsored fund compensation decreased $7m due to a decline in grant activity in some areas; compensation for graduate fellows and post-docs increased." There were also changes in non-personnel expenditures related to state payments, subcontract expenses, and equipment purchases in the Medical School, for example. Overall, this category dropped from 49.7% to 49.3% of total institutional expenditures.

In Mission Support and Facilities, $999 million or about 32.5% of expenditures, Mr. Kallsen explained, they included all non-supervisory positions, such as "audit/finance/HR/info tech/legal and clerical support" as well as "Other specialized support" such as "advisors, librarians, curators, child care workers, coaches" and various other job codes. It also included all buildings and grounds workers, skilled trades, engineers, safety technicians, environmental health and safety workers" and prorated shares of supplies, services, etc., and a number of other expenses. Expenditures in this category increased about $42 million; compensation increases were $22 million of that total. The majority of the personnel increase is in academic-focused support (e.g., "Program growth in some areas leads to additional support [e.g. CSE growth in instruction and research = more academic support; Neutrino Lab requires shop foreman & lab mechanics-sponsored grants]"). Utilities expenses vary from year to year, as do non-recurring purchases and expenses in auxiliary units.

Leadership and Oversight, $272 million or about 8.8% of total expenditures, increased 3% from FY12, or $7.9 million. Of that, $4.9 million were compensation increases; the remainder was a variety of small items.

Student aid constituted 9.4% of total expenditures, Mr. Kallsen said.

Professor Morrison asked why there was an increase in the leadership category. Primarily because of personnel costs, Mr. Kallsen said. Professor Luepker asked where Sponsored Projects Administration (SPA) fits in the categories. They have different types of personnel, Mr. Kallsen explained, so some would be in Leadership and Oversight, some would be in Mission Support.

Mr. Kallsen reviewed briefly an expense summary for the system but said that the real value of these summaries will be at the unit level (campus, college, support units, vice presidents), each of which will receive its own expense summary.

Mr. Kallsen turned next to an overview of administrative cost reductions, cost definitions, and benchmarking analysis. The president has promised $15 million per year for six years in administrative cost reductions, which are proposed to occur in non-personnel costs in all three categories and in reductions in personnel costs in Mission Support and Facilities and in Leadership and Oversight. Strategies to achieve the $15 million annual reductions include these:

-- Redesign work processes to increase efficiency and effectiveness:
  - ESUP - reengineering/restructuring current processes, applying best practices

- Procurement – automation of vendor invoicing and payments

-- Redesign & reconfigure organizations to increase efficiency and effectiveness:
- Organizational design (spans, layers)
- Shared services design across the enterprise
- Targeted restructurings and attrition

-- Leveraging the institution's technology capabilities to drive efficiencies
- Automation and integration of travel expense processes

-- Targeted operational budget reductions (e.g., travel, printing, consulting, supplies, equipment)
-- Spending audits and controls; elimination of spending with low value-add.

The focus of the reductions will be on Leadership and Oversight, Mr. Kallsen said, but they will have an impact on all areas of the University. The reductions will be developed on an annual basis.

Finally, Mr. Kallsen highlighted the "key takeaways" from the FY13 analysis.

-- "Operational Excellence" activities in all 3 areas:
- Direct Mission Delivery
- Mission Support & Facilities
- Leadership & Oversight

-- Cost saving strategies and efficiency improvements will come from all areas of University operations
-- Evidence of specific efficiencies or savings will not be detected in this level of analysis – masked by program growth & service increases
-- Refining job families to better understand what people do will help analysis
-- Greatest value will be in monitoring data over time
-- Focus of the annual budget process

Professor Luepker asked if the $15 million per year figure includes inflation. It does not, Mr. Kallsen said. And it is not a percentage of anything, it is a number. Professor Roe said it can tricky to measure cuts that are not reallocation. Ms. Tonneson agreed, and said that next year most reductions would be made in order to cover compensation increases.

Professor Cohen congratulated Ms. Tonneson and Mr. Kallsen on the methodology, which he said will be useful for many purposes. Is what is implied, albeit not said, is that the analysis can be used in talking with legislative committees about administrative costs at the University? The University started the conversation with legislators last year, Ms. Tonneson said, and eventually they will reach the point when all will agree on what administrative cost reductions are. They will create a list of cuts, but that will be separate from this analysis. If the University talks about percentages of costs that are administrative, and reductions in those costs, will they be based on this analysis or some other numbers, Professor Cohen asked? Ms. Tonneson said that the University will try to use the same numbers, although it is possible some might use different ones. Mr. Kallsen said that at least broadly, the numbers will be consistent.

