Minutes*

Senate Committee on Finance and Planning
Tuesday, August 9, 2005
2:00 – 4:00
238A Morrill Hall

Present: Fred Morrison (chair), Rose Blixt, Charles Campbell, Steve Fitzgerald, Lincoln Kallsen, Thomas Klein, Joseph Konstan, Michael Korth, Judith Martin, Kathleen O'Brien, Kathryn Olson, Richard Pfutzenreuter, Justin Revenaugh, Karen Seashore, Charles Speaks, Alfred Sullivan, Kate VandenBosch, Susan Van Voorhis, Michael Volna

Absent: none counted for a summer meeting

Guests: Mark Bohnhorst (Office of the General Counsel)

Others: Michele Gross (Office of the Controller); Jon Steadland (Office of the Board of Regents); Julie Tonneson (Office of Budget and Finance)

[In these minutes: (1) update on the new financial system; (2) Regents' investment and social concerns policy; (3) new budget model]

1. Update on the New Financial System

Professor Morrison convened the meeting at 2:00, introduced himself as the new chair, and called for a round of introductions. He then turned to Mr. Volna to provide the Committee with an update on the implementation of the new financial system.

Mr. Volna distributed copies of a set of PowerPoint slides and a table with financial data. He recalled that he last reported to the Committee in February, 2005 and observed that work on the project has been going on since the mid-1990s. He summarized the effort by noting that the new financial system is "critical to support the University's mission," that it will provide "better functionality for departmental and central users," that the first phase of implementation has gone extremely well, and that the readiness is high. Mr. Volna reviewed the history of the effort since January 2004, pointed out that the grants management systems enhancements will be managed and funded separately, noted that the Phase One "Trail Blazing" project was budgeted at $2.7 million from existing funds, and explained the key outcomes. They spent $2.5 million of the $2.7 million budgeted for Phase One.

Following completion of Phase One ("Trail Blazing"), they are moving to Phase Two, full implementation. The guiding principles are that implementation will emphasize internal resources, not consultants; that "functionality and system infrastructure supporting sponsored research" will be given a high priority; that costs of retrofits and interfaces to other systems will be included in the cost; and that related and follow-on projects are not included (these will require independent justification and will be managed and funded as separate projects).

* 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 represents the views of, nor are they binding on, the Senate or Assembly, the Administration, or the Board of Regents.

The total budget for Phase Two, implementation, is $28.6 million, over 2½ years. Phase Two began this month (August, 2005); the "go-live" date is July 1, 2007. The approach to implementation will include project teams with representatives from academic and business process units, business analysts, and technical specialists; it will change policy and procedure before modifying the system, where possible; it will continue judicious use of consultants for specific knowledge; and will provide "a strong project methodology to ensure quality outcomes." Mr. Volna emphasized the point about changing policy and procedures rather than trying to change the systems, and added that they need to be sure the system can't do something before trying to change it. Ms. Olson asked if employees pulled from departments will be paid their salaries from project funds. Mr. Volna said it will pay whatever was agreed, including picking up salaries; although Mr. Pfutzenreuter said that it will not simply give money to departments that do not hire replacements but instead simply spread the work among remaining staff. They will pay the real costs to a department, Mr. Volna agreed.

Professor Morrison said that the biggest risk to the project was not hiring consultants and relying on volunteers in the University. With CUFS, however, the consultants came and left and there was no expertise left on campus. While the decision to use University employees was made before the strategic planning process began, now there will be a lot of competition for employee time; he said he was worried about added costs that might be incurred as a result. Mr. Volna agreed that they had decided early to go with internal University resources and there were a lot of people involved in Phase One. Now, however, they are finding it hard to get people in the units to help with Phase Two. They have several options: spend the money and bring in consultants again, use central rather than departmental staff, or eliminate consultation and implement the system based on what they know now. Mr. Volna said they don't like any of those options but will need to do something because they do not want to delay implementation of the new financial system for another year—and they do not want to spend a lot of money on consultants.

What is their fall-back position, Professor Konstan asked? Implementation should not be delayed because departments are not volunteering people. Is there a need for deans or others to tell departments they should help out? He urged that Mr. Volna and his colleagues not give up on a user-centered design. Mr. Volna said he did not want to say that departments are not pulling their fair share; he recognized that there is a lot going on in departments, especially with strategic planning, and employees have a lot to do. Mr. Pfutzenreuter said that if the Committee, however, were to emphasize the importance of helping with implementation of the new financial system, he would take such a sentiment to the President. The next two weeks are critical, Mr. Volna said, and they are telling people they will proceed without consultation if they must. Mr. Klein said that everyone faces the same problems; this is the issue of the commons. He suggested publishing a list of those who are participating and letting those who are not again be invited to join the effort and be reminded that others are already contributing.

There is a benefit to the unit to having someone work on the project, Professor Campbell observed; the person learns the system inside out. Mr. Volna agreed; people coming off work on the project will be very valuable to the institution because they know the system.

Mr. Volna said that when the system goes live, access to it will no longer be granted based simply on attendance at training; "a successful assessment of financial competency will be required prior to access." Prospective users may, however, test out of training. It will not be necessary to take courses or instruction, although most people will need to do so; those who have worked on the project will most likely be able to test out. But access to the system will not be based on seat time in a course.

Professor Konstan inquired how high the level of engagement in the change is at the University. He recalled that the President of the United States issued a directive to get rid of federal tracking of frequent flyer miles. The University is following state law on the matter, but as he reads the law, the

President (of the University) could declare frequent flyer miles compensation for employee time away. Most of the decisions about the new financial system will not be at the presidential level, Mr. Volna said; the Executive Steering Committee for the project includes the senior vice presidents as well as Vice Presidents O'Brien, Mulcahy, Muscoplat, and Pfutzenreuter. They will develop recommendations and take them to unit financial officers for review. As for frequent flyer miles, he said, this is a matter of state law and they rely on the Office of the General Counsel to determine the University's flexibility.

In terms of potential risks to the success of the project, a "fit/gaps" analysis may reveal major functional gaps, there could be problems with interdependency of PeopleSoft and other systems, there are other complementary projects that must be integrated with the new financial system (student and human resources upgrades, the position management project), and there will be competition for resources from other projects.

Professor Konstan reported that he had participated in a session about the chart of accounts, which he found very useful. Many, however, did not like some part of the chart of accounts and said it needed to be fixed; is that process underway? Mr. Volna replied that the process did contemplate the possibility of having to change aspects of the chart of accounts as the project proceeded. They looked at three different alternatives for the chart of accounts; the one they chose met 88-92% of requirements. If they find things that do not work, they will be open to making changes—they will not make them lightly, but will do so if there is a need.

Professor Konstan offered a resolution concerning participation in the project; Mr. Klein offered an addition. The Committee (with one nay vote) approved the resolution:

> The Senate Committee on Finance and Planning is pleased with the Phase Two plans for the financial system replacement project, but is extremely concerned that a lack of unit-level participants threatens to undermine the quality of a system that is key to our research mission and operations.
>
> While we recognize that some units may feel that their benefit for participation does not justify the effort involved, we see this as a classic public goods problem—one where rational local decision-making can lead to results detrimental to all.
>
> Accordingly, we strongly urge the President to act quickly to encourage greater unit-level participation, through whatever appropriate means necessary. We also ask that the Executive Steering Committee for the project provide a report that summarizes the time commitment by unit.

Vice President O'Brien said that they do look at the time commitments by unit. Mr. Klein commented that it is important that others BE AWARE that the Executive Steering Committee is doing so.

Professor Martin inquired if there is a way to identify recently-retired employees who could work on the project. Mr. Volna said they looked at that possibility, but Human Resources is nervous about people working when they have chosen a retirement incentive.

Professor Seashore said she was glad to see that so much progress has been made to solve a lot of problems that are annoying even to faculty, but one glitch could cause a lot of stress: the inability to work with external financial organizations. They hold much of the University's money and there could be a problem with cash flow. Mr. Volna pointed out that this problem ONLY affects asset management, not the entire University. They have the University's and PeopleSoft's best people working on the problem and he said he was confident it would be fixed. What is the worst case outcome if the system does not work, Professor Seashore asked? That they continue to have to record transactions manually, Mr. Pfutzenreuter said. They will be no worse off than if the system had not been installed, Mr. Volna said.

Professor Morrison thanked Mr. Volna for the report.

2. Investment Social Concerns

Professor Morrison turned next to Mr. Pfutzenreuter to begin a discussion of the Regents' Policy on Investment Social Concerns.

Mr. Pfutzenreuter explained that this policy, and the Targeted Group Business policy, were the last two to go through a complete re-write of Board financial policies. The Investment Social Concerns policy will go to the Regents in September; the other one not until next winter.

Mr. Bohnhorst, from the Office of the General Counsel, reported that the policy went through the normal Board review process. Most of the changes made were to bring it into compliance with the Delegation of Authority policy or they were stylistic. The Office of the General Counsel is involved because the law has evolved in the last ten years. It is now unconstitutional for a state institution to have investments that are contrary to United States foreign policy, so language to accommodate that change has been inserted.

Professor Morrison said that the changes to the policy are very modest, almost technical. Professor Konstan agreed but observed that when a policy recommendation from the Committee on Social Concerns about restrictive investments is made, it is typically brought to this Committee for a balanced view. That does not seem to be the case here; is that because of the context? Professor Martin said that in the past the recommendations began with the Social Concerns committee; in this case, the recommendations were taken from the administration to that committee and it had no objections.

Professor Morrison suggested that the minutes reflect the fact that the Committee acquiesced to the proposed changes.

3. Budget Model

Professor Morrison began by remarking that some might find the next presentation too elementary, some might find it too complicated, and no one will see it as just right. Some bring a great deal of background, because they have worked on it; others will come to it new. He turned to Mr. Pfutzenreuter.

Mr. Pfutzenreuter introduced Julie Tonneson, from his office, who has done much of the work on the budget model. He distributed a handout and reviewed briefly the history of the discussions thus far, and then turned to the Working Principles that have guided the discussion:

> **1) Mission and Goals** – Model should encourage behaviors that support the University’s mission and goal to be one of the top three public research Universities in the world and the actions and strategies necessary to achieve that goal. Specific attention should be given to supporting efforts at crossing disciplinary and collegiate boundaries in working toward that goal.

2) Transparency – Model should make budget decisions related to subsidies, investments, reallocations, etc., transparent and acknowledge that no units are "tubs-on-their-own-bottoms".

3) Efficiency/Cost Control – Model should optimize the use of the University's physical, financial and technological resources; encourage excellence, service and continuous improvement; and provide clear incentives for member of the University community to control costs.

4) Revenue Enhancement – Model should provide incentives where appropriate to enhance revenues.

5) Simplicity – Model should be as simple as possible to understand and administer.

6) Predictability – Model should result in predictable rules, consistent application of policies and clear outcomes.

7) Adaptability – Model should be responsive to external "shocks".

8) Central Investment – Model should support the ability of the President to "steer the ship" through reallocations and central investments.

9) Information Rich – Model should foster an all-funds discussion using detailed information related to true costs and service levels and provide good information to support fact-based decision making at all levels of the University.

10) Implementation – Model should be as easy to implement as possible.

11) Risk – The model should place the management of financial risk at the level of the institution that can best control the contributing factors and act to address them.

They looked at several budget models, Mr. Pfutzenreuter said, and focused on one labeled as "Earned Income/Full Cost." He recalled that Professor Morrison had correctly described this model as attributing costs in place of Internal Revenue Sharing; the model would get rid of the internal IRS tax, would attribute costs, and would change revenue allocations only a little. The Committee reviewed a chart with boxes and arrows indicating the flow of revenues.

In terms of allocation of costs, central costs (which include facilities management, debt service, libraries, the Vice President for Research office, information technology, student services, and the administrative service units (including central offices) will be attributed to all academic units/coordinate campuses. They spent a lot of time deciding the best way to allocate costs, Mr. Pfutzenreuter said. The consensus was that tuition attribution should not be changed (continue to be split 75/25 between colleges) and the University Fee should be attributed to the college, that all indirect cost recoveries should go to the units, that unit-earned revenue should stay in the unit (as is the case at present). The President would retain the state appropriation for annual allocation to the academic units (although State Special appropriations would be spent as required by law). There are several potential bases for attribution of costs: square foot (metered), square foot, consumption (utilities), number of students/faculty, sponsored research expenditures, number of students/faculty/staff, number of students, and total expenditures.

Professor Martin reflected that a lot of discussions have emphasized that there has not been enough central administrative money to do what central administration needs to do. This model appears to redirect even more central funds to the units. Will a shortage of central funds be a continuing problem? They are talking about that, Mr. Pfutzenreuter said. In the case of revenues for academic compact investments, for example, there could be a fixed percent of unit revenue or expense (a small form of the IRS), or there could be funds taken off the stop of the state appropriation before it is distributed to units. They have focused mostly on costs thus far, he said.

Professor Seashore pointed out that institutions are seeing a shift in state subsidies to higher education. Have they tested what will happen if the state appropriation goes down—which is where the

President obtains his money? Mr. Pfutzenreuter said that none of the state fund will go to central units. Central units will be funded on the basis of attribution of costs. There will be no allocations to colleges and (for example) to Facilities Management; there will be a charge to the college.

Professor Speaks asked when it would be appropriate to take a fiscal year and run the model to see the extent to which the model satisfies the working principles and does what the University wants. Mr. Pfutzenreuter said he did not know what the University wants; as for running the model, they expect to be able to do so in October.

There are two critical numbers if the model is to adhere to the principles, Professor Konstan said: the state subsidy and the "franchise fee" (smaller form of the IRS). From everything that is being said, the fee will be small. If so, then units really are tubs on their own bottom—and as long as they can stay afloat, they can continue to use the land and reputation of the University. A revenue-generating, low-quality unit could continue and there would be no brakes on them. He said he was encouraged by the language in the first principle about crossing disciplinary and collegiate boundaries but how will the University encourage quality? The President has few new funds and those he does have will need to go to units that cannot afford the compact tax or franchise fee. If the President can take 10% of the funds and steer them toward quality, the model can work; if he only has 1%, the President will have abdicated his responsibility to units that can generate money.

Professor Campbell agreed with Professor Konstan but pointed out that the President can decide to de-emphasize programs, and assuming a stable budget, he can move money.

Professor Seashore said there are two principles in conflict that the budget model cannot resolve. One is that there should be long-term investments that favor quality. The other is that the University wants entrepreneurial faculty dreaming up new things, some of which have a dollar value attached; it is not always possible to tell which of the new things will have that value. The budget model can't address that problem except that it can help prevent the University from being skewed wildly in favor of one or the other. No budget model will substitute for leadership, Mr. Pfutzenreuter observed.

Professor VandenBosch asked about the current percentage of University subsidy to units and whether some units do not rely on a subsidy. Mr. Pfutzenreuter said that indeed some units do not rely on a subsidy (e.g., the Carlson School, Law, Public Health); overall, the subsidy is about 30% across the University. 30% is a big lever for the President, Professor VandenBosch observed. There are three levers, Mr. Pfutzenreuter said: the state appropriation (O&M funds), any small version of the IRS, and the costs that are charged to the units. He pointed out that the University cannot achieve its goal of being among the top three public universities in the world without incurring some costs (such as libraries, student systems, etc.). The President can increase investments in these areas and thus increase the charges to units.

Ms. Olson recalled that Mr. Pfutzenreuter said the current IRS is about 8.5% per year. She asked if he had any idea what the allocated costs would be. The change is expected to be revenue-neutral, Mr. Pfutzenreuter said; at present the IRS generates about $90 million per year. Professor Morrison said the allocated costs would be much higher than the IRS; it will be an across-the system application of an indirect cost recovery system and could be at the 40-50% level. That would, for example, reflect the funds that are currently allocated directly to Facilities Management—the money will now be directed to the colleges and they in turn will be charged.

It is not irrational to charge units if the charge is for items they can manage (e.g., turning off lights, etc.). But it is possible to hamper good leadership with the budget model. The President does not have complete discretion with the O&M funds; it would help to know the percent of those funds he could move around without putting units into a negative balance. It may be necessary to exempt start-up activities for a period, and that can be transparent.

Mr. Pfutzenreuter reported that the budget model committee has developed recommendations concerning allocation of costs for Facilities Management, debt, the Office of Information Technology, and administrative service units; it has pending recommendations for research, the libraries, and for student services. He reviewed the core businesses of Facilities Management (building services, maintenance, energy management, water/sewer, land care/grounds, and the Building Systems Automation Center): these are the activities for which it is allocated funds. The committee recommends two ways to allocate Facilities Management costs: (1) charges allocated by assignable square feet (building services—custodial, waste, recycling—maintenance, land care/grounds, water sewer, and repairs/replacement; and (2) charges allocate by consumption (energy—steam, chilled water, electricity). These charges would be at the college/campus level. The items in (1) are not suitable to charge by consumption so they propose to charge them by assignable square feet.

Professor Campbell cautioned that it was not completely accurate to say that the budget model committee had made these recommendations because no votes have been taken. Mr. Pfutzenreuter agreed that these are PRELIMINARY recommendations. He said he did not know if the committee would take votes.

How will they address the issue that space is not of the same quality around the University and that some units cannot control energy use because the buildings are inefficient, Professor VandenBosch asked? It does not seem fair that new-building occupants pay the same as units in 50-year-old buildings. Vice President O'Brien reported that they have modeled the charges in detail and that there are no material differences across the University. The work it would take to capture the small distinctions would not justify the cost. Mr. Pfutzenreuter observed that older buildings are usually cheaper to operate than new ones. If the University were to level charges exactly, Professor Morrison said, it would have to hire a lot more accountants and assessors; it is a question of balance. Mr. Klein said he was reminded of President Lyndon Johnson's comment about a piece of legislation: it is equally unfair to everyone.

If units are assessed on the basis of square feet, Professor VandenBosch continued, and the building does not work properly, there will be less tolerance for things that do not work. At the same time, the University cannot fix everything. There will be complications from this change.

Professor Campbell said he has to remind himself constantly that the process will start with making each unit whole; it is what happens after that that matters. He said he hoped that the rates for new space will reflect quality. With fuel cost increases, and the possibility of an IRS-type tax, unit will have to handle expenses within their own budgets. Or the President says that unit X needs more dollars and unit Y receives fewer, Mr. Pfutzenreuter added.

Mr. Fitzgerald asked how the costs for public spaces will be paid—restrooms and the like. Ms. Tonneson said that all space will be assigned to someone. Centrally-scheduled classrooms will be assigned to the Provost. The total building costs (including public spaces) billed to a unit will depend on its proportion of the assignable square feet in the building. Professor Konstan said that seems reasonable; the two things a unit can control are energy and assignable square feet. This system will put pressure on Vice President O'Brien, he said, because nothing in the department incentive structure will lead units to specify designs that are inexpensive to maintain--they will presumably focus only on size, energy use, and function. For example, expensive-to-maintain landscaping would cost the same as low-maintenance landscaping. University Services will need to provide guidelines or policies for new buildings so they are designed mindful of all long-term costs, not just those used as part of the cost allocation. Vice President O'Brien agreed there will be pressure points in a lot of places that they do not yet recognize. There may be an increase in demand for quality customer service because units are being billed for services. The change will put pressure on the quality of service and the value of what units pay for. She said she hoped that one incentive from the new system will be that people see the cost of space and do not keep seeking more. They see in University Services how much space the University has and realize that if one were designing the campus from scratch, it would not require 28 million square feet.

Will the square feet of a new football stadium be assigned to athletics, Professor Konstan asked? It will be, Mr. Pfutzenreuter said.

Mr. Pfutzenreuter returned to the preliminary cost allocation recommendations from the budget model committee. In the area of core technologies, there are a number of things that the Office of Information Technology (OIT) currently spends its money on (data network, email, calendar, various other applications, PeopleSoft/WebCT, etc., and student/faculty/staff support (help desk, Digital Media Center, etc.). These items will be charged out to units under the new budget model. Certain other OIT operations are already charged to units (telephones, voice mail, desk-top support, server management, etc.).

Professor Konstan said that a large number of units replicate services provided in the second set (those already charged out) because OIT cannot provide what the units need, such as help desks. If the change is made, will OIT fund these unit costs or reimburse the units? Heavy users are not consuming services from OIT, they are using their own. Help desks are currently part of what OIT funds; if a unit also has one, it find it more beneficial to give it up and perhaps gain in efficiency. But that will not support the mission of the unit, Professor Konstan said; the units provide the service themselves because they cannot get the support they need from OIT. Right now services are being offered in two places. That may continue, Mr. Pfutzenreuter said. That is not fair, Professor Konstan argued, because units are being charged for services they do not use. It is no more unfair than 0100 funds being paid out for the same thing, Professor Morrison said.

Vice President O'Brien said she appreciated the discussion about units and what they will get when they pay for services. They will try to ensure consistency in standards across the University and to eliminate duplication. If OIT tries to provide more services, for example, doing so would probably cost less than each unit providing the service.

Mr. Klein entreated the Committee not to look for solutions to leadership and management issues in the budget model. It will only provide information, about which people must then make decisions. It only sets the stage for more accuracy in discussions about costs. The key role the budget model can play is to place consistent information in full view of the entire organization. This allows people to understand how the money moves, what drives the financial decisions, and the arithmetic underneath the financial flows.

Vice President Pfutzenreuter then turned to the methods that can be used to allocate headcount, which can include an annual snapshot-in-time (fall 10th day for students, fall 9th pay period for employees, etc.). Professor Konstan asked if there is any evidence that top universities minimize headcount? If the goal is to be among the top three, the University does not want a system that encourages minimizing headcount. If a unit reduces the number of students, it reduces its revenue, Professor Morrison pointed out. But there is an incentive to reduce staff headcount, Professor Konstan countered, and anything that creates an incentive to minimize staff is not a direction the University should go. Mr. Klein said that decisions on staffing are not going to be driven by one variable. Clearly there several other factors in addition to the cost side issues that a department will take into consideration in determining the headcount needed. The University should not try to build into the budget model things that require integrated decisions by administrators.

Nor will units make rational decisions unless the data are smoothed out, Professor Seashore added. Budgets are usually stable, but in small units they can fluctuate. Why will the model only use one year's worth of data? Mr. Pfutzenreuter said they have discussed this issue—and he reminded the Committee that the unit of measure is the college, not departments. Professor Seashore said she has lived through irrational headcount discussions; there must be a mechanism to smooth them out.

Professor Speaks said that for information technology or the libraries he could see advantages and disadvantages to both headcount and user/use measures. What have peer institutions tried, what problems have they encountered, and what worked? Ms. Tonneson said she did not have an answer because they have not asked questions in such detail of colleagues at peer institutions. Headcount could be an odd measure if one does not use a service; usage is not good because the University does not want to create disincentives to using technology or the libraries. Professor Campbell reported that University Librarian Wendy Lougee discussed with the budget model committee the experiences of the University of Michigan with these measures for cost allocation for libraries. He said that usage "was a disaster" and they were not happy with headcount; the result was that libraries are fully funded centrally. Ms. Tonneson said that universities have backed away from allocating ALL costs, but they do allocate some. If the only alternatives for information technology and libraries are headcount or usage, they are both unattractive and perhaps central funding is the answer, Professor Speaks said. Mr. Pfutzenreuter reported that Mr. Cawley, who heads OIT, advocates a headcount system for information technology because his costs are driven by the number of people at the University. Mr. Kallsen observed that given the inflation in library costs, central funding will require taking money from academic units.

Mr. Pfutzenreuter next identified the administrative service units that are in the cost pool for which colleges will be assessed. There are two categories, those with a system reach and those that are only for the Twin Cities. The system offices are audits, Board of Regents, Budget and Finance (excluding Bursar), Capital Planning and Project Management, Controller's Office (excluding Sponsored Financial Reporting), General Counsel, Human Resources, President's Office, BSAC, Public Safety (excluding Police), Senior Vice President for Academic Affairs and Provost (Senior Vice President office only), Senior Vice President for the Health Sciences, Senior Vice President for System Administration (excluding centers), University Health and Safety, University Relations (will be reviewed to determine if some or all should be considered Twin Cities only), and Vice President for University Services (vice presidential office only). The initial proposal for Twin Cities service units in the pool for charging Twin Cities academic units are Bursar, Police, University Services, Printing, and University Stores.

What about the Graduate School, Professor Konstan asked? That is viewed as a student services unit and not included here, Ms. Tonneson said.

Mr. Pfutzenreuter reviewed briefly how the costs of the system units would be assessed (as a prorated share of total expenditures for each unit); the same method would be used for Twin Cities administrative units. Some units, however, do not "fit" in the cost pool; since the budget model committee was not responsible for reorganizing the University, it concluded it would treat these units like a cost center. They include athletics, ROTC, Weisman, Cancer Center, University Press, and a number of other centers and units. Mr. Pfutzenreuter agreed with Professor Martin's comment that the status of some of these units could be changed as the strategic planning process moves forward.

Mr. Pfutzenreuter then explained the cost allocation system for debt. The actual cost by building will be allocated to units (excluding general purpose classroom space). If a college gets a new building, it is allocated the debt costs. To the extent there are general purpose classrooms in the building, the cost will be shared by all academic units. This will be retroactive, but units will be given the money to pay the debt already incurred. If a unit pays off a debt, does it get to keep the money and have a windfall? They will not, Mr. Pfutzenreuter indicated.

Professor Martin asked about funding for classroom upgrades, which is behind what it should be. Mr. Fitzgerald noted that the classroom upgrade issue is no longer one of funding the technology upgrade installations, it is now one of sustaining the upgrades that we have accomplished with adequate recurring funding of operations and replacement costs. Mr. Pfutzenreuter said that when deans are considering whether to have departmental or centrally-scheduled classrooms (e.g., in a new building), they will see that it will cost them less to have centrally-scheduled classrooms.

The recommendations for revenue attribution are not significantly different from what is currently in place. All tuition will be attributed to the colleges; all ICR will also be attributed (once per term), and the University Fee will be attributed to colleges on the same basis as tuition.

Mr. Pfutzenreuter also drew the Committee's attention to "Notes on Allocation of the State Subsidy":

-- Annual decision by the President
-- Strategic decision each year used to implement University priorities: leadership to be held accountable for addressing priorities through the budget
-- Allocations made in support of unit level performance agreements, based on programmatic outcomes and financial management – decisions supported through unit level analysis
-- Budget process, information and formatting will all be consistent across units to support decision making
-- Total annual allocations cannot exceed the available state resources
-- Allocation decisions cannot force a unit into a deficit for the year, but can force discussions about alternate levers in revenues and cost allocation categories.

These are intended to provide guidance to the President, not a mandate, he said.

Professor Morrison said these seem risky; this is the present system, in a way. If there were a dramatic shift in a year, and the costs could be covered by the unit, the President could eliminate state funding for IT or CLA. The reality, however, is that budget changes are incremental or decremental, Mr. Pfutzenreuter pointed out.

Professor Konstan said he was uncomfortable with the last note; if a unit is low-quality and on the edge, it needs to be forced into discipline. Mr. Pfutzenreuter pointed out again that the analysis is at the college level—and he said emphatically that the University will not put a college into deficit; that would be irresponsible. The University could make a college cut costs, however, Mr. Kallsen observed, but if a unit has contractual obligations (e.g., tenure), the University must provide the funds. Even at present no org can be in deficit more than $15,000, Mr. Pfutzenreuter commented. Is the first note inconsistent with the tenure code, Professor Seashore asked, because it does not guarantee there will be funds where there are tenured faculty? Professor Martin responded that tenure is in the University so paid for across the University.

Mr. Pfutzenreuter reviewed finally the near-term agenda items and the fall schedule. He pointed out that the budget process for central units will have to be completed much earlier in the year than at present in order to determine the charges to the colleges—in order that the colleges can do their budget planning. The support units will probably have to have their budgets ready by January every year. Professor Campbell noted that budgets are now done biennially and there would need to be adjustments if decisions were made in January. Mr. Pfutzenreuter agreed.

Professor Morrison said he was concerned that if this is truly a model that passes through full costs, what mechanism will there be to control costs in central units? The units will have no costs because they pass everything on. What controls will be in place? Vice President Pfutzenreuter said the vice presidents with whom he has worked have been good stewards—and he watches expenditures. Vice President O'Brien said there are several responses to Professor Morrison's concern. One, the principles include transparency, which will mean more dialogue about what service units are receiving for their money. The support units have to justify their rates in the budget process. More importantly, for her, units will have to pay more attention to what services they are getting and what they are paying for them.

Professor Morrison said there are no arguments about the central budget because they are paid through a tax assessment. The question is how to decide the appropriate level of service from OIT, for custodial services, etc. (to which units can add if they wish). Is the appropriate level a collective decision of the deans or those who are paying—or a decision by the providers of the service? A service may look more valuable to the providers than to the consumers. Ms. O'Brien said that in the case of custodial services, for example, there is a national organization that sets standards and the University benchmarks its service levels with peers. There are professional standards that can be reviewed and choices made about levels of service. Who decides that level, Professor Morrison inquired? The consumer units must be engaged in the process, Ms. O'Brien said. In the end, the President will decide on the basis of recommendations from the executives and from consultation, Mr. Pfutzenreuter said. The executives are precisely the ones who are not paying anything, Professor Morrison responded; the consultation should be with the taxpayers.

Mr. Klein repeated his earlier observation that the budget model sets the stage for consultation, with a set of facts (e.g., what custodial standards mean and cost). There needs to be a clear link between costs and what a unit gets for the money, and the unit has to have that information. In some places there are users budget committees, Professor Morrison said, which reviews the budgets of all charging units and make decisions about whether windows will be washed, etc. That could be an interesting role for this Committee, Mr. Klein commented. That also plays into the question about the flexibility units will have, Professor Campbell said; can they opt for a higher level of service and pay for it? Can they go down a level and pay less? Vice President O'Brien said there are administrative standards that a unit could not opt to go below. But could they opt up, Professor Morrison asked? That would depend on the service, Ms. O'Brien said.

It makes a big difference whether the review committee is a users group or a payers group, Professor Konstan said. A users group can be advocates for the service. The group has to be made up of people whose job is to balance needs. There also needs to be an option to outsource an activity because a unit can get it done more cheaply. If there are these kinds of checks and balances, the President can approve the budget. Vice President O'Brien later responded to Professor Konstan: she said that whoever is in her position or other administrative positions does not operate in a vacuum. They interact with deans, department heads, and directors regularly. Right now, however, not all is known about the issue of incentives and putting in systems; there is a need to work through the problems. 99.9% of the people in positions are trying to do the best job they can for the institution, not feather their own nests. Professor Morrison said he agreed 100%. The old Northwestern Bell wanted to provide really good telephone services, but it was not permitted to set its own rates. There was an outside group to look at the rates. She is in a monopoly situation, Professor Morrison said, similar to Northwestern Bell. Ms. O'Brien said it can readily be shown how much her units contributed to recent budget reductions and, she said, it will be helpful to have shared expectations on service standards, which they do not have now.

Professor Seashore said that ultimately the model is premised on colleges and deans providing the primary oversight. That makes sense because the University has a strong-dean system. But some deans are better financial managers than others, better leaders, some have more vision. A college that lacks a dean with these attributes could suffer. A lot of deans are people who were associate deans at other institutions, who come to Minnesota and have not a clue about financial matters. The system is not prepared to give the University deans who can handle these responsibilities. There needs to be a different way to staff deans' offices.

Professor Martin commented, apropos the principles, that no matter what they do, there are few motivations to change faculty behavior to become more efficient and save money. The "faculty culture" discussions portion of the strategic planning process need to address this issue.

Given that the schedule says the budget model recommendations are going to the President in October, Professor Martin added, will this Committee see the recommendations again before they go to the President? Professor Morrison said this topic would be on the agenda for the first meeting in October. Professor Campbell said he was concerned that the trial of the model would take place after the last meeting of the budget model committee. That is a bad idea, he said.

Mr. Pfutzenreuter commented that when the dean, department heads, and faculty want a new building or more students or more faculty, they will have all the elements they need to make a decision.

Professor Morrison adjourned the meeting at 4:15.

-- Gary Engstrand

University of Minnesota