UNIVERSITY OF MINNESOTA

Twin Cities Campus

Office of the Dean
College of Liberal Arts

215 Johnston Hall
101 Pleasant Street S.E.
Minneapolis, MN 55455

Fax: 612-624-6839

January 21, 2000

Mark G. Yudof, President
University of Minnesota
202 Morrill Hall

Dear President Yudof:

On behalf of the Budget Management Task Force, I am pleased to submit our final report.

The task force met regularly over the past eight months to address the questions you posed in your May 1999 charge, in which you asked us to "review and make recommendations with regard to possible improvements in the University's budgeting framework, and the organization and allocation of costs to address University-wide needs and obligations." As part of its work, the task force reviewed the University's budget and planning processes, examined financial data, discussed strategies used by other universities, and analyzed various approaches for improving the University's budgeting framework, revenue streams, and the allocation of costs. The task force consulted broadly with faculty, administrators, and staff throughout the University of Minnesota system to get their guidance on the critical questions you posed. Although the immediate fiscal challenges facing the University of Minnesota framed the work of the task force, the recommendations put forth in our report are designed to offer a broader, longer-term view and to provide principles and strategies to guide University budget planning and fiscal management now and into the future.

I know I speak for the entire task force when I say that we have appreciated this opportunity to serve the University. We learned a great deal about the University, its complex budget and planning processes, and the budget challenges that we confront as an institution. Each member brought considerable experience and expertise to the table, but each of us found our level of knowledge and understanding grew as our deliberations evolved.

A remarkable spirit prevailed throughout the task force discussions. Our work was a genuinely collaborative effort in which colleagues contributed not as deans, vice presidents, financial managers, or faculty, but as citizens of the University. The committee worked hard to formulate ideas and recommendations that would best serve the University in the long run. Every member of the committee contributed countless hours to the deliberations and helped craft and redraft sections of the report. We are proud of the collaborative spirit with which we worked together. We end our service with tremendous optimism for the University and for our capacity to work together to address challenging issues.

1851 150 YEARS 2001

We also learned a great deal from our discussions with faculty, staff, and administrators on each of the University of Minnesota campuses. We left those conversations impressed with how committed our community is to ensuring the excellence of the University and to serving our students and the people of Minnesota. There is a tremendous spirit on each campus and a real willingness on everyone's part to pitch in to ensure the strength and vitality of the University for years to come.

I also want you to know how grateful we are to Suzanne Bardouche and Julie Tonneson for their help in crafting sections of the report, gathering the data that informed our analysis, and checking and rechecking the facts contained in the final document. We are also grateful to Tom Cook for his efficient handling of the administrative chores associated with pulling together a group of this size on a regular basis. He found ways to overcome the seemingly endless set of scheduling conflicts that would otherwise have stood in our way.

The Report

Our report is essentially divided into two sections. The first nine pages are an introduction to our work and provide background on the University, its finances, its budget and planning processes, and the budget challenges facing the University. We wrote this section to share with the University community our understanding of the challenges the University confronts and the processes in place to address them. We think it is important that colleagues throughout the University understand the complexity and magnitude of these challenges.

The second half of the report (beginning on page 14) takes up in turn each of the five broad issues that you outlined for us in your May 1999 charge to the task force. Contained in each section are specific recommendations in response to the questions that you posed.

In our deliberations and in the report itself, we have sought to address two related but distinct budgetary problems: the gap between the University's obligations for FY00-01 and the disposable resources available to the central administration, and the persistent structural issues that regularly produce such gaps. As you will see, we have made recommendations on both fronts. We believe there are appropriate means available to resolve the immediate budget deficit and future such deficits, should they occur. At the same time, there are steps the University's senior leadership should take to right the structural imbalances that create this annual problem. We believe that both sets of recommendations are reasonable and will be useful in the work ahead.

The task force found that many features of the University's current budget and planning processes, including the compact process, work very well. To build upon these strengths, we recommend improvements in these processes, strategies to increase revenue and reduce costs, and principles for the internal allocation of resources. We outline broad principles to guide financial planning and budget management not just for this year or next, but well into the future.

To close the immediate budget gap, the task force recommends the use of four strategic levers: (1) Continue an overhead charge on all incremental programmatic legislative funds to cover the costs associated with implementing new programs. (2) Implement a single tax applied to all University units, based on an all-funds framework of non-sponsored resources, to meet shared University responsibilities. This tax is predictable, and allows individual units to exercise discretion in what funding sources to use to cover their portion of the tax. This tax clearly follows the principle of "shared responsibility" in that it distributes the responsibility to all units, regardless of their funding sources. (3) For FY00-01, continue the enterprise systems payroll tax, according to the terms already implemented. Starting in FY01-02, consider folding this tax into the single tax for FY01-02. Given the relatively short planning horizon for FY00-01, and given that units are expecting the enterprise tax to continue at the same level for FY00-01, maintaining predictability is important. (4) Make targeted reductions in activities that are ineffective, inefficient, or deemed to be of lower priority.

We ask that you share the task force report widely with the University community. We believe that broad understanding of the University's budget and planning process, the budget challenges the University faces, and the thinking that led to these recommendations will help our colleagues throughout the University to have a richer and more informed discussion of these issues.

Finally, we suggest that you establish mechanisms for regular consultation and communication about the implementation of these recommendations. For example, in six months' time we would urge a status report to the University community on the actions the administration has taken in response to this report.

Again, we are all grateful to have had the opportunity to serve the University in this way.

On behalf of the Budget Management Task Force,

Steven J. Rosenstone
Task Force Chair and
Dean, College of Liberal Arts

SJR:cj
Enclosure

Report of the Budget Management Task Force

University of Minnesota

January 21, 2000

Task Force Members:

Carl Adams, Professor, Carlson School of Management
Robert Bruininks, Executive Vice President and Provost
Charles Campbell, Professor, Institute of Technology
Frank Cerra, Senior Vice President for Health Sciences
Greg Fox, Vice Chancellor, Duluth
Stephen Gudeman, Professor, College of Liberal Arts
Katherine Johnston, Associate Vice President, Academic Health Center
Eric Kruse, Vice President for University Services
Fred Morrison, Professor, Law School
Richard Pfutzenreuter, Associate Vice President for Budget and Finance
Steven Rosenstone, Dean, College of Liberal Arts (Chair)
Gail Skinner-West, Interim Dean, College of Continuing Education
Marilyn Speedie, Dean, College of Pharmacy
Al Sullivan, Dean, College of Natural Resources

Task Force Staff:

Suzanne Bardouche, Chief Financial Officer, College of Liberal Arts
Tom Cook, Associate to the Dean, College of Liberal Arts
Julie Tonneson, Assistant Budget Director, Budget and Finance

Executive Summary

In May 1999, President Mark Yudof appointed a task force, to "review and make recommendations with regard to possible improvements in the University's budgeting framework, and the organization and allocation of costs to address University-wide needs and obligations." Over a period of eight months, the task force reviewed the University's budget and planning processes, examined financial data, discussed strategies used by other universities, and analyzed various approaches for improving the University's budgeting framework, revenue streams, and the allocation of costs. The task force consulted with faculty, administrators, and staff throughout the University of Minnesota system to get their guidance on the critical questions before the task force. Although the immediate fiscal challenges facing the University of Minnesota framed the work of the task force, the recommendations put forth are designed to offer a broader, longer-term view and to provide the principles and strategies that should be used to guide University budget planning and fiscal management now and into the future.

To carry out its mission of teaching, research, and public service, the University of Minnesota has developed into one of the most comprehensive and complex public research universities in the country with a total FY99-00 operating budget of $2 billion ($354 million of which is sponsored research).

The report provides a brief overview of the complex set of budget and planning processes at the University of Minnesota that occur within four distinct cycles—the biennial budget, the capital budget, the compact cycle, and the annual budget cycle—and provides a brief overview of how each process works.

Currently identified revenue streams—recurring funds provided by the State of Minnesota, tuition revenue, income from grants and contracts, royalties, and philanthropic support—are not adequate to cover the costs of higher education facing the University. This is partly an issue of the adequacy of overall resources and partly an issue of the internal allocation of resources. Simply, in recent years, the operating costs of the University have grown at higher rates than the revenues identified to support them.

In FY97-98, the University implemented the Incentives for Managed Growth (IMG) financial allocation framework that provided formulas to allocate tuition revenues and a portion of indirect cost recovery directly to the units that generate the revenues. Although IMG affects the allocation of only 19% of non-sponsored funding, it has decreased the *proportion* of total University revenue allocated by central administration from 58% in FY95-96 to 42% in FY99-00.

In FY99-00, the funding gap for costs residing with central administration was $32 million recurring; for FY00-01, it is estimated at $25 million recurring. Three sets of system-wide costs—compensation, facilities, and technology—account for about 85% of the shortfall. These costs—central to supporting the University's academic priorities—are likely to increase over the foreseeable future. Although IMG has focused attention on this budget gap, it is not solely an IMG-related problem, as budget gaps of comparable magnitude also occurred before IMG was implemented.

The task force puts forth three types of recommendations designed to set the University on a course that should, over time, provide adequate ongoing support for key University priorities, allow for new strategic academic investments, reduce fiscal uncertainty, enhance the match between priorities and spending, and make for more efficient use of scarce resources.

Process Improvements

Many features of the University's current budget and planning systems work very well, and the task force recommendations build upon those strengths. Recommendations for improvement include:

- More clearly articulate the principles that should guide the University's financial planning and budget management. These include shared responsibility, leadership, accountability, connectedness, consultation, an all-funds approach, periodic programmatic and financial reviews, and efficiency.
- Improve the University's various budget and planning processes to enhance their interconnectedness and make more explicit consideration of the opportunity costs and tradeoffs of various investment decisions.
- Enhance the consultative and communication processes by which deans, chancellors, faculty, and staff advise on the broad policies, principles, and strategic directions that inform the University's fiscal strategies.
- Improve forward-year financial planning to document and analyze the impact of future commitments and the specific plans for the resources to cover them.
- Improve risk management strategies to provide appropriate levels of protection against risk.

Strategies for Increasing Revenues and Reducing Costs

- All the traditional partners in the funding of the University of Minnesota must share responsibility for providing the incremental resources needed to address the University's priorities: there must be increased state and philanthropic support; increased tuition revenue; more grant and contract activity; and new revenues from technology transfer, patents, and royalties.
- Enhance the accountability of financial decision-makers (from unit chairs, heads, and directors to deans and vice-presidents).
- Increase the accountability of support units by monitoring the costs and quality of services and by setting performance standards.
- Create a "Best Practices Team" to identify strategies for achieving collective efficiencies.

Strategies for the Internal Allocation of Resources

- Implement criteria for deciding which costs are the responsibility of individual units and which costs should be a shared responsibility; implement criteria to guide decisions about whether specific costs should be distributed to the unit level rather than funded exclusively by central allocations.
- Establish a set of simple, fair, and transparent mechanisms that can be used to balance the budget; these mechanisms should be stable and predictable from year to year.
- Continue an overhead charge on all incremental programmatic legislative funds to cover the costs associated with implementing new programs.
- Implement a single tax applied to all University units, based on an all-funds framework of non-sponsored resources, to meet shared University responsibilities.
- Make targeted reductions in activities that are ineffective, inefficient, or deemed to be of lower priority.

Contents

Background

Charge to the Task Force

On May 27, 1999, University of Minnesota President Mark Yudof appointed the Budget Management Task Force, charging it to "review and make recommendations with regard to possible improvements in the University's budgeting framework, and the organization and allocation of costs to address University-wide needs and obligations." (See Appendix A to this report.) The president asked the task force to address five broad concerns

I. What revisions are needed to the University's budgeting framework and processes?

II. How should we conceptualize and organize the various costs, expenditures, and investments of the University?

III. How should the funding of common goods and core administrative activities be balanced with unit priorities? Under what circumstances should central administration and units (campus, colleges, etc.) share responsibility for all-University costs and investments?

IV. What governance strategies should be considered to evaluate costs, expenditures, and budgeting strategies in relationship to University-wide costs and investment needs and the costs and investment needs of the colleges and campuses?

V. What funding principles and budget strategies should be used to support current and anticipated obligations?

The Budget Management Task Force met nine times between June 4, 1999, and January 12, 2000, to review current University budget and planning processes, examine University financial data, discuss budgeting strategies used at other universities, and analyze alternative approaches for improving the University's budgeting framework and the organization and allocation of costs. During October and November 1999, the task force met with faculty, administrators, and staff throughout the University of Minnesota system to seek the University community's advice on the key issues before the task force (Appendix B).

Although the immediate fiscal challenges facing the University of Minnesota framed the work of the task force, our recommendations take a broader, more long-term view to offer principles that will serve the University now and into the future. We begin by providing an overview of the University of Minnesota, the flow of resources and expenditures, the budget and planning processes that are now in place. We then address the five broad concerns that President Yudof posed to the task force.

Scope and Complexity of the University of Minnesota

The University of Minnesota, founded in the belief that all people are enriched by understanding, is dedicated to the advancement of learning and the search for truth; to the sharing of this knowledge through education for a diverse community; and to the application of this knowledge to benefit the people of the state, the nation, and the world. The University's mission, carried out on multiple campuses and throughout the state, is threefold:

- Research and Discovery: Generate and preserve knowledge, understanding, and creativity by conducting high-quality research, scholarship, and artistic activity that benefit students, scholars, and communities across the state, the nation, and the world.
- Teaching and Learning: Share that knowledge, understanding, and creativity by providing a broad range of educational programs in a strong and diverse community of learners and teachers; and prepare graduate, professional, and undergraduate students, as well as non-degree-seeking students interested in continuing education and lifelong learning, for active roles in a multiracial and multicultural world.
- Outreach and Public Service: Extend, apply, and exchange knowledge between the University and society by applying scholarly expertise to community problems, by helping organizations and individuals respond to their changing environments, and by making the knowledge and resources created and preserved at the University accessible to the citizens of the state, the nation, and the world.