Professor Roe followed Professor Luepker's question: when the colleges receive their statements, can they be shared with the Committee? Ms. Tonneson said they can but there will be many pages of data and they'll have to give some thought to how best to do so.

Professor Luepker thanked Ms. Tonneson and Mr. Kallsen for their work and said it would be a big help for the Committee. He then asked how the job family classification project is going.

Mr. Kallsen noted that that is not their area of responsibility but commented that it will help the benchmarking analysis considerably because the more the job codes are right, the more accurate the analysis will be.

## 2. Simplifying Fringe Benefit Accounting

Ms. Tonneson next explained to the Committee the proposal to "redesign how we process fringe expense and encumbering transactions at the University." Professor Luepker reported that the origin of the discussion is that a former Faculty Consultative Committee chair had a discussion with P&A employees who were concerned about changes in the fringe benefit system.

Ms. Tonneson said that this is a complicated and detailed issue but emphasized that it has NOTHING to do with any employee's benefits. No one should be nervous about their benefits. The proposal has only to do with calculating how the employer (University units) pays fringe benefit costs. They have been working on the proposal for some time, since before the Enterprise Systems Upgrade Program, but the upgrade process would have required conscious decisions about modifying or retaining the current methodology in any event. The current system of charging fringe benefits is very complex; the proposal they have developed seeks to simplify how departments are charged. Conceptually it is no different from what is done now but there are changes in how the charges are calculated.

Ms. Tonneson posed a question and laid out answers.

How is the proposal different from the current fringe process?

The proposal would classify employees into one of five groups that represent typical benefits packages. For instance, there are two groups for full-time benefits – academic and non-academic - and there are three groups for partial benefits – grad students with (the GA) health insurance, post-docs and others with UPlan benefits, and another group for whom the University only needs to pay FICA, Medicare, worker's comp, and unemployment insurance. (She noted that at present there are 87 different fringe rates charged, depending on the characteristics of employees, which creates a very data-rich environment—that no one uses.)

Each of the five groups would receive its own fringe rate that accounts for the benefits the employee group is eligible for. All salary transactions would be charged this fringe rate. No adjustments would be made to the salary base used in the calculations based on an individual employee's actual participation in benefits.

The advantages of implementing the proposal are several, Ms. Tonneson explained.

- Transparency – fringe rates would be easily grasped and not have any exceptions
- Resource savings – productive time would not be lost in departments or in central creating complex fringe matrices or in analyzing issues where fringe charges do not meet expectations of department finance personnel
- Easier budgeting process for fringe expenses – no exceptions would have to be considered and the fringe budget would more accurately align with fringe actuals

-- Elimination of extensive system customizations – our current fringe process is all customized and requires maintenance and collaboration between HR, Payroll, Benefits, and Accounting analysts. The Simplify Fringe proposal would be implemented in the HRMS system and would require minimal maintenance, e.g., only updating rates once a year. It is still a modification to delivered PeopleSoft functionality, but much less complex than the current system configuration.

One question that arose had to do with part-time employees. Ms. Tonneson's handout explained the logic of the change with respect to them.

Why does the proposal expand the salary base on which the rates are based to include the salaries of employees that are ineligible for some fringe benefits – particularly salaries of part-time employees? The "pool" concept for fringe is hard for people to understand when faced with charges on salaries that are ineligible for the benefits. In addition, under today's methodology hiring managers sometimes make decisions about hiring part-time people because they are less expensive, and that advantage would be eliminated under this proposal.

-- In the early stages of proposal development, an analysis was completed on the option of including or excluding part-time salaries from the base on which the rates are calculated. The results of that analysis indicated that excluding the part-time salaries for the benefits for which they are ineligible would have a very negligible impact on the actual resulting fringe benefit rate (tenths of a percent – less than half a percent).

-- The goal of the project was to simplify the fringe process to reduce the number of fringe benefit rates and the complexity in the individual characteristics that would impact the rate charged on any particular salary (earnings codes, appointment status etc.). So the results of the analysis combined with the goal of the project led to the recommendation to use the full salary base – no exceptions.

-- The new proposal was made with the understanding that part-time employees will continue to be less expensive (they will still have part-time salaries) and that the practice related to fringe costs was the result of years of working with that methodology: under the new methodology the cost of non-academic employees will be significantly less due to the decrease in that rate – so there will be a new understanding of relative costs, and decisions might be made about hiring around that variable now. People gain an understanding of the policies and methods when they change, and react to new sets of incentives and disincentives.

It would be possible to modify the system to eliminate part-time salaries from the base of the fringe benefit calculation for those fringe benefits for which part-time employees are not eligible, Ms. Tonneson said, but doing so would naturally add some complexity.

Ms. Tonneson reviewed the rates that would attach to each of the five employee categories; she noted actual FY12 rates and the FY12 rates that would have been charged if the proposal had been in place. These are NOT the rates that would be implemented – only a restatement of FY12 under the two different methodologies.

| | Actual | Proposed |
|---|---|---|

| | | |
|---|---|---|
| Academic | 36.00 | 37.70 |
| Non-academic CS-LR (MSRS staff) | 41.30 | 31.20 |
| Trades, residents/fellows, others | 9.50 | 7.80 |
| Grad/prof with GA health | 18.50 | 19.50 |
| Undergrads/grads with no benefits | 0.00 | 0.00 |

The reason for the difference in the non-academic category is because the only significant difference in cost to the University between those employees and academic employees is the retirement plan. The non-academic fringe rates have been subsidizing the academic fringe rate under current practice (it is NOT the case that non-academic employees themselves have been subsidizing academic employees, it is the internal charging system the University uses for the University-based funds that creates the subsidy). This proposal eliminates that situation.

Professor Roe commented that in order to stretch funds on a research project, this system may create an incentive to use non-academic personnel. Ms. Tonneson agreed, but pointed out that since FY12 the rates have dropped so the differences would not be as dramatic—although the pattern would be the same.

Professor Feeney recalled that during the discussions about adopting the current budget model, the point was made that because of the constant charge rate for Social Security against salaries, lower salaries were cross-subsidized by the higher salaries within the institution. The underlying question is why there is no cap on social security charges once a salary reaches the annual Social Security contribution limit. Is the goal that higher salaried groups subsidize lower salaried groups because the rate against salary is constant without a cap, but the benefits are capped as are the individual contributions? It is not, Ms. Tonneson said; the goal is to identify cost differences across groups, they did not surface or look at this specific question during these cost pool discussions.

Professor Roe asked if the changes would affect student pay. They will not, Ms. Tonneson said. This is only a question of how to spread the employer portion of costs.

Professor Morrison asked why the University does not use the "plain vanilla" version. That is a policy question for the president and Vice President Brown, Ms. Tonneson said. She said she believes it is because the "direct charging" methodology (PeopleSoft-delivered) will make the hiring decision more transparent—such as hiring a person with a family versus hiring an individual—which they did not want to introduce in the system. Professor Morrison asked how much the proposed customization would cost. Ms. Tonneson said she did not know; the University's consultant advised that the "plain vanilla" option was not a good way to go for the University and is not a way that any higher-education institution has gone.

One big expense that the University is not planning for but that will come up is the under-funding of civil service retirement costs at the state level, Professor Morrison said. The Minnesota State Retirement System (MSRS) is not fully funded. Professor Ho asked whether it is news that personnel funds for non-academic staff are funding academic retirement funds; it is not, Ms. Tonneson said, and she emphasized that it is not employees who are subsidizing the retirement funds, it is just a function of the calculations used to distribute the employer costs of fringe benefits to departments. Which highlights the view that the non-academic retirement plan is not as good as the one for academics, Professor Ho said.

They are different, Ms. Tonneson said, and hold different costs for the institution. Professor Morrison said that the academic retirement plan is fully funded; MSRS is mostly funded, and presumably there will be money there eventually. Professor Luepker observed that the academic retirement plan is fully funded because it is a defined contribution plan not a defined benefit plan, so it must be. A defined contribution plan is subject to the market and benefits are not guaranteed.

Professor Luepker responded to Professor Feeney's question about subsidies; he said that departmental fringe charges on high-salaried people have been subsidizing the Social Security pool by paying the full fringe-benefit rate even though there is a federal cap on payments based on income. He noted a study a number of years ago of the Art department that reported that it had a large number of part-time adjunct faculty, so departments with many part time employees could be hit hard by these changes.

Ms. Tonneson reviewed a table of data modeling the impact of the changes by fund group; it showed some fairly significant gains and losses, varying with the unit, but she emphasized that the numbers are not what units will actually experience—they are a statement of what would have been different in FY12 under the two methodologies. Implementation in FY15 will result in less significant variances because fringe rates have decreased since FY12. In addition, in cases where there is a significant impact, they will propose mitigation for the O&M/unrestricted funds so that the change will be as close to budget-neutral as possible (they cannot make such accommodations with restricted or sponsored funds).

The plan will be implemented in FY15 if it is a "go," Ms. Tonneson reported.

Professor Gunn asked how the change will affect job descriptions, hiring, and seeking postdocs. Ms. Tonneson said the organization responds to incentives and she believes departments may choose to hire nonacademic employees, rather than academic employees where they have a choice. The Medical School already has a large number of non-academic employees, and there is a large number of part-time employees in Facilities Management, Information Technology, the Medical School, Public Health, and Veterinary Medicine. The change will not hurt those units, but at the individual level, units may decide to hire non-academic employees because they will be cheaper. Mr. Rollefson predicted that use of the "scientist" category in civil service could increase dramatically. Ms. Tonneson said that Human Resources is satisfied with the proposal and believes the advantages will exceed any potential negative impacts.

## 3. The Impact of Mandatory Salary Increases

Professor Luepker turned once again to Ms. Tonneson to respond to a question that Professor Morrison had originally raised, about the impact of mandatory salary increases and how the FY15 2.5% salary and fringe benefit increase would be funded.

Ms. Tonneson pointed out that there is no "pool" of money to allocate beyond the state funds. At present they calculate (e.g., for a college) additional tuition revenues and take into account the state appropriation increase for tuition relief, calculate what portion of these funds go to each college, identify reallocation targets, and then compare those data with the anticipated college costs (cost pools, compensation, investments, etc.). For support units, which do not receive tuition revenues or state funds, their only source of money is reallocation; they will look at compensation increases and reallocation to

see if the latter covers the former. If not, the administration must decide whether to add funds to the unit or implement further cuts.

The end game is the same on the college side, Professor Morrison observed. Ms. Tonneson agreed but added that there are more "tools" available for the colleges. Professor Morrison said that a college could go through the process and still end up with a large reduction. Ms. Tonneson agreed but said the administration looks across units and tries to make allocations based on priorities. Some colleges could come out with a net positive result, others with a negative result.

Professor Roe asked if the same percentage increase in compensation will be delivered across units. Ms. Tonneson said the administration assumes a 2.5% increase; a unit could decide to provide more in select cases. Does the process allow deviation below the University-wide average, Professor Roe inquired? It generally does not, Ms. Tonneson said, and the central officers rarely grant permission to deliver less than the average.

Professor Cohen said he believes the question came up when Vice President Pfutzenreuter presented the FY15 budget framework. There were new state funds for FY14 but not for FY15. He said that Ms. Tonneson's description of the process applies to FY14 as well as FY15. Ms. Tonneson concurred. She said the University originally planned to cut more recurring spending in the FY14 budget in order to save money for FY15, because they expected to see a significant increase in fringe-benefit costs. The approved FY14 budget did not set aside those planned funds for FY15, but it is also the case that there will not be a big increase in FY15 fringe costs, either. Cost estimates change as they get closer to the budget year. The University must still reallocate $25 million in FY15 to pay for compensation increases, inflationary costs, and a small number of academic investments, however, even with an appropriations increase.

Professor Morrison asked what the college reallocation targets are; they are 1.5%, Ms. Tonneson said. Colleges will have to rely on O&M funds (appropriation and tuition increases where applicable) plus reallocation to fund salary increases, Professor Morrison said, so most of them will be struggling.

Professor Feeney asked what base is used to calculate the amount for compensation increased and if it is separate from clinic income and so on. They calculate estimated cost increases on the total compensation budget of a college but do not count practice plans, Ms. Tonneson said. The budget framework just described focuses on the O&M/Tuition/State Special portion of compensation costs, however. So for the Medical School, Professor Feeney said, the 2.5% compensation increase is based on the O&M portion of funds and the rest is free market. Ms. Tonneson said the Medical School, and all other units, have a process for dealing with non-O&M compensation increases.

Professor Luepker thanked Ms. Tonneson for the explanation and for her reports at this meeting.

## 4. Committee Business

Professor Luepker said that the draft statements on student indebtedness and on the budget process will come back in the future, and in the meantime Vice Provost and Dean Kohlstedt will join the Committee to talk about graduate student indebtedness (where there are also problems).

Professor Cohen asked if there has been any development in the impact of the change in deductions in the UPlan and University savings. Professor Morrison said there has been no change in the University's proposal; it has agreed to the distribution of the savings on a one-time basis and after that it will retain the dollars, beginning in FY15. There has been no remediation proposed for future years.

Professor Luepker said this item would remain on the agenda; he then adjourned the meeting at 4:45.

-- Gary Engstrand

University of Minnesota