To carry out this diverse mission, the University of Minnesota has developed into one of the most comprehensive, complex public research universities in the country.

- Its four campuses serve 51,835 students (fall 1999), making the University of Minnesota the third largest university in the United States.
- The $1.6 billion (nonsponsored) operating budget is the third largest of any public university in the U.S.
- The University of Minnesota offers more degree programs (370) than any other university in the country.
- Its academic programs are organized into 21 colleges, more colleges than at all but one other public university in America.
- It is one of only three top-30 research institutions in the nation that supports both a medical and an agricultural school.

The University of Minnesota is a dynamic institution that strives for excellence, responds to change, and engages in continuous reallocation and investment to maintain outstanding academic programs and to develop emerging fields of inquiry that will advance the frontiers of science and enhance the state's economy and quality of life.

For nearly 150 years, the University of Minnesota has been a powerful force in the state's economic and cultural vitality. The application of new discoveries, from new varieties of crops to medical devices to artistic creations, has stimulated the economy. Our graduates go on to lead our communities, manage our businesses, build our new industries, feed our people, teach our children, and enrich our lives through the arts. By preparing graduates who are creative, inventive, and technologically literate, who embrace change and know how to cross geographic, cultural, and theoretical boundaries, the University helps ensure the economic and cultural vitality of the state. The University helps the state of Minnesota retain its most talented young people and helps draw the best and brightest minds from across the country and around the world to study, to work, and to live in Minnesota.

Through outreach and public service, the University of Minnesota contributes to every community throughout the state. The University of Minnesota Extension Service is at work in every Minnesota county, serving 700,000 citizens annually through programs aimed at children and families, farmers, and small businesses. The University's K-12 partnerships are aimed at early literacy, school and career transitions, the professional development of teachers, and the implementation of the state's new graduation standards. The University's continuing education programs ensure that Minnesotans from all walks of life have access to learning the new skills they will need in the evolving global economy. The Rapid Response Fund, Law School clinics, the Veterinary Diagnostic Lab, the Industrial Relations Center, the Center for Transportation Studies, and scores of other community partnerships bring the experience and insight of experts at the University to bear on the real-life concerns of communities throughout the state.

Fiscal Overview of the University

Revenues. For FY99-00, the University projects $1.6 billion in available nonsponsored resources from the following sources:

- 35% operations and maintenance funds, appropriated by the state of Minnesota
- 5% state specials, appropriated by the state of Minnesota
- 15% tuition revenue
- 4% gifts and endowment interest
- 4% indirect cost recovery
- 11% auxiliary enterprises (e.g., housing, bookstores, intercollegiate athletics, parking)
- 10% internal service organizations (e.g., telecommunications, fleet services)
- 16% other (e.g., educational sales and services, grants and contracts with business and industry, private practice, and restricted government funds).

An additional $354 million in revenue is projected to be received and expended in FY99-00 to cover the direct costs of sponsored research.

Expenditures. For FY99-00, the University has budgeted the following categories of nonsponsored expenditures:

- 61% salaries and fringe benefits
- 12% supplies and services
- 12% utilities, repairs and maintenance, equipment, and capital assets
- 4% student aid
- 11% other (e.g., materials for resale, subcontracts, rents, and leases).

Revenue Generation and Allocation. Projected FY99-00 revenues (both sponsored and nonsponsored) are generated and distributed as follows:

- University units (colleges, campuses, and service units) will generate 58% of the University's total nonsponsored revenue through tuition, fees, grants and contracts, sales and services, auxiliary operations, clinical income, endowments, gifts, and indirect cost recovery. These revenues are distributed directly to the units that generate them.

- The remaining 42%—which is distributed by central administration—consists of state support (34.8%), state specials (5.4%), central reserves (0.2%), and indirect cost recovery or ICR (1.7%).

Incentives for Managed Growth (IMG). With FY97-98, the University of Minnesota implemented the IMG financial allocation framework. IMG uses specific formulas to allocate indirect cost recovery (4% of the University's nonsponsored revenues) and tuition (15% of the University's nonsponsored revenues). At the moment of transition to IMG, central administration allocated to each unit a base revenue budget consisting of a specified amount of state support, based on the past levels of such support and a specified amount of anticipated tuition revenue and anticipated indirect cost recovery revenue.

- Under IMG, 51% of indirect cost recovery revenue the University receives is allocated to the collegiate unit that generates the ICR; 49% is allocated to central administration;
- Under IMG, 75% of a student's tuition is allocated to the college that provides the instruction (the course); 25% goes to the student's college of enrollment.

Under IMG, central administration reviews the existing base of state support to each unit, and adjusts that base. In addition, each unit generating tuition and ICR must set targets for these revenues for the next fiscal year. After central administration approval, the unit may budget for that level of estimated revenue. If the unit's *actual* tuition and ICR revenues are over or under the projections, however, the unit is responsible for the additional revenue or deficit.

Tuition rate increases and increases in numbers of students can generate significant new revenue for the institution. Under IMG, all new revenue generated through increases in tuition revenue is attributed by formula directly to the tuition-generating units (colleges). Although IMG governs only the allocation of tuition and ICR revenues, under IMG, the proportion of total University revenue annually allocated by central administration decreased from 58% in FY95-96 to 42% in FY99-00.

Under IMG, responsibility for day-to-day decisions affecting revenue and expenditures is placed largely at the unit level. IMG offers clear financial incentives for the units that generate tuition and ICR revenues not only to carefully manage their expenditures, but also to consider how their activities will affect current and future revenues. Under IMG, unit actions can have a measurable effect on increasing unit budgets, and those increases remain in the unit and are not allocated into a central pool of funds.

The University's Budget and Planning Processes

Budgeting and planning at the University of Minnesota involves a complex set of processes that occur within four distinct cycles (described in more detail in Appendix C).

- Biennial Budget. In even years, the state asks the University to prepare a two-year operating budget request for consideration during the odd-year legislative session. Following approval by the regents, the budget is submitted to the state for its consideration. The appropriations that emerge from the legislative process include both recurring and nonrecurring state monies and some restricted state special funds. Typically, the formal approval is in late spring of odd years (e.g., May 1999 for FY99-00 and FY00-01).

- Capital Budget. Annually, the University's Capital Improvements Advisory Committee and Capital Oversight Group review unit requests for major remodeling and new building projects. These requests form the basis for a capital proposal to the state every two years, and for the internal annual capital budget and six-year capital plan. In odd years, the University prepares and submits a capital budget request to the state of Minnesota for consideration during the even-year legislative session. Formal approval occurs in late spring of even years.
- Compact Cycle. Each fall, central administration asks every budgetary unit (each Resource Responsibility Center or RRC) to submit its plans, priorities, and funding needs in the form of a compact. The central budget office and the provost or the vice president for health sciences review those documents. Following meetings during the winter with the provost or the vice president for health sciences to discuss units' priorities and progress on items in their previous compacts, the RRC unit revises its compact document. After the document is approved, any new funding authorized by the provost or senior vice president for health sciences is transferred to the RRC unit (typically in early fall, post-budget).
- Annual Budget Cycle. The annual budget cycle begins in October of each year with the development of preliminary base funding levels for the fiscal year that will begin the following July 1. This Phase I of the annual budget cycle involves determining each unit's base budget—the recurring level of central allocations for each unit, which is the funding level that would continue if no programmatic or policy changes were approved for the upcoming year. During Phase II (from November through May or June), each unit's financial status is reviewed, revenue projections for the upcoming year are developed for all funds, and central administration determines which, if any, additional investments or reallocations will occur relative to the base level developed in Phase I. During Phase II, decisions are also made on the allocation of available resources to the investment priorities, and on changes to existing budget policies (such as changes in tuition rates, assessment methodologies, etc.). The complete balanced budget presented to the Board of Regents for approval in May or June includes descriptions of all relevant budget policies and methodologies employed in the budget, projections of all University resource-associated planned expenditures, and central allocations to each unit.

Beyond these major processes, numerous people throughout the University make decisions that have fiscal consequences for other units and for the University as a whole. Central administration exercises varying degrees of control over these unit-level decisions, although central is ultimately responsible for many of the fiscal consequences of these decisions.

Budget Challenges Currently Facing the University of Minnesota

Currently identified revenue streams—recurring funds provided by the state of Minnesota, tuition revenue, income from grants and contracts, fees, royalties, and philanthropic support—are not adequate to cover the costs of higher education facing the University. This is partly an issue of the adequacy of overall resources and partly an issue of the internal allocation of resources.

- In FY99-00, the funding gap for costs that resided with central administration was approximately $32 million recurring.
- In FY00-01, the gap is estimated to be an additional $26 million recurring.

- Additional shortfalls are occurring within some units. Within other units, identified resources are not adequate to meet many pressing teaching, research, and outreach priorities.
- Shortfalls of comparable magnitude also occurred before IMG was implemented.

Three major cost drivers are largely responsible for the projected funding gap: (1) competitive compensation and fringe benefits to maintain the excellence of our faculty and staff; (2) adequate facilities and infrastructure to support the teaching, research, and outreach missions of the University; and (3) information technology to meet the learning needs of our students and the teaching and research needs of our faculty, to provide efficient and effective administration of the University, and to connect the University to those it serves throughout the state of Minnesota.

1. **Currently identified revenue streams are not adequate to cover the costs of <u>competitive compensation</u> needed to maintain the excellence of our faculty and staff.**

A world-class university depends, first and foremost, upon the quality and reputation of its faculty, who carry out the University's mission of teaching, research, and outreach. Although salaries have improved over the past three years, Minnesota's faculty salaries are not nationally competitive. Salaries for Twin Cities full professors currently rank 25th among the nation's top 30 research universities and are 13.4% below the mean. The new faculty the University seeks to recruit often have competing offers from peer institutions. Many of our established faculty are actively recruited by competing institutions.

The University also depends upon the talents and energies of its staff: librarians, accountants, lab technicians, Web designers, office support staff, custodians, electricians, and many others. Competitive compensation is needed to recruit, train, and retain staff, particularly when labor markets are as tight as they currently are in Minnesota.

The University's ability to compete successfully for sponsored research funds, make breakthrough scientific discoveries, create new patents, and develop commercial applications for its inventions is based on the creative research of a world-class faculty, working with bright graduate students and supported by a top-notch staff. These discoveries and inventions (in medicine, technology, genetics, agriculture, and the social sciences) help fuel Minnesota's economy. Yet salaries for Minnesota's graduate research and teaching assistants currently rank ninth among the Big 10 institutions and are 13% below the mean, hindering our ability to recruit the best graduate students to Minnesota. We need competitive compensation for graduate students to ensure that we will attract the nation's best and brightest minds to Minnesota to help advance new scientific discoveries that are so critically important to the state's economic vitality.

The amount of money needed to ensure competitive compensation and fringe benefits for all employee groups at the University of Minnesota exceeds the level of resources the state of Minnesota has provided and is likely to provide the University. In some employee groups (such as the faculty) the substantial ground that was lost over the past two decades must be regained. In other employee groups (such as information technology specialists), market forces will continue to dramatically drive up labor costs. For all employee groups, increases in fringe benefit cost (especially health and disability insurance) are likely to outpace basic inflation.

Compensation (salary and fringe benefit expenditures) comprises $961.4 million (61% of the University's nonsponsored expenditures) in FY99-00.

- Each 1% increase in faculty, graduate assistant, and staff salaries, with associated fringe benefits, requires $9.6 million in recurring funds.
- The rising cost of health, dental, and disability insurance benefits means that additional funds will be needed—approximately $6 million recurring in FY00-01 alone—simply to maintain the current benefit levels, which already include more than a 20% increase in health care costs.

2. **Currently identified revenue streams are not adequate to cover the costs of new and renovated facilities and infrastructure necessary to support the University's teaching, research, and outreach missions.**

The University has a responsibility to preserve its historic buildings and grounds and to provide the facilities needed to advance its teaching, research, and outreach missions. Although 14% of the University's FY99-00 nonsponsored expenditures are designated for operations and maintenance of the University's physical plant (including debt service), the current budget system does not identify adequate resources to cover the rising costs of maintaining current facilities, the debt service associated with new facilities, and the incremental utility and maintenance costs of new building operations.

Deferred capital improvements can undermine effective teaching and limit research opportunities, and neglected facilities lead to greater costs in the long run. Although progress has been made in the past year, all four campuses are struggling with deferred capital maintenance issues.

Classrooms are part of the deferred capital improvement problem. After the latest round of construction, the University will have approximately 400 centrally scheduled classrooms system-wide (300 on the Twin Cities campus, 60 in Duluth, and 20 each at Morris and Crookston). Additionally, there are departmentally scheduled classrooms (225 on the Twin Cities campus). Although the University has an adequate *number* of classrooms, their *quality* is lacking. On the Twin Cities campus, for example, 66% of the classrooms are below basic standards of physical condition and functional capacity; 75% lack video/data projection capacity; 73% lack Internet access.

- The cost of upgrading the physical condition and basic functionality of University classrooms and instructional laboratories would exceed $20 million on the Twin Cities campus alone. Technology upgrades for Twin Cities classrooms would add another $7 million. Current estimates indicate that $1.2 million would be needed to address ongoing equipment maintenance, repair and replacement in the 300 Twin Cities general purpose classrooms.

New facilities and major renovations of existing facilities are needed to support key academic initiatives; to enhance the student experience, in and out of the classroom; to meet health, safety, and accessibility code requirements; to enable the University to make information technology infrastructure and facilities available to students and faculty for teaching and research; and to successfully recruit top students and attract top faculty.

- For FY99-00, centrally allocated funds managed by the treasurer and Facilities Management will support $16.0 million in debt service on currently authorized and approved projects. That cost is estimated to be $18.5 million in FY00-01. Additional debt service costs are borne by revenue-generating operations such as parking and residence halls.

- The projected increased (recurring) cost to the University of maintaining and operating new and renovated facilities currently authorized and funded is $2.3 million in FY99-00 and $3.7 million in FY00-01.

The level of resources required to maintain adequate facilities and infrastructure at the University of Minnesota is expected to continue to outpace the resources the state of Minnesota is likely to provide the University. Given that the state now requires the University to fund both one third of the cost of new and renovated facilities and the incremental costs associated with maintaining new facilities approved by the state, the resources provided by the state of Minnesota will not be adequate to cover these rising costs. It is likely that the University of Minnesota will need to rely upon private donations and internal resources to supplement state resources in maintaining facilities and the supporting infrastructure.

3. **Currently identified revenue streams are not adequate to cover the costs of the <u>technology and information resource systems</u> needed to ensure that the University continues to meet its teaching, research, and outreach missions.**

Information technology accounts for approximately $120 million (7.5%) of the Twin Cities' nonsponsored expenditures. Telecommunications, including data networking, is the lifeline of a modern research university. In the digital information age, faculty and students must be able to access information and communicate with scientists, professional communities, and institutions around the world. Technology is also essential to our ability to plan, manage resources, monitor compliance with state and federal laws, and execute the transactions necessary to serve the nearly 100,000 students, faculty, and staff in the University community.

- The Twin Cities' 14-year-old telephone system has outlived its anticipated useful life of 10 years and the vendor will not support the system beyond 2003. A telephone system replacement project should start in FY01 to be completed by July 1, 2003. The estimated replacement cost is $15 million.
- Research and teaching are demanding greater Internet capacity. The University has doubled its consumption of commercial Internet capacity every year since 1991. If historical growth and cost trends continue, the annual cost will grow from $300,000 in FY99-00 to $1.2 million in FY01-02.
- Resources are needed to incorporate new information technologies into the curriculum and to train faculty, students, and staff in the creation and delivery of digital information.

<u>The University Libraries</u> serve not only the faculty and students at the University, but libraries, schools, governments, professionals, communities, and businesses throughout the state of Minnesota. New technological investments are needed to link electronically all the University's campus libraries, to promote resource sharing among all types of libraries in Minnesota, within the broader MINITEX region, and within the Committee on Institutional Cooperation (CIC) consortium.

The University of Minnesota Libraries, like libraries at all major research institutions, face escalating costs (far in excess of inflation) of information resources (traditional and digital); increasing volume of publications in all formats; expanded user expectations and demands for services and resources; and rapid changes in the computing and telecommunication infrastructure.

- Scholarly books cost some 60% more than they did ten years ago, while journal subscription prices have risen more than 160% during the same period.
- The library computer system will likely be replaced during summer 2001 as part of the MNLink statewide library initiative. State funds are anticipated to cover most of the estimated $5 million cost.

Sophisticated administrative systems are needed to manage effectively the operations of a large, complex university: student registration, class scheduling, purchasing, admissions, student transcripts, accounting, facilities management, payroll, and grants management. These systems and accompanying staff register more than 50,000 students each academic term, produce paychecks for over 20,000 full-time and part-time employees, and accurately track revenues and expenses of over $1.9 billion.

Among those systems, the current Enterprise Systems Project is key to the University's long term strategy to improve quality and decentralization of basic administrative services. The major components of the project include student systems and human resource systems, including payroll and benefits. The Board of Regents approved the original enterprise project plan, budget, and financing proposal in December 1997. One element of the financing plan called for a portion of the project to be financed by a unit-level assessment against total salaries. This assessment occurred in FY97-98, at a 0.7% level; it was suspended in FY98-99, but was reinstated in FY99-00 at a 1% level. The assessment is projected to be in effect at least through FY07-08.

- Beginning with the first year of the financing plan, FY97-98, it will take ten years to pay off the approximately $55 million investment in the new Enterprise Systems. Additional investments will be needed to update and maintain these systems over time and eventually to implement new systems in the future.
- The age and lack of vendor support of the CUFS general ledger accounting system will make the system increasingly difficult to support. The estimated cost of replacement is approximately $20 million.

In summary, these three sets of costs—compensation, facilities, and technology—are system-wide, and together they account for approximately 85% of the budgetary shortfall in the 1999-2001 biennium. Other costs, such as the cost of financial aid, insurance, legal counsel, and Title IX compliance, are also likely to rise over the next decade.

I. What revisions are needed to the University's budgeting framework and processes?

The task force finds that many features of the University's current budget and planning processes work well. The budget processes are more consultative and transparent than in the past. Considerable resources, and discretionary authority over those resources, reside at the unit level. During the University's compact planning process, which began in 1997, the provost and the senior vice president for health sciences have regular, structured conversations with collegiate and service units about mission, priorities, resources, and fiscal issues. This process often provides meaningful opportunities for faculty consultation. Priorities and commitments that emerge are explicit and public, and there is general confidence that these commitments will be honored. Communication between the central budget office and the RRC managers is timely, clear, and collegial. The on-line fiscal information is accessible, is useful to managers, and is being improved. The University's capital improvement plan and the capital improvement planning process are becoming more transparent, especially through the development of specific criteria for capital projects. All capital projects are now required to complete a predesign document. Placement of projects into categories ("funding lanes") has clarified the timing and funding expectations for various types of projects.

Throughout its discussions, the task force grew to appreciate and understand the complexity of the University. With changes in the external funding environment, growing pressures on scarce resources, and demands for greater accountability, thoughtful distribution of resources is more important now than ever. Over the past decade, the University planned and weighed its financial decisions, only to find itself facing shortfalls that led to retrenchments or taxes on units. The University of Minnesota has resources comparable to those of many other public universities, yet certain areas such as salaries, libraries, and building and classroom maintenance seem to be chronically under funded. As the task force gathered information, asked questions, and grappled with the issues, the complexity and the importance of matching resources to missions and priorities became an underlying theme. It also became apparent that the connections among the University's various budget and planning processes need to be enhanced and the implications of individual budgetary decisions must be made apparent in other relevant budget processes and in the long-term budget of the University.

Recommended Principles for Financial Planning and Budget Management

The task force reviewed the financial planning and budget management principles that were developed when IMG was implemented. Those principles remain important and have been incorporated into the task force recommendations below. The following principles are intended to further strengthen the core values underlying the University's financial management processes. The president should formally adopt these principles with appropriate consultation.

Shared Responsibility. Every academic and administrative unit must share responsibility for the welfare of the institution as a whole, and for addressing ongoing costs at the unit level. Every financial decision maker has a responsibility to protect and preserve the University of Minnesota. Decision makers must consider the impact of their actions not only on their own unit, but also on the University as a whole; they must also be mindful of the long-term consequences of their actions for the strength and vitality of the University.

Leadership. The leadership of the university, at all levels, is responsible for effective resource management. Leaders are ultimately accountable for creating a viable long-range financial plan, the oversight of institutional financial performance, the efficient use of scarce resources, and the maintenance of financial stability. Every financial decision-maker has a responsibility to protect and preserve the University.

Accountability. Management, budgetary, and reward structures must tie resources to performance closely enough so that individuals can see how their actions influence the fiscal well-being of their units and the University as a whole. The management structure should strengthen decentralized decision making so that funding and expenditure decisions are made close to the areas that are affected. Proper incentives are necessary for members of the University community to enhance revenues and control costs. Annual reviews of administrators at all levels should include evaluations of how effectively they manage unit resources and how they allocate resources to match priorities. Service units, in particular, must be subjected to continuous scrutiny for efficiency, effectiveness, and appropriate levels of service.

Connectedness. It is critical that the cumulative effect of the many financial decisions made across the University interact in a way that helps the University achieve its priorities and goals. The opportunity costs and tradeoffs of decisions must be considered, and the implications of decisions made in one budget and planning process must be connected to the impact that they have on other budget and planning processes.

Consultation. Resource allocation decisions should involve the shared participation of chancellors, vice presidents, deans, faculty, staff, and students. Cross-subsidies and entitlements to support valued University programs and services must be clear. Discussions on the budget must be "information rich," to develop a better understanding of the budget and budget processes throughout the University community.

All-Funds Approach. The University's compact and budget process should allocate state support among academic and administrative units, taking into consideration all resources available to those units to support targeted programmatic investments. The continuing financial management involving IMG should recognize that units are not equally positioned in their ability to grow revenues or to respond to unexpected financial pressures. The University cannot look to just one budgetary strategy or rely on one source of new funding to deal with financial constraints, but rather it must manage through an integrated strategy, drawing upon all sources of funding.

Periodic Programmatic and Financial Review. Periodically, the president, executive vice president and provost, senior vice president for health sciences, chancellors, and relevant consultative bodies should review the programmatic and financial plans of academic and administrative support units, to assess the ability of each unit to meet projected programmatic goals and the associated expenditure requirements. Similarly, deans and unit heads should periodically review the units within their span of authority.

Efficiency. The University must face financial challenges by maximizing the efficient use of resources as well as by aggressively managing growth. Both academic and service units must be encouraged to seek continuous improvements in efficiency and effectiveness and should use internal reallocation strategies to improve the efficiency and effectiveness of their operations.

Recommendations to Improve the University's Budget and Planning Processes

1. Underlying institutional values and priorities should be made a more explicit part of the budget and planning processes, communicated annually so that those values and priorities clearly inform budget planning and decision making throughout the University. This could take the form of a brief annual presidential statement of current resources and allocation priorities.
2. To clarify the impact of individual budgetary decisions on the system as a whole, linkages among the major University budget and planning processes need to be enhanced:
   - The compact process should be timed to inform the development of the biennial budget request to the state, with unit-level priorities communicated to central administration during the winter of even years.

- Information on possible financial stringencies that units face, gained through the oversight meetings of the annual winter budget process should be combined with the compact priorities in developing the biennial budget request to the state.
- Capital budget development, particularly the projections for debt service and increased operational costs of buildings, should be estimated and communicated as a component of the predesign document and approved prior to the budget going forward.

3. In each of the four budget and planning processes, a consultation strategy should be developed so that the University community can participate in discussions regarding the choices and trade-offs among various investments.

Recommendations to Improve the Annual Budget Process

1. The annual operating budget cycle should be revised so that base budgets are developed in September rather than October of each year. With the overall parameters of budget planning in place, consultation on specific budget issues and methodologies can occur between October and February/March. This change will add one month to the consultation schedule.
2. A clear process should be developed for assessing financial decisions made outside of the annual budget development process. Many decisions with financial consequences are made throughout the year, by different persons, without full assessment of the financial implications of those decisions in the context of the overall University budget. (One example of these decisions is the rate setting done by service units.) These latent or unforeseen linkages have significant effects (externalities) on other units. A method for plotting the implications of isolated decisions should be developed. This method should outline a way to track the recurring and nonrecurring costs of such decisions, as well as the specific resources needed to cover the costs. The financial impacts must then be tracked and built into the University's financial planning. There must be adequate and timely consultation on these decisions.
3. Any budgetary commitment with funding implications beyond funding provided by the individual unit involved should be approved by the executive vice president and provost or the president before the commitment is considered final.
4. Financial forecasting models at the central level should be improved and expanded to include three- to five-year projections of revenues and expenditures.
5. A template for financial forecasting at the unit level should be developed and distributed to improve the management of resources.
6. Timing of information on ICR and tuition revenues should be enhanced to allow units to monitor income and expenses in time to adjust both short- and long-term plans.

Recommendations to Improve the Compact Process

1. The review and revision of compact documents should be on a two-year cycle, keyed to the University's biennial budget. Compact discussions should be held annually, but those leading to a full compact agreement should occur in the winter of even years, with the new compact commencing on July 1 of odd years. When a unit is undergoing significant change or restructuring, the provost or the senior vice president for health sciences may wish to put a unit on an annual compact cycle.

2. Compact discussions and agreements should focus more on long-term planning and multi-year funding commitments. The compacts should clearly represent the units' highest priorities and operating/programmatic goals and should give information on the actions to be taken in the near- and long-term to achieve those goals.
3. In evaluating the funding needed to achieve desired results, the compact process should consider the resources that can be secured from internal unit reallocations, as well as the amount of new incremental resources needed.
4. Compact agreements should better integrate discussion and planning on important University-wide issues (such as technology issues) across units. Guidelines for compact development should instruct units to address a chosen issue (in addition to institutional and unit values and priorities), with the results summarized and used in central planning.
5. When appropriate, compact discussions should involve multiple units concerned with a common issue (e.g., colleges involved in the biological sciences initiative; colleges and units that provide undergraduate education/services; linkages with the University Extension Service). Compact documents centered on these issues, in addition to those centered around a unit, should be pursued when the result will add value to program planning.
6. The compact process should place more emphasis on developing strategies for enhancing the level and quality of various administrative support services to support academic priorities.

Recommendations to Improve the Biennial Budget Process

1. The timeline for development of the biennial budget should be adjusted to allow for incorporation of issues arising from the compact priorities. A review of the draft compacts in early spring of even years should inform strategy discussions on development of the biennial budget request.
2. Because they will inform development of the biennial budget request, compacts should clearly describe the participation and governance processes by which they were generated.

Recommendations to Improve the Capital Budget Process

1. As part of the recommendation to improve forecasting at the central level, financial parameters or "benchmarks" (themselves subject to revision) should be developed for University capital expenditures, including debt service, with a view toward their impact on operating budgets in later years. The parameters should involve different budgeting perspectives, such as percentage commitments, ratios, and comparisons with other comparable universities.
2. Significant progress has been made in establishing a coherent process for capital budget planning and development and for monitoring the inventory and use of space. To help reduce the need for the construction of new facilities and ensure an efficient utilization of existing facilities, the University should further integrate its assessment of space utilization into its capital budget planning and development process.

Recommendations to Improve Risk Management

The task force discussions about budgetary frameworks and processes recognized that managing risk is a factor in decisions about how resources are managed at all levels. Uncertainty can breed inefficiency. Faced with uncertainty, units may create overly large financial cushions, and thereby miss opportunities to achieve their goals. In an environment where resources are decentralized, this underutilization of resources can occur at multiple levels (central administration, colleges, departments, and even individual faculty members). Although decision-makers at each level may be appropriately cautious, the combined result across levels may be an overprotection against the same risks.

Throughout the institution there should also be a better understanding of the differences between financial risks to revenue streams and financial risks due to unanticipated expenditures, and a better understanding of how best to mitigate those risks (holding cash reserves is not always the best strategy). Achieving clarification of the different kinds of budgetary risk will allow managers better to anticipate fiscal changes.

1. A financial policy establishing guidelines on the "proper" levels of reserves for units and for central administration should be developed. Included in this policy should be information on the different types of risks and the potential strategies for dealing with them.
2. A working group should be established during the summer of 2000 to examine whether some specific types of risk should be borne centrally (e.g., various types of sick leave, vacation payouts for employees who retire or resign, fluctuations in tuition and ICR revenue) rather than at the unit level. Any recommendations from this examination could then be built into the development of the FY01-02 budget.

II. How should we conceptualize and organize the various costs, expenditures, and investments of the University?

At present there are no consistent criteria for deciding which costs are the responsibility of individual units and which costs should be the shared responsibility of the University community. In recent years, central administration has tried to move to units some of the costs that traditionally were borne centrally. Units also have tried to move some of their costs to central. Because shifts in cost assignment can create budget uncertainties, a set of criteria that could be applied over time would be useful. Although the particular circumstances may change over time, a set of criteria will help decide how costs should be assigned.

Recommended Criteria for Deciding whether Costs Should Be Considered the Shared Responsibility of the University Community

Basic Services. Some basic services and operations are absolutely needed to keep the University running, and they should be regarded as a shared responsibility of the University community. These items include those that are essential to the ongoing basic operations of the campuses and that are available to all units on an equitable basis, although the actual use per unit may vary over time. Examples include water, police, snow removal, the Regents' Office, President's Office, the Office of Institutional Relations, the central Budget Office, the State Fair building, basic technological infrastructure, centrally scheduled classrooms, the data warehouse. How much of a particular service or operation is needed overall may be subject to central review.

Legal Requirements. Some goods, services, and activities are necessary to meet the legal requirements of operating the University (e.g., data collection as required by law; disability accommodations; hazardous waste disposal; the Office of Equal Employment Opportunity and Affirmative Action; the

General Counsel's Office). These are outside the control of local units, and the University is obligated to provide them. They should be considered a shared responsibility.

University Enhancement. Goods, services, or activities that enhance University values (e.g., museums, signage, landscaping in common spaces designed to ensure that the campuses are accessible to students, faculty, staff, and the community) should be considered a shared responsibility. Decisions about shared responsibilities must recognize that the University community has a long-term shared responsibility to preserve and enhance the University's capital assets (e.g., buildings, facilities, landscaping, library collections, classrooms, and other infrastructure). Over time, some investments may benefit particular units more than others, but the cumulative value to the institution over the long term is maintained. Investments that preserve and enhance the University's capital assets are the shared responsibility of the University community.

Targeted Academic Investments. The University may choose to fund a specific set of activities to encourage investment in the intellectual future of the University. Many of the University's greatest opportunities in future years may well be in initiatives that cut across collegiate units and that will require presidential and provostal leadership. The president and provost must be in a position to respond quickly and effectively to sudden opportunities, to new discoveries, and to changes in fields of inquiry. Targeted academic investments should be considered a responsibility shared by the entire University community because they are designed to enhance the vitality of the University as a whole.

Efficiencies. When there are substantial cost efficiencies from economies of scale or standardization, and when it is impractical or cost-ineffective to calculate or distribute costs (e.g., central accounting system, centralized heating system, standardized library catalogues), the item should be the shared responsibility of the University community.

Campus Differences. Because the University of Minnesota has four campuses and some programs based off campus, decisions about shared responsibility should recognize the fact that some activities are system-based and are hence a shared system-wide responsibility, while others are campus-based and should be funded at the campus (not system) level.

Consultation. Significant changes in the assignment of responsibility for costs (whether direct, through the shifting of administrative responsibility, through taxes, or through rate changes) should be consistent with the above criteria and should be made after appropriate consultation with the University community (described in section IV, below).

III. How should the funding of common goods and core administrative activities be balanced with unit priorities? Under what circumstances should responsibility be shared by central administration and units (campus, colleges, etc.) for all-University costs and investments?

The intellectual vitality of the University of Minnesota requires continuous reinvestment to maintain the strength of outstanding academic programs and to support expansion into emerging and promising fields of inquiry. Targeted academic investments must draw upon the internal reallocation of resources and the prudent investment of new state resources and private giving.

Targeted academic investments must occur at the collegiate, campus, and University levels. The increased share of University resources under the direct control of deans and chancellors as a result of IMG has increased the ability of these academic leaders to respond to strategic initiatives within their units. It is important that deans and chancellors continue to have the discretionary resources they need to advance the academic priorities of their units. However, local reallocation is alone insufficient to support many important, emerging opportunities in areas that will advance the frontiers of science and the state's economy and quality of life. Many promising new initiatives cut across collegiate units and require presidential and provostal leadership. For example, developments in plant genomics, biomedical technology, cognitive sciences, and medical anthropology are cross-college ventures. The provost and senior vice president for health sciences must be able to use the compact process to target University resources to such strategic academic investments.

The task force recognizes that a portion of the University's budget must be dedicated to providing basic services and operations, to meeting legal requirements, and to providing goods, services, and activities that enhance University values and preserve the University's capital assets. All units must participate in the funding of these shared University responsibilities. Moreover, the University community needs to recognize that expenditures for many of these activities and services (e.g., technologically adequate classrooms, modern research facilities, up-to-date library collections, cutting-edge information technology) are essential costs of academic programs achieving their academic priorities.

Given scarce resources, an inevitable tension develops among the provision of discretionary resources at the collegiate and campus level to support targeted academic investment; provision of discretionary resources at the central level to support broader, targeted academic investments; and provision of resources to cover the costs of basic University services and operations. The task force believes that academic programs must have priority in the allocation of resources.

Recommendations To Guide the Balance of Support Between Shared University Responsibilities and Collegiate and Campus Priorities

1. The president—in consultation with the faculty, deans, the President's Executive Committee, and other relevant staff councils and committees—should establish targets for the resources that should reside at the collegiate, campus, and University levels to fund targeted academic investments and the resources that should be devoted to cover the costs of basic University services and operations.
2. Significant recurring funds must be budgeted that will allow the provost and senior vice president for health sciences to make targeted academic investments each year through the compact process.
3. The compact process should identify for each unit the resources that will be set aside within the unit for the unit leader to make targeted investments, respond to unit emergencies, and contribute to the costs of shared University responsibilities.
4. The annual compact process for support units should identify standards for the quantity and quality of services provided. Executive management and users should have input into the development of those standards, and annual budget development for support units should acknowledge the standards and the success in meeting them.

5. Care must be taken to avoid the passing down of previously centrally funded services down to the units as unfunded mandates without full consideration of the impact of the action. While it may be appropriate for units to assume the provision and cost of some services, particularly those that are not used equally by all, it should be done consciously with recognition of the impact on the unit. Ordinarily there should be a transfer of funding from the central unit that previously supported the costs to the units now responsible for providing the service.

Recommended Criteria for Deciding Whether Specific Costs Should be Distributed to the Unit Level Rather than Funded Exclusively by Central Allocations

Expensive Marginal Costs. When there are marginal costs from increased consumption *and* increased consumption is potentially expensive (e.g., unlimited use of ITV, unlimited modem use, unlimited appetite for new and renovated buildings), a user fee or some other form of cost sharing or distribution should be applied.

Unit Revenue, with Shared Costs. When a revenue stream is controlled by an individual or unit, but the operating costs are subsidized by the University community (e.g., a unit facility that is rented out to generate income), some or all of the operating costs should be paid for by user fees.

Increased Accountability and/or Efficiency. When a charging mechanism clearly increases accountability and efficiency without creating increased administrative costs and workload, a user fee or some other distribution method may be implemented (e.g., long distance charges). When charging mechanisms are used, they should be clear and simple to implement, with minimal transaction costs.

IV. What governance strategies should be considered to evaluate costs, expenditures, and budgeting strategies in relationship to University-wide costs and investment needs and the costs and investment needs of the colleges and campuses?

The University needs a more formal and consultative process by which deans, chancellors, faculty, and staff are consulted about whether a particular cost should be treated as a shared responsibility of the University community or whether a particular cost should be incurred, and if so whether all or some of that cost should be distributed to the unit or individual level. This consultative process should ensure that all voices, including those representing the University Libraries, Facilities Management, Campus Health and Safety, and Classroom Management, are represented in the discussions.

The task force recommends two consultation strategies for improving the development of long-term, substantial budget priorities of the University. They could be adopted singly, or in combination, to address the issue of governance. Enhanced consultation would focus on broad policies, principles, and strategic directions rather than on individual allocation decisions. It should help to frame broad strategies rather than guide tactical decisions. It should focus on the tradeoffs and opportunity costs that come from decisions.

Strategy #1: Strengthen consultation with existing leadership organizations of the University, including the Faculty Senate, Deans' Council, President's Executive Committee, and other relevant staff councils and committees. This option would establish a schedule for advanced consultation for the major budget processes of the University. Consultation should occur before substantial new costs, before commitments are made, before cost allocations are changed, and before new levels of debt are incurred.

Strategy #2: Create a University Budget Advisory Committee to provide counsel on the application of the task force recommendations and on the major fiscal issues that the University will need to confront over the years to come. The University Budget Advisory Committee should broadly represent the whole University community—drawing upon faculty, staff, and administrators for its membership. Members should serve for staggered four-year terms, so their cumulative knowledge and understanding can be brought to bear on the complex issues. The president, in consultation with the faculty, the senior officers, and deans, would appoint this committee. The committee would consult on major budgetary requests, substantial long-term investments, and the long-term support of University programs and services. It would likely replace the current ad hoc committee on the biennial budget. Its recommendations would be advisory to the president. The associate vice president for budget and finance would be expected to participate in this group.

V. What funding principles and budget strategies should be used to support current and anticipated obligations?

If competitive compensation, modern research and teaching facilities, cutting-edge technology, and strategic academic investments are University priorities, then recurring revenue streams and/or resource reallocation must be identified to cover the costs associated with these priorities. There are no easy answers here, and the solutions require that the University, the legislature, and the University's alumni and donor community work together to ensure the financial vitality of the University of Minnesota. Within the University, all members of the community—central administration and collegiate and campus units, administrators, faculty, staff, and students—must share in the collective responsibility to meet these fiscal challenges.

Recommendations for Securing Incremental Resources To Address University Priorities

The University must develop new sources of recurring revenue if it is to meet the rising recurring costs of compensation, facilities, technology, and strategic academic investments. All the traditional partners in the funding of the University of Minnesota must share responsibility for providing the incremental resources needed to address these priorities.

1. The state of Minnesota must continue to play a leadership role in ensuring the excellence of the University of Minnesota and enhancing its mission of research and discovery, teaching and learning, outreach, and public service.
2. Philanthropic support of the University of Minnesota must grow if we are to attract and retain distinguished faculty and attract the best and brightest students to the University and to the state. The capital campaign is critical to the University's vitality.
3. Tuition revenue must continue to grow beyond the rate of inflation. The primary revenue growth will be through rate increases. (Resident tuition on the Twin Cities campus is $1,500 less than that of Michigan, Michigan State, and Penn State. Resident tuition at Minnesota has increased at a lower rate than at most other public top-30 research institutions.) A 5% increase in tuition revenue, using FY99-00 projected revenues of $234 million, yields $11.7 million. Additional small amounts of tuition revenue growth can be realized through increases in

average student credit load, selected increases in student headcount, and a change in the out-of-state/in-state mix to attract more nonresident students and broaden the geographic diversity of our student body.

4. Sponsored grant and contract activity must increase to generate new revenues needed to cover a larger share of the direct costs of faculty research and to increase the indirect cost recovery required to sustain the University's research infrastructure.
5. Faculty research in applied areas is important for generating new revenues through technology transfer, patents, and royalties. When the University materially benefits from intellectual property it owns, both the inventor and the institution share the income.

Recommendations Concerning the Internal Funding Mechanisms To Meet the Costs of the Shared Responsibilities of the University Community

Currently, commitments are made, obligations accumulate, and then a collection of ad hoc methods is used (including targeted reductions, taxes, passing expenses from central down to units, and raising rates) to piece together the resources needed to meet those obligations. A more stable, predictable, controllable, and transparent system is needed to budget and fund these expenses.

For FY99-00, the $32 million resource gap was covered in the following way:

- The Institutional Revenue Sharing (IRS) plan was instituted to generate a net increase in revenue of $5.4 million. (See Appendix D.) The assessment of academic units equaled 1% of total nonsponsored revenues for the fiscal year. The total assessment on support units equaled 2% of "sales and services" revenue for the fiscal year.
- In addition, an Enterprise Assessment was levied, based on 1% of each unit's salary expenditures, to generate $6.1 million.
- Increased state appropriations, internal unit reallocations, some ISO rate and fee adjustments, and some targeted base reductions funded the remainder of the $32 million shortfall.

Because the majority of the funding gap is recurring costs, recurring reductions in expenditures and/or additional recurring revenues are needed to fill it. The use of central reserves or other soft balances is a stopgap method.

The mechanisms used to pay for commitments that are deemed shared responsibilities of the University community should be *simple, fair, and transparent.* The mechanisms and their budgetary impact on units should be predictable a year or more in advance so that units and central administration can plan.

1. Central administration should levy an overhead charge on all incremental programmatic legislative funds to cover the overhead costs associated with implementing new programs.
2. A single tax applied to all University units should be implemented based upon an all-funds framework of nonsponsored resources to meet all other shared University responsibilities. This framework provides equity in the impact of the assessment across units and ensures that the entire University community contributes a proportionate share of resources to help cover the cost of commitments. Taxes should not involve complicated systems of attribution formulas

tied to particular goods (e.g., one tax for the libraries, another tax for the office of the general counsel, etc.).

In FY99-00, there are two taxes, with different rate structures and different tax bases. In the interests of predictability, those separate taxes should continue into FY00-01.

For FY01-02 and following years a new strategy should be adopted to levy only a single tax. Specification of the tax base and other issues should be discussed through the consultative strategies identified above.

3. The University should make targeted reductions in activities that are ineffective, inefficient, or deemed to be of lower priority. Consolidation, streamlining, or elimination of activities should be considered. This is both a University-wide and an individual unit responsibility.

The task force considered a number of other mechanisms: changes in the distribution of tuition, including implementation of a base tuition that is distributed to central administration rather than collegiate units; implementation of a system-wide or campus-wide student technology fee that would be distributed to central administration; and changes in the funding mechanisms for compensation increases, including the possibility of instructing units to draw upon their tuition and ICR revenue to fund a larger share of the centrally mandated compensation increases. These mechanisms are not among those recommended by the task force.

Recommendations To Increase Accountability and Efficiency in the Use of Scarce Resources

The University of Minnesota needs to build into the budget framework better incentives to encourage decision-makers at all levels to act in an efficient and cost-effective manner, guided by the core values and priorities of the institution. Although IMG has created important new incentives for colleges to monitor closely their instructional costs and tuition revenues, additional incentives are needed to improve accountability and increase efficiency for all units, with all funds.

1. Systems of accountability must be developed to reduce the opportunities for units to make, independently, decisions that generate fiscal consequences for other units and for the University as a whole. Decisions made by a unit, which have fiscal consequences beyond the unit, must be approved explicitly by the president or the executive vice president and provost.
2. Because most units tend to overestimate the proportion of their budgeted expenses that will actually be spent in a particular fiscal year, better financial tools and incentives are needed to help units project their actual expenditures and thus free up resources that can be used to meet priorities.
3. Administrators who are in positions to make decisions about resources (from unit chairs, heads, and directors to deans and vice-presidents) need more and better fiscal management training. Staff who work in support of these decision-makers should have access to frequent training and upgrading of their skills and knowledge.
4. The University should continue to monitor any deficits and maintain strong incentives for units to avoid deficits.
5. The University should explore a broad range of strategies for achieving collective efficiencies—including considering economies of scale, eliminating redundancy, streamlining

operations, and reducing transaction costs. Some possible areas that surfaced in the task force discussions included these areas:

- Better coordinate the use of space over time of day and time of year (particularly classrooms and conference facilities).
- Establish more self-service options, with lower transaction costs.
- Set a higher level of performance standards for centrally provided services in some areas (e.g., custodial services, classroom maintenance).
- Eliminate multiple options for basic services (e.g., the current option of either direct deposit or paper payroll checks).
- Examine business processes and streamline where possible (e.g., reduce the more than 250 official University of Minnesota "forms").
- Explore out-sourcing of selected functions.
- Continue working for greater energy efficiency and utility cost savings (e.g., should portions of the various campuses be closed for 8-10 days in December and January?).
- Analyze the benefits of centralization or decentralization of selected activities.
- Devise a more cost-effective timing of external reviews of graduate programs.

6. The cost of goods and services provided by internal service organizations, auxiliary units, and central service units should continue to be carefully analyzed. Mechanisms need to be enhanced to ensure the cost competitiveness and quality of these goods and services.
7. Support units throughout the University should guarantee that best practices are employed to minimize the University resources required to provide the services. Performance and efficiency benchmarks should be established to measure the use of resources in service units. Before any costs for services are allocated to other units, there needs to be a clear model that defines for the support unit its roles and responsibilities, the revenues and expenses it will bear, its accountabilities, and the process for setting performance standards.
8. The University of Minnesota spends more per square foot to operate and maintain its physical plant than do comparable public universities. Efforts must be made to identify more cost-effective ways to manage this space.
9. The president should appoint a "Best Practices Team" comprising faculty, staff, students, and administrators charged with identifying practical efficiencies each year. The team should have a goal of identifying ways to save the University at least $1 million recurring each year. Identified savings should be reinvested in key areas of the University so that faculty, staff, and students can share in the benefits of the cost savings.
10. Students on the Twin Cities campus take much longer to complete their degree programs than do students at comparable public universities: the Twin Cities four-year graduation rate of 17% is less than half that of peer institutions. When students take five, six, or more years to complete their degree programs, they use libraries, computer facilities, laboratories, advisors, administrative services, and the like for a longer period of time than do students who graduate in four years, all at significantly increased costs to the University. Vigorous efforts must be made to create further incentives for students to take full course loads so they will graduate in four years. A dramatic increase in four-year graduation rates will allow the University to educate more students more cost effectively while at the same time providing each student a better educational experience.

Conclusions

Although the immediate fiscal challenges framed the work of the task force, the task force recommendations are designed to offer a broader, longer-term view and to provide principles and strategies to guide University budget planning and fiscal management now and into the future. There are no easy solutions or quick fixes for the fiscal challenges facing the University. A mixed strategy must be followed that improves the University's budget and planning processes, increases revenues, reduces costs, and internally reallocates resources.

Process Improvements. Although many features of the University's current budget and planning systems work very well, we need to improve these processes to ensure that they are grounded in core principles; better interconnected so that they make more explicit the opportunity costs and trade-offs of various investment decisions; involve enhanced consultation and communication processes in which deans, chancellors, faculty, and staff advise on the broad policies, principles, and strategic directions that inform the University's fiscal strategies; improve forward-year financial planning to document and analyze the impact of future commitments and the specific plans for the resources to cover them; and improve risk management strategies to provide appropriate levels of protection against risk.

Strategies for Increasing Revenues and Reducing Costs. All of the traditional partners in the funding of the University must share responsibility for providing the incremental resources needed to address the University's priorities: there must be increased state and philanthropic support; increased tuition revenue; more grant and contract activity; and new revenues from technology transfer, patents, and royalties. On the cost side, we must increase the level of accountability of financial decision-makers (from unit chairs, heads, and directors to deans and vice-presidents); increase the accountability of support units by monitoring the costs and quality of services and by setting performance standards; and create a "Best Practices Team" to identify strategies for achieving collective efficiencies.

Strategies for the Internal Allocation of Resources. The University should implement specific criteria for deciding which costs are the responsibility of individual units and which are the shared responsibility of the University community, and then implement specific criteria to guide decisions about whether particular costs should be distributed to the unit level or funded exclusively by central allocations. To meet the funding gap for costs residing with central administration, the task force recommends that the central administration continue an overhead charge on all incremental programmatic legislative funds to cover the costs associated with implementing new programs; implement a single tax on all nonsponsored funds applied to all University units, to meet shared University responsibilities; and make targeted reductions in activities that are ineffective, inefficient, or deemed to be of lower priority.

Together, these recommendations will set the University on a course that should, over time, provide adequate ongoing support for key University priorities, allow for new strategic academic investments, reduce fiscal uncertainty, more closely align priorities and spending, and make more efficient use of scarce resources. Together, these recommendations will ensure the vitality of the University of Minnesota for years to come and will ensure that the University continues to excel its missions of teaching and learning, research and discovery, and outreach and public service. We urge the president to implement the task force recommendations in a timely fashion and to report back to the University community within six months on the actions he has taken.

Appendix A
Charge to the Budget Management Task Force

MEMORANDUM

May 27, 1999

TO: Steven Rosenstone, Dean--CLA (Task Force Chair)
Marilyn Speedie, Dean--Pharmacy
Al Sullivan, Dean--CNR
Gail Skinner-West, Dean, UC
Steve Gudeman, Faculty--CLA
Fred Morrison, Faculty--Law
Carl Adams, Faculty--CSOM
Charles Campbell, Faculty--IT
Katherine Johnston, AHC Administration
Eric Kruse, VP for University Services
Greg Fox, UMD Administration
Richard Pfutzenreuter, Associate VP for Budget and Finance
Robert Bruininks, Ex Officio
Frank Cerra, Ex Officio
Committee Staff:
Suzanne Bardouche, Chief Financial Officer—CLA
Julie Tonneson, Assistant Budget Dir., Budget & Finance
Tom Cook, Associate to CLA Dean

FROM: Mark G. Yudof

RE: Budget Management Task Force

I am asking you to serve on a task force to review and make recommendations with regard to possible improvements in the University's budgeting framework, and the organization and allocation of costs to address University-wide needs and obligations. Since the 1996 implementation of the IMG system of revenue allocation, several concerns about its impact and operation have been expressed. One of these is ensuring that there are adequate funds to support "common goods" and costs to maintain University-wide resources and services, and to provide critically needed investment in long-term academic needs. Another concern is the allocation of "common good" investments in an environment in which most new revenue is directly attributed to coordinate campuses, colleges, and other units with very limited resources outside the biennial budget allocations to address system obligations and investments. The biennial budget allocations are increasingly targeted to address specific priorities, providing little flexibility and insufficient resources.

When the decentralized IMG budget system was implemented in 1996, it was recognized by members of the original committee that no provision, other than the biennial budget, was made to address increasing University-wide costs (e.g., debt, utilities, libraries, technology, etc.) or valued academic investments (i.e., strengthening specific campus and unit programs). The Regents, central administrators, chancellors, deans, faculty leadership, and a special joint-

University Senate committee have expressed concerns about these issues. Various background materials on the University's budget context are attached in a report I presented to the Regents in May, and further analyses will be conducted as part of this study process.

Although I remain committed to the basic concept of the allocation of revenues found in the IMG model, I do believe that some aspects of the budgeting framework and system need to be reviewed and improved. I am asking the task force to consider the following questions and other issues that should be considered in revising the University's budget framework and processes.

1. What revisions are needed to the University's budgeting framework and processes?

- How should University budget priorities be defined, and communicated to the broader University community?
- How is the total amount of institutional risk (including future financial obligations) established?
- What are the boundaries of fiscal responsibilities in central units and in collegiate units?
- What principles, assumptions and guidelines should be developed to govern the decentralization of decision making in establishing budget priorities and to provide a reliable funding base for campuses and colleges?

2. How should we conceptualize and organize the various costs, expenditures and investments of the University?

1. What types of investments and expenses should be considered common expenditures of the University? What characteristics define "common good"?
- How can the University establish a realistic, longer-term financial framework to guide budget decisions?

3. How should the funding of common goods and core administrative activities be balanced with unit priorities? Under what circumstances should responsibility be shared by central administration and units (campus, colleges, etc.) for all-University costs and investments?

- What principles should help guide how common goods and core administrative activities on the one hand are balanced with unit priorities on the other? How are priorities set?
- Should some of those traditionally described as "common expenditures" be assigned as unit responsibilities?
- Are some of the expenditures common only to a single campus or other grouping of units, and, if so, should they be charged on that basis?
- Capital, facility operations and technology costs are rising rapidly on all campuses. Should capital costs for facilities and the operating costs of facilities be allocated to users, in whole or in part? Should more technology infrastructure costs be allocated to users?
- Should the initial and maintenance costs of the Enterprise Business Systems be folded into a charging system or should they remain a separate charge for the development and implementation cycle, and a part of overall University costs for ongoing maintenance?

4. What governance strategies should be considered to evaluate costs, expenditures, and budgeting strategies in relationship to University-wide costs and investment needs and the costs and investment needs of the colleges and campuses?

5. What funding principles and budget strategies should be used to support current and anticipated obligations?

- What mix of resources (e.g., state allocations, modification to IMG, assessments for common goods or overhead, unit assessment, targeted reductions, revenue measures, changes in rate structures for central services, etc.) should be used to address this problem?
- Should a formula allocation of costs be employed, and if so, what formula best meets the test of clarity, equity, and simplicity?
- Should all funds and units contribute to the shared responsibility? Should the providers of central services contribute to these charges?
- Should the providers of central services continue to receive O&M allocations or should their budgets be based entirely or partially on a cost allocation methodology?

You may find other questions that require discussion. I urge you, however, to concentrate your attention on these questions in developing alternative strategies to meet the common needs of the University, and not to seek a fundamental review of the entire budgeting system. Although you may wish to review the "common good" investments for the current year to understand the nature and scope of the problem, I am not asking you to make recommendations with regard to these specific costs.

The administration will implement a temporary solution to address the significant problem in recurring costs (about $30 million) for FY2000. However, the task force is intended to consider the broader issues facing the University, and to formulate a longer-term solution.

I would like the task force to begin its work during this academic year, continue work through the summer, and provide a final report by November 1, 1999. I am proposing a meeting in June to begin the process, identify the questions to be addressed, and more fully develop the scope of our work. I want to thank you for your willingness to serve on this committee.

MGY/jn

Attachments: May Regents Presentation
Draft IMG paper

cc: Board of Regents
Chancellors
Deans
Tonya Moten Brown, Chief of Staff

Appendix B
Budget Management Task Force
Consultation Meetings with the University Community

University of Minnesota Chancellors and Deans Retreat	October 11, 1999
Joint meeting of Faculty Consultative Committee & Senate Committee on Finance and Planning	October 28, 1999
University of Minnesota-Morris: Area Managers Group; Vice Chancellors and Deans Group	November 2, 1999
University of Minnesota-Crookston: All-campus open meeting	November 5, 1999
Representatives of Teamsters Local 320, AFSCME Council 6, UEA	November 10, 1999
University of Minnesota-Duluth: Chancellor's Group, Deans, & Directors; Assembly Executive & Budget Committees, Area Class Managers	November 16, 1999
Resource Responsibility Center Managers (TC)	November 17, 1999
Senate Committee on Educational Policy	November 17, 1999
Civil Service Committee	November 18, 1999
Academic Staff Advisory Committee	November 19, 1999

Appendix C
Comprehensive Summary – Central Budget Processes & Cycles

Months	Biennial Budget	Annual Budget	Compact Cycle	Capital Budget
June	**Even Yr. – Budget Instructions From the State to Each Agency** Begin Proposal Dev.	President's Budget Reviewed & Approved by Board Final Budget Prep Entry into CUFS	Post-Budget Allocations of Academic Initiatives Finalized Edit Draft Compacts	Board Approves Annual Budget, 5 Yr. Plan & Preliminary State Capital Request for Even Yr. Session
July	Internal Development of Budget Proposal	New Fiscal Year Begins	Finalize Compact Documents for President's Review	Legislative Visits
August	Agency Base Adjustments Loaded into State System			Legislative Visits
September	Conceptual Framework to Board - Agency Submits Preliminary Plan to State	**Phase I Budget Instructions to RRCs**	**Compact Instructions to RRCs**	Board Reviews State Capital Request
October	Bd. Reviews Biennial Proposal	Base Budget Established - ISO Rate Development Begins	Compacts Finalized in July/August – Reported to the Board	Board Approves Final St. Capital Request – Submitted to the State for Even Yr. Session
November	Board Approves Biennial Proposal – Submitted to the State	Planning Estimates of Revenues & Expenses Created	Submittal of Initial Compact Responses by RRCs – Compact Review Meetings Begin	**Capital Budget Instructions to RRCs for Annual Budget and 5 Year Plan**

Months	Biennial Budget	Annual Budget	Compact Cycle	Capital Budget
December	St. Revenue Forecast Final Tax & Budget Decisions Made for Governor's Budget	Phase II Budget Instructions to RRCs Prepare for Financial Oversight Meetings	Compact Review Meetings Continue	Unit Submissions Due
January	Governor's Budget Submitted to the Legislature-odd yr	Submittal of Phase II Response – Oversight Meetings Begin	Compact Review Meetings Continue	
February	Legislative Hearings	Oversight Meetings		CIAC Hearings
March	Legislative Hearings	Phase III – Budget Prep Beings Refine Planning Estimates of Rev. & Expenses	Refined Compact Submittals from RRCs with Timelines, Budgets, etc.	CIAC Hearings
April	Legislative Hearings Legislative Targets Set – Conference Committees Begin	Continue to Refine Planning Estimates of Revenues and Expenses	Review and Edit Draft Compacts	CIAC develops Recommended Annual Budget/6 yr. Plan & State Request Consultation Occurs
May	Legislature Passes Appropriation Bill & Governor Signs it into Law	Package Budget Decisions – Await Final State Appropriation	Review and Edit Draft Compacts	Board Reviews Annual Budget, 5 Year Plan & State Request

Appendix D

FY99-00 Budget Framework
Institutional Revenue Sharing

I. Institutional Revenue Sharing = Total Revenues x 1%

<u>Part 1</u>

Calculate revenue yield @ 2% of "Sales & Services" Revenue*

*[Includes Central Support Units]

<u>Part 2</u>

Subtract "2% Sales & Services" Revenues from 1% IRS and collect remaining assessment from collegiate/campus units

Office of Budget and Finance

Report of the Budget Management Task Force

January 21, 2000

Task Force Members:

Carl Adams, Professor, Carlson School of Management
Robert Bruininks, Executive Vice President and Provost
Charles Campbell, Professor, Institute of Technology
Frank Cerra, Senior Vice President for Health Sciences
Greg Fox, Vice Chancellor, Duluth
Stephen Gudeman, Professor, College of Liberal Arts
Katherine Johnston, Associate Vice President, Academic Health Center
Eric Kruse, Vice President for University Services
Richard Pfutzenreuter, Associate Vice President for Budget and Finance
Steven Rosenstone, Dean, College of Liberal Arts (Chair)
Gail Skinner-West, Interim Dean, College of Continuing Education
Marilyn Speedie, Dean, College of Pharmacy
Al Sullivan, Dean, College of Natural Resources

Task Force Staff:

Suzanne Bardouche, Chief Financial Officer, College of Liberal Arts
Tom Cook, Associate to the Dean, College of Liberal Arts
Julie Tonneson, Assistant Budget Director, Budget and Finance

---

Executive Summary

In May 1999, President Mark Yudof appointed a task force, to "review and make recommendations with regard to possible improvements in the University's budgeting framework, and the organization and allocation of costs to address University-wide needs and obligations." Over a period of eight months, the task force reviewed the University's budget and planning processes, examined financial data, discussed strategies used by other universities, and analyzed various approaches for improving the University's budgeting framework, revenue streams, and the allocation of costs. The task force consulted with faculty, administrators, and staff throughout the University of Minnesota system to get their guidance on the critical questions before the task force. Although the immediate fiscal challenges facing the University of Minnesota framed the work of the task force, the recommendations put forth are designed to offer a broader, longer-term view and to provide the principles and strategies that should be used to guide University budget planning and fiscal management now and into the future.

To carry out its mission of teaching, research, and public service, the University of Minnesota has developed into one of the most comprehensive and complex public research universities in the country with a total FY99-00 operating budget of $2 billion ($354 million of which is sponsored research).

The report provides a brief overview of the complex set of budget and planning processes at the University of Minnesota that occur within four distinct cycles—the biennial budget, the capital budget, the compact cycle, and the annual budget cycle—and provides a brief overview of how each process works.

Currently identified revenue streams—recurring funds provided by the State of Minnesota, tuition revenue, income from grants and contracts, royalties, and philanthropic support—are not adequate to cover the costs of higher education facing the University. This is partly an issue of the adequacy of overall resources and partly an issue of the internal allocation of resources. Simply, in recent years, the operating costs of the University have grown at higher rates than the revenues identified to support them.

In FY97-98, the University implemented the Incentives for Managed Growth (IMG) financial allocation framework that provided formulas to allocate tuition revenues and a portion of indirect cost recovery directly to the units that generate the revenues. Although IMG affects the allocation of only 19% of non-sponsored funding, it has decreased the *proportion* of total University revenue allocated by central administration from 58% in FY95-96 to 42% in FY99-00.

In FY99-00, the funding gap for costs residing with central administration was $32 million recurring; for FY00-01, it is estimated at $25 million recurring. Three sets of system-wide costs—compensation, facilities, and technology—account for about 85% of the shortfall. These costs—central to supporting the University's academic priorities—are likely to increase over the foreseeable future. Although IMG has focused attention on this budget gap, it is not solely an IMG-related problem, as budget gaps of comparable magnitude also occurred before IMG was implemented.

The task force puts forth three types of recommendations designed to set the University on a course that should, over time, provide adequate ongoing support for key University priorities, allow for new strategic academic investments, reduce fiscal uncertainty, enhance the match between priorities and spending, and make for more efficient use of scarce resources.

Process Improvements

Many features of the University's current budget and planning systems work very well, and the task force recommendations build upon those strengths. Recommendations for improvement include:

- More clearly articulate the principles that should guide the University's financial planning and budget management. These include shared responsibility, leadership, accountability, connectedness, consultation, an all-funds approach, periodic programmatic and financial reviews, and efficiency.
- Improve the University's various budget and planning processes to enhance their interconnectedness and make more explicit consideration of the opportunity costs and

tradeoffs of various investment decisions.
- Enhance the consultative and communication processes by which deans, chancellors, faculty, and staff advise on the broad policies, principles, and strategic directions that inform the University's fiscal strategies.
- Improve forward-year financial planning to document and analyze the impact of future commitments and the specific plans for the resources to cover them.
- Improve risk management strategies to provide appropriate levels of protection against risk.

Strategies for Increasing Revenues and Reducing Costs

- All the traditional partners in the funding of the University of Minnesota must share responsibility for providing the incremental resources needed to address the University's priorities: there must be increased state and philanthropic support; increased tuition revenue; more grant and contract activity; and new revenues from technology transfer, patents, and royalties.
- Enhance the accountability of financial decision-makers (from unit chairs, heads, and directors to deans and vice-presidents).
- Increase the accountability of support units by monitoring the costs and quality of services and by setting performance standards.
- Create a "Best Practices Team" to identify strategies for achieving collective efficiencies.

Strategies for the Internal Allocation of Resources

- Implement criteria for deciding which costs are the responsibility of individual units and which costs should be a shared responsibility; implement criteria to guide decisions about whether specific costs should be distributed to the unit level rather than funded exclusively by central allocations.
- Establish a set of simple, fair, and transparent mechanisms that can be used to balance the budget; these mechanisms should be stable and predictable from year to year.
- Continue an overhead charge on all incremental programmatic legislative funds to cover the costs associated with implementing new programs.
- Implement a single tax applied to all University units, based on an all-funds framework of non-sponsored resources, to meet shared University responsibilities.
- Make targeted reductions in activities that are ineffective, inefficient, or deemed to be of lower priority.

Contents

Appendix D: FY99-00 Budget Framework: Institutional Revenue Sharing

---

Background

Charge to the Task Force

On May 27, 1999, University of Minnesota President Mark Yudof appointed the Budget Management Task Force, charging it to "review and make recommendations with regard to possible improvements in the University's budgeting framework, and the organization and allocation of costs to address University-wide needs and obligations." (See Appendix A to this report.) The president asked the task force to address five broad concerns

I. What revisions are needed to the University's budgeting framework and processes?

II. How should we conceptualize and organize the various costs, expenditures, and investments of the University?

III. How should the funding of common goods and core administrative activities be balanced with unit priorities? Under what circumstances should central administration and units (campus, colleges, etc.) share responsibility for all-University costs and investments?

IV. What governance strategies should be considered to evaluate costs, expenditures, and budgeting strategies in relationship to University-wide costs and investment needs and the costs and investment needs of the colleges and campuses?

V. What funding principles and budget strategies should be used to support current and anticipated obligations?

The Budget Management Task Force met nine times between June 4, 1999, and January 12, 2000, to review current University budget and planning processes, examine University financial data, discuss budgeting strategies used at other universities, and analyze alternative approaches for improving the University's budgeting framework and the organization and allocation of costs. During October and November 1999, the task force met with faculty, administrators, and staff throughout the University of Minnesota system to seek the University community's advice on the key issues before the task force (Appendix B).

Although the immediate fiscal challenges facing the University of Minnesota framed the work of the task force, our recommendations take a broader, more long-term view to offer principles that will serve the University now and into the future. We begin by providing an overview of the University of Minnesota, the flow of resources and expenditures, the budget and planning processes that are now in place. We then address the five broad concerns that President Yudof posed to the task force.

Scope and Complexity of the University of Minnesota

The University of Minnesota, founded in the belief that all people are enriched by understanding, is dedicated to the advancement of learning and the search for truth; to the sharing of this knowledge through education for a diverse community; and to the application of this knowledge to benefit the people of the state, the nation, and the world. The University's mission, carried out on multiple campuses and throughout the state, is threefold:

- Research and Discovery: Generate and preserve knowledge, understanding, and creativity by conducting high-quality research, scholarship, and artistic activity that benefit students, scholars, and communities across the state, the nation, and the world.

- Teaching and Learning: Share that knowledge, understanding, and creativity by providing a broad range of educational programs in a strong and diverse community of learners and teachers; and prepare graduate, professional, and undergraduate students, as well as non-degree-seeking students interested in continuing education and lifelong learning, for active roles in a multiracial and multicultural world.

- Outreach and Public Service: Extend, apply, and exchange knowledge between the University and society by applying scholarly expertise to community problems, by helping organizations and individuals respond to their changing environments, and by making the knowledge and resources created and preserved at the University accessible to the citizens of the state, the nation, and the world.

To carry out this diverse mission, the University of Minnesota has developed into one of the most comprehensive, complex public research universities in the country.

- Its four campuses serve 51,835 students (fall 1999), making the University of Minnesota the third largest university in the United States.

- The $1.6 billion (nonsponsored) operating budget is the third largest of any public university in the U.S.

- The University of Minnesota offers more degree programs (370) than any other university in the country.

- Its academic programs are organized into 21 colleges, more colleges than at all but one other public university in America.

- It is one of only three top-30 research institutions in the nation that supports both a medical and an agricultural school.

The University of Minnesota is a dynamic institution that strives for excellence, responds to change, and engages in continuous reallocation and investment to maintain outstanding academic programs and to develop emerging fields of inquiry that will advance the frontiers of science and enhance the state's economy and quality of life.

For nearly 150 years, the University of Minnesota has been a powerful force in the state's economic and cultural vitality. The application of new discoveries, from new varieties of crops to medical devices to artistic creations, has stimulated the economy. Our graduates go on to lead our communities, manage our businesses, build our new industries, feed our people, teach our children, and enrich our lives through the arts. By preparing graduates who are creative, inventive, and technologically literate, who embrace change and know how to cross geographic, cultural, and theoretical boundaries, the University helps ensure the economic and cultural vitality of the state. The University helps the state of Minnesota retain its most talented young people and helps draw the best and brightest minds from across the country and around the world to study, to work, and to live in Minnesota.

Through outreach and public service, the University of Minnesota contributes to every community throughout the state. The University of Minnesota Extension Service is at work in every Minnesota county, serving 700,000 citizens annually through programs aimed at children and families, farmers, and small businesses. The University's K-12 partnerships are aimed at early literacy, school and career transitions, the professional development of teachers, and the implementation of the state's new graduation standards. The University's continuing education programs ensure that Minnesotans from all walks of life have access to learning the new skills they will need in the evolving global economy. The Rapid Response Fund, Law School clinics, the Veterinary Diagnostic Lab, the Industrial Relations Center, the Center for Transportation Studies, and scores of other community partnerships bring the experience and insight of experts at the University to bear on the real-life concerns of communities throughout the state.

Fiscal Overview of the University

Revenues. For FY99-00, the University projects $1.6 billion in available nonsponsored resources from the following sources:

- 35% operations and maintenance funds, appropriated by the state of Minnesota
- 5% state specials, appropriated by the state of Minnesota
- 15% tuition revenue
- 4% gifts and endowment interest
- 4% indirect cost recovery
- 11% auxiliary enterprises (e.g., housing, bookstores, intercollegiate athletics, parking)
- 10% internal service organizations (e.g., telecommunications, fleet services)
- 16% other (e.g., educational sales and services, grants and contracts with business and industry, private practice, and restricted government funds).

An additional $354 million in revenue is projected to be received and expended in FY99-00 to cover the direct costs of sponsored research.

Expenditures. For FY99-00, the University has budgeted the following categories of nonsponsored expenditures:

- 61% salaries and fringe benefits
- 12% supplies and services
- 12% utilities, repairs and maintenance, equipment, and capital assets
- 4% student aid

- 11% other (e.g., materials for resale, subcontracts, rents, and leases).

Revenue Generation and Allocation. Projected FY99-00 revenues (both sponsored and nonsponsored) are generated and distributed as follows:

- University units (colleges, campuses, and service units) will generate 58% of the University's total nonsponsored revenue through tuition, fees, grants and contracts, sales and services, auxiliary operations, clinical income, endowments, gifts, and indirect cost recovery. These revenues are distributed directly to the units that generate them.

- The remaining 42%—which is distributed by central administration—consists of state support (34.8%), state specials (5.4%), central reserves (0.2%), and indirect cost recovery or ICR (1.7%).

Incentives for Managed Growth (IMG). With FY97-98, the University of Minnesota implemented the IMG financial allocation framework. IMG uses specific formulas to allocate indirect cost recovery (4% of the University's nonsponsored revenues) and tuition (15% of the University's nonsponsored revenues). At the moment of transition to IMG, central administration allocated to each unit a base revenue budget consisting of a specified amount of state support, based on the past levels of such support and a specified amount of anticipated tuition revenue and anticipated indirect cost recovery revenue.

- Under IMG, 51% of indirect cost recovery revenue the University receives is allocated to the collegiate unit that generates the ICR; 49% is allocated to central administration;

- Under IMG, 75% of a student's tuition is allocated to the college that provides the instruction (the course); 25% goes to the student's college of enrollment.

Under IMG, central administration reviews the existing base of state support to each unit, and adjusts that base. In addition, each unit generating tuition and ICR must set targets for these revenues for the next fiscal year. After central administration approval, the unit may budget for that level of estimated revenue. If the unit's *actual* tuition and ICR revenues are over or under the projections, however, the unit is responsible for the additional revenue or deficit.

Tuition rate increases and increases in numbers of students can generate significant new revenue for the institution. Under IMG, all new revenue generated through increases in tuition revenue is attributed by formula directly to the tuition-generating units (colleges). Although IMG governs only the allocation of tuition and ICR revenues, under IMG, the proportion of total University revenue annually allocated by central administration decreased from 58% in FY95-96 to 42% in FY99-00.

Under IMG, responsibility for day-to-day decisions affecting revenue and expenditures is placed largely at the unit level. IMG offers clear financial incentives for the units that generate tuition and ICR revenues not only to carefully manage their expenditures, but also to consider how their activities will affect current and future revenues. Under IMG, unit actions can have a measurable effect on increasing unit budgets, and those increases remain in the unit and are not allocated into a central pool of funds.

The University's Budget and Planning Processes

Budgeting and planning at the University of Minnesota involves a complex set of processes that occur within four distinct cycles (described in more detail in Appendix C).

- Biennial Budget. In even years, the state asks the University to prepare a two-year operating budget request for consideration during the odd-year legislative session. Following approval by the regents, the budget is submitted to the state for its consideration. The appropriations that emerge from the legislative process include both recurring and nonrecurring state monies and some restricted state special funds. Typically, the formal approval is in late spring of odd years (e.g., May 1999 for FY99-00 and FY00-01).

- Capital Budget. Annually, the University's Capital Improvements Advisory Committee and Capital Oversight Group review unit requests for major remodeling and new building projects. These requests form the basis for a capital proposal to the state every two years, and for the internal annual capital budget and six-year capital plan. In odd years, the University prepares and submits a capital budget request to the state of Minnesota for consideration during the even-year legislative session. Formal approval occurs in late spring of even years.

- Compact Cycle. Each fall, central administration asks every budgetary unit (each Resource Responsibility Center or RRC) to submit its plans, priorities, and funding needs in the form of a compact. The central budget office and the provost or the vice president for health sciences review those documents. Following meetings during the winter with the provost or the vice president for health sciences to discuss units' priorities and progress on items in their previous compacts, the RRC unit revises its compact document. After the document is approved, any new funding authorized by the provost or senior vice president for health sciences is transferred to the RRC unit (typically in early fall, post-budget).

- Annual Budget Cycle. The annual budget cycle begins in October of each year with the development of preliminary base funding levels for the fiscal year that will begin the following July 1. This Phase I of the annual budget cycle involves determining each unit's base budget—the recurring level of central allocations for each unit, which is the funding level that would continue if no programmatic or policy changes were approved for the upcoming year. During Phase II (from November through May or June), each unit's financial status is reviewed, revenue projections for the upcoming year are developed for all funds, and central administration determines which, if any, additional investments or reallocations will occur relative to the base level developed in Phase I. During Phase II, decisions are also made on the allocation of available resources to the investment priorities, and on changes to existing budget policies (such as changes in tuition rates, assessment methodologies, etc.). The complete balanced budget presented to the Board of Regents for approval in May or June includes descriptions of all relevant budget policies and methodologies employed in the budget, projections of all University resource-associated planned expenditures, and central allocations to each unit.

Beyond these major processes, numerous people throughout the University make decisions that have fiscal consequences for other units and for the University as a whole. Central administration exercises varying degrees of control over these unit-level decisions, although central is ultimately responsible for many of the fiscal consequences of these decisions.

Budget Challenges Currently Facing the University of Minnesota

Currently identified revenue streams—recurring funds provided by the state of Minnesota, tuition revenue, income from grants and contracts, fees, royalties, and philanthropic support—are not *adequate to cover the costs of higher education facing the University. This is partly an issue of the adequacy of overall resources and partly an issue of the internal allocation of resources.*

- In FY99-00, the funding gap for costs that resided with central administration was approximately $32 million recurring.
- In FY00-01, the gap is estimated to be an additional $26 million recurring.
- Additional shortfalls are occurring within some units. Within other units, identified resources are not adequate to meet many pressing teaching, research, and outreach priorities.
- Shortfalls of comparable magnitude also occurred before IMG was implemented.

Three major cost drivers are largely responsible for the projected funding gap: (1) competitive compensation and fringe benefits to maintain the excellence of our faculty and staff; (2) adequate facilities and infrastructure to support the teaching, research, and outreach missions of the University; and (3) information technology to meet the learning needs of our students and the teaching and research needs of our faculty, to provide efficient and effective administration of the University, and to connect the University to those it serves throughout the state of Minnesota.

1. **Currently identified revenue streams are not adequate to cover the costs of competitive compensation needed to maintain the excellence of our faculty and staff.**

   A world-class university depends, first and foremost, upon the quality and reputation of its faculty, who carry out the University's mission of teaching, research, and outreach. Although salaries have improved over the past three years, Minnesota's faculty salaries are not nationally competitive. Salaries for Twin Cities full professors currently rank 25th among the nation's top 30 research universities and are 13.4% below the mean. The new faculty the University seeks to recruit often have competing offers from peer institutions. Many of our established faculty are actively recruited by competing institutions.

   The University also depends upon the talents and energies of its staff: librarians, accountants, lab technicians, Web designers, office support staff, custodians, electricians, and many others. Competitive compensation is needed to recruit, train, and retain staff, particularly when labor markets are as tight as they currently are in Minnesota.

   The University's ability to compete successfully for sponsored research funds, make breakthrough scientific discoveries, create new patents, and develop commercial applications for its inventions is based on the creative research of a world-class faculty, working with bright graduate students and supported by a top-notch staff. These discoveries and inventions (in medicine, technology, genetics, agriculture, and the social sciences) help fuel Minnesota's economy. Yet salaries for Minnesota's graduate research and teaching assistants currently rank ninth among the Big 10 institutions and are 13% below the mean, hindering our ability to recruit the best graduate students to Minnesota. We need competitive compensation for graduate students to ensure that we will attract the nation's best and brightest minds to Minnesota to help advance new scientific discoveries that are so critically important to the state's economic vitality.

   The amount of money needed to ensure competitive compensation and fringe benefits for all employee groups at the University of Minnesota exceeds the level of resources the state *of Minnesota has provided and is likely to provide the University.* In some employee groups (such as the faculty) the substantial ground that was lost over the past two decades must be regained. In other employee groups (such as information technology specialists), market forces will continue to dramatically drive up labor costs. For all employee groups, increases in fringe benefit cost (especially health and disability insurance) are likely to outpace basic inflation.

Compensation (salary and fringe benefit expenditures) comprises $961.4 million (61% of the University's nonsponsored expenditures) in FY99-00.

- Each 1% increase in faculty, graduate assistant, and staff salaries, with associated fringe benefits, requires $9.6 million in recurring funds.
- The rising cost of health, dental, and disability insurance benefits means that additional funds will be needed—approximately $6 million recurring in FY00-01 alone—simply to maintain the current benefit levels, which already include more than a 20% increase in health care costs.

2. **Currently identified revenue streams are not adequate to cover the costs of new and renovated <u>facilities and infrastructure</u> necessary to support the University's teaching, research, and outreach missions.**

The University has a responsibility to preserve its historic buildings and grounds and to provide the facilities needed to advance its teaching, research, and outreach missions. Although 14% of the University's FY99-00 nonsponsored expenditures are designated for operations and maintenance of the University's physical plant (including debt service), the current budget system does not identify adequate resources to cover the rising costs of maintaining current facilities, the debt service associated with new facilities, and the incremental utility and maintenance costs of new building operations.

<u>Deferred capital improvements</u> can undermine effective teaching and limit research opportunities, and neglected facilities lead to greater costs in the long run. Although progress has been made in the past year, all four campuses are struggling with deferred capital maintenance issues.

<u>Classrooms</u> are part of the deferred capital improvement problem. After the latest round of construction, the University will have approximately 400 centrally scheduled classrooms system-wide (300 on the Twin Cities campus, 60 in Duluth, and 20 each at Morris and Crookston). Additionally, there are departmentally scheduled classrooms (225 on the Twin Cities campus). Although the University has an adequate *number* of classrooms, their *quality* is lacking. On the Twin Cities campus, for example, 66% of the classrooms are below basic standards of physical condition and functional capacity; 75% lack video/data projection capacity; 73% lack Internet access.

- The cost of upgrading the physical condition and basic functionality of University classrooms and instructional laboratories would exceed $20 million on the Twin Cities campus alone. Technology upgrades for Twin Cities classrooms would add another $7 million. Current estimates indicate that $1.2 million would be needed to address ongoing equipment maintenance, repair and replacement in the 300 Twin

Cities general purpose classrooms.

New facilities and major renovations of existing facilities are needed to support key academic initiatives; to enhance the student experience, in and out of the classroom; to meet health, safety, and accessibility code requirements; to enable the University to make information technology infrastructure and facilities available to students and faculty for teaching and research; and to successfully recruit top students and attract top faculty.

- For FY99-00, centrally allocated funds managed by the treasurer and Facilities Management will support $16.0 million in debt service on currently authorized and approved projects. That cost is estimated to be $18.5 million in FY00-01. Additional debt service costs are borne by revenue-generating operations such as parking and residence halls.

  The projected increased (recurring) cost to the University of maintaining and operating new and renovated facilities currently authorized and funded is $2.3 million in FY99-00 and $3.7 million in FY00-01.

The level of resources required to maintain adequate facilities and infrastructure at the University of Minnesota is expected to continue to outpace the resources the state of Minnesota is likely to provide the University. Given that the state now requires the University to fund both one third of the cost of new and renovated facilities and the incremental costs associated with maintaining new facilities approved by the state, the resources provided by the state of Minnesota will not be adequate to cover these rising costs. It is likely that the University of Minnesota will need to rely upon private donations and internal resources to supplement state resources in maintaining facilities and the supporting infrastructure.

3. **Currently identified revenue streams are not adequate to cover the costs of the technology and information resource systems needed to ensure that the University continues to meet its teaching, research, and outreach missions.**

Information technology accounts for approximately $120 million (7.5%) of the Twin Cities' nonsponsored expenditures. Telecommunications, including data networking, is the lifeline of a modern research university. In the digital information age, faculty and students must be able to access information and communicate with scientists, professional communities, and institutions around the world. Technology is also essential to our ability to plan, manage resources, monitor compliance with state and federal laws, and execute the transactions necessary to serve the nearly 100,000 students, faculty, and staff in the University community.

- The Twin Cities' 14-year-old telephone system has outlived its anticipated useful life of 10 years and the vendor will not support the system beyond 2003. A telephone system replacement project should start in FY01 to be completed by July 1, 2003. The estimated replacement cost is $15 million.

- Research and teaching are demanding greater Internet capacity. The University has doubled its consumption of commercial Internet capacity every year since 1991. If historical growth and cost trends continue, the annual cost will grow from $300,000 in FY99-00 to $1.2 million in FY01-02.

- Resources are needed to incorporate new information technologies into the curriculum and to train faculty, students, and staff in the creation and delivery of digital information.

The University Libraries serve not only the faculty and students at the University, but libraries, schools, governments, professionals, communities, and businesses throughout the state of Minnesota. New technological investments are needed to link electronically all the University's campus libraries, to promote resource sharing among all types of libraries in Minnesota, within the broader MINITEX region, and within the Committee on Institutional Cooperation (CIC) consortium.

The University of Minnesota Libraries, like libraries at all major research institutions, face escalating costs (far in excess of inflation) of information resources (traditional and digital); increasing volume of publications in all formats; expanded user expectations and demands for services and resources; and rapid changes in the computing and telecommunication infrastructure.

- Scholarly books cost some 60% more than they did ten years ago, while journal subscription prices have risen more than 160% during the same period.

- The library computer system will likely be replaced during summer 2001 as part of the MNLink statewide library initiative. State funds are anticipated to cover most of the estimated $5 million cost.

Sophisticated administrative systems are needed to manage effectively the operations of a large, complex university: student registration, class scheduling, purchasing, admissions, student transcripts, accounting, facilities management, payroll, and grants management. These systems and accompanying staff register more than 50,000 students each academic term, produce paychecks for over 20,000 full-time and part-time employees, and accurately track revenues and expenses of over $1.9 billion.

Among those systems, the current Enterprise Systems Project is key to the University's long term strategy to improve quality and decentralization of basic administrative services. The major components of the project include student systems and human resource systems, including payroll and benefits. The Board of Regents approved the original enterprise project plan, budget, and financing proposal in December 1997. One element of the financing plan called for a portion of the project to be financed by a unit-level assessment against total salaries. This assessment occurred in FY97-98, at a 0.7% level; it was suspended in FY98-99, but was reinstated in FY99-00 at a 1% level. The assessment is projected to be in effect at least through FY07-08.

- Beginning with the first year of the financing plan, FY97-98, it will take ten years to pay off the approximately $55 million investment in the new Enterprise Systems. Additional investments will be needed to update and maintain these systems over time and eventually to implement new systems in the future.

- The age and lack of vendor support of the CUFS general ledger accounting system will make the system increasingly difficult to support. The estimated cost of replacement is approximately $20 million.

In summary, these three sets of costs—compensation, facilities, and technology—are system-wide, and together they account for approximately 85% of the budgetary shortfall in the 1999-2001 biennium. Other costs, such as the cost of financial aid, insurance, legal counsel, and Title IX compliance, are also likely to rise over the next decade.

I. What revisions are needed to theUniversity's budgeting framework and processes?

The task force finds that many features of the University's current budget and planning processes work well. The budget processes are more consultative and transparent than in the past. Considerable resources, and discretionary authority over those resources, reside at the unit level. During the University's compact planning process, which began in 1997, the provost and the senior vice president for health sciences have regular, structured conversations with collegiate and service units about mission, priorities, resources, and fiscal issues. This process often provides meaningful opportunities for faculty consultation. Priorities and commitments that emerge are explicit and public, and there is general confidence that these commitments will be honored. Communication between the central budget office and the RRC managers is timely, clear, and collegial. The on-line fiscal information is accessible, is useful to managers, and is being improved. The University's capital improvement plan and the capital improvement planning process are becoming more transparent, especially through the development of specific criteria for capital projects. All capital projects are now required to complete a predesign document. Placement of projects into categories ("funding lanes") has clarified the timing and funding expectations for various types of projects.

Throughout its discussions, the task force grew to appreciate and understand the complexity of the University. With changes in the external funding environment, growing pressures on scarce resources, and demands for greater accountability, thoughtful distribution of resources is more important now than ever. Over the past decade, the University planned and weighed its financial decisions, only to find itself facing shortfalls that led to retrenchments or taxes on units. The University of Minnesota has resources comparable to those of many other public universities, yet certain areas such as salaries, libraries, and building and classroom maintenance seem to be chronically under funded. As the task force gathered information, asked questions, and grappled with the issues, the complexity and the importance of matching resources to missions and priorities became an underlying theme. It also became apparent that the connections among the University's various budget and planning processes need to be enhanced and the implications of individual budgetary decisions must be made apparent in other relevant budget processes and in the long-term budget of the University.

Recommended Principles for Financial Planning and Budget Management

The task force reviewed the financial planning and budget management principles that were developed when IMG was implemented. Those principles remain important and have been incorporated into the task force recommendations below. The following principles are intended to further strengthen the core values underlying the University's financial management processes. The president should formally adopt these principles with appropriate consultation.

Shared Responsibility. Every academic and administrative unit must share responsibility for the welfare of the institution as a whole, and for addressing ongoing costs at the unit level. Every financial decision maker has a responsibility to protect and preserve the University of Minnesota. Decision makers must consider the impact of their actions not only on their own unit, but also on the University as a whole; they must also be mindful of the long-term consequences of their actions for the strength and vitality of the University.

Leadership. The leadership of the university, at all levels, is responsible for effective resource management. Leaders are ultimately accountable for creating a viable long-range financial plan, the oversight of institutional financial performance, the efficient use of scarce resources, and the maintenance of financial stability. Every financial decision-maker has a responsibility to protect and preserve the University.

Accountability. Management, budgetary, and reward structures must tie resources to performance closely enough so that individuals can see how their actions influence the fiscal well-being of their units and the University as a whole. The management structure should strengthen decentralized decision making so that funding and expenditure decisions are made close to the areas that are affected. Proper incentives are necessary for members of the University community to enhance revenues and control costs. Annual reviews of administrators at all levels should include evaluations of how effectively they manage unit resources and how they allocate resources to match priorities. Service units, in particular, must be subjected to continuous scrutiny for efficiency, effectiveness, and appropriate levels of service.

Connectedness. It is critical that the cumulative effect of the many financial decisions made across the University interact in a way that helps the University achieve its priorities and goals. The opportunity costs and tradeoffs of decisions must be considered, and the implications of decisions made in one budget and planning process must be connected to the impact that they have on other budget and planning processes.

Consultation. Resource allocation decisions should involve the shared participation of chancellors, vice presidents, deans, faculty, staff, and students. Cross-subsidies and entitlements to support valued University programs and services must be clear. Discussions on the budget must be "information rich," to develop a better understanding of the budget and budget processes throughout the University community.

All-Funds Approach. The University's compact and budget process should allocate state support among academic and administrative units, taking into consideration all resources available to those units to support targeted programmatic investments. The continuing financial management involving IMG should recognize that units are not equally positioned in their ability to grow revenues or to respond to unexpected financial pressures. The University cannot look to just one budgetary strategy or rely on one source of new funding to deal with financial constraints, but rather it must manage through an integrated strategy, drawing upon all sources of funding.

Periodic Programmatic and Financial Review. Periodically, the president, executive vice president and provost, senior vice president for health sciences, chancellors, and relevant consultative bodies should review the programmatic and financial plans of academic and administrative support units, to assess the ability of each unit to meet projected programmatic goals and the associated expenditure requirements. Similarly, deans and unit heads should periodically review the units within their span of authority.

Efficiency. The University must face financial challenges by maximizing the efficient use of resources as well as by aggressively managing growth. Both academic and service units must be encouraged to seek continuous improvements in efficiency and effectiveness and should use internal reallocation strategies to improve the efficiency and effectiveness of their operations.

Recommendations to Improve the University's Budget and Planning Processes

1. Underlying institutional values and priorities should be made a more explicit part of the budget and planning processes, communicated annually so that those values and priorities clearly inform budget planning and decision making throughout the University. This could take the form of a brief annual presidential statement of current resources and allocation priorities.

2. To clarify the impact of individual budgetary decisions on the system as a whole, linkages among the major University budget and planning processes need to be enhanced:

   - The compact process should be timed to inform the development of the biennial budget request to the state, with unit-level priorities communicated to central administration during the winter of even years.

   - Information on possible financial stringencies that units face, gained through the oversight meetings of the annual winter budget process should be combined with the compact priorities in developing the biennial budget request to the state.

   - Capital budget development, particularly the projections for debt service and increased operational costs of buildings, should be estimated and communicated as a component of the predesign document and approved prior to the budget going forward.

3. In each of the four budget and planning processes, a consultation strategy should be developed so that the University community can participate in discussions regarding the choices and trade-offs among various investments.

Recommendations to Improve the Annual Budget Process

1. The annual operating budget cycle should be revised so that base budgets are developed in September rather than October of each year. With the overall parameters of budget planning in place, consultation on specific budget issues and methodologies can occur between October and February/March. This change will add one month to the consultation schedule.

2. A clear process should be developed for assessing financial decisions made outside of the annual budget development process. Many decisions with financial consequences are made throughout the year, by different persons, without full assessment of the financial implications of those decisions in the context of the overall University budget. (One example of these decisions is the rate setting done by service units.) These latent or unforeseen linkages have significant effects (externalities) on other units. A method for plotting the implications of isolated decisions should be developed. This method should outline a way to track the recurring and nonrecurring costs of such decisions, as well as the specific resources needed to cover the costs. The financial impacts must then be tracked and built into the University's financial planning. There must be adequate and timely consultation on these decisions.

3. Any budgetary commitment with funding implications beyond funding provided by the individual unit involved should be approved by the executive vice president and provost or the president before the commitment is considered final.

4. Financial forecasting models at the central level should be improved and expanded to include three- to five-year projections of revenues and expenditures.

5. A template for financial forecasting at the unit level should be developed and distributed to improve the management of resources.

6. Timing of information on ICR and tuition revenues should be enhanced to allow units to monitor income and expenses in time to adjust both short- and long-term plans.

Recommendations to Improve the Compact Process

1. The review and revision of compact documents should be on a two-year cycle, keyed to the University's biennial budget. Compact discussions should be held annually, but those leading to a full compact agreement should occur in the winter of even years, with the new compact commencing on July 1 of odd years. When a unit is undergoing significant change or restructuring, the provost or the senior vice president for health sciences may wish to put a unit on an annual compact cycle.

2. Compact discussions and agreements should focus more on long-term planning and multi-year funding commitments. The compacts should clearly represent the units' highest priorities and operating/programmatic goals and should give information on the actions to be taken in the near- and long-term to achieve those goals.

3. In evaluating the funding needed to achieve desired results, the compact process should consider the resources that can be secured from internal unit reallocations, as well as the amount of new incremental resources needed.

4. Compact agreements should better integrate discussion and planning on important University-wide issues (such as technology issues) across units. Guidelines for compact development should instruct units to address a chosen issue (in addition to institutional and unit values and priorities), with the results summarized and used in central planning.

5. When appropriate, compact discussions should involve multiple units concerned with a common issue (e.g., colleges involved in the biological sciences initiative; colleges and units that provide undergraduate education/services; linkages with the University Extension Service). Compact documents centered on these issues, in addition to those centered around a unit, should be pursued when the result will add value to program planning.

6. The compact process should place more emphasis on developing strategies for enhancing the level and quality of various administrative support services to support academic priorities.

Recommendations to Improve the Biennial Budget Process

1. The timeline for development of the biennial budget should be adjusted to allow for incorporation of issues arising from the compact priorities. A review of the draft compacts

in early spring of even years should inform strategy discussions on development of the biennial budget request.

2. Because they will inform development of the biennial budget request, compacts should clearly describe the participation and governance processes by which they were generated.

Recommendations to Improve the Capital Budget Process

1. As part of the recommendation to improve forecasting at the central level, financial parameters or "benchmarks" (themselves subject to revision) should be developed for University capital expenditures, including debt service, with a view toward their impact on operating budgets in later years. The parameters should involve different budgeting perspectives, such as percentage commitments, ratios, and comparisons with other comparable universities.

2. Significant progress has been made in establishing a coherent process for capital budget planning and development and for monitoring the inventory and use of space. To help reduce the need for the construction of new facilities and ensure an efficient utilization of existing facilities, the University should further integrate its assessment of space utilization into its capital budget planning and development process.

Recommendations to Improve Risk Management

The task force discussions about budgetary frameworks and processes recognized that managing risk is a factor in decisions about how resources are managed at all levels. Uncertainty can breed inefficiency. Faced with uncertainty, units may create overly large financial cushions, and thereby miss opportunities to achieve their goals. In an environment where resources are decentralized, this underutilization of resources can occur at multiple levels (central administration, colleges, departments, and even individual faculty members). Although decision-makers at each level may be appropriately cautious, the combined result across levels may be an overprotection against the same risks.

Throughout the institution there should also be a better understanding of the differences between financial risks to revenue streams and financial risks due to unanticipated expenditures, and a better understanding of how best to mitigate those risks (holding cash reserves is not always the best strategy). Achieving clarification of the different kinds of budgetary risk will allow managers better to anticipate fiscal changes.

1. A financial policy establishing guidelines on the "proper" levels of reserves for units and for central administration should be developed. Included in this policy should be information on the different types of risks and the potential strategies for dealing with them.

2. A working group should be established during the summer of 2000 to examine whether some specific types of risk should be borne centrally (e.g., various types of sick leave, vacation payouts for employees who retire or resign, fluctuations in tuition and ICR revenue) rather than at the unit level. Any recommendations from this examination could then be built into the development of the FY01-02 budget.

II. How should we conceptualize and organize the various costs, expenditures, and investments of the University?

At present there are no consistent criteria for deciding which costs are the responsibility of individual units and which costs should be the shared responsibility of the University community. In recent years, central administration has tried to move to units some of the costs that traditionally were borne centrally. Units also have tried to move some of their costs to central. Because shifts in cost assignment can create budget uncertainties, a set of criteria that could be applied over time would be useful. Although the particular circumstances may change over time, a set of criteria will help decide how costs should be assigned.

Recommended Criteria for Deciding whether Costs Should Be Considered the Shared Responsibility of the University Community

Basic Services. Some basic services and operations are absolutely needed to keep the University running, and they should be regarded as a shared responsibility of the University community. These items include those that are essential to the ongoing basic operations of the campuses and that are available to all units on an equitable basis, although the actual use per unit may vary over time. Examples include water, police, snow removal, the Regents' Office, President's Office, the Office of Institutional Relations, the central Budget Office, the State Fair building, basic technological infrastructure, centrally scheduled classrooms, the data warehouse. How much of a particular service or operation is needed overall may be subject to central review.

Legal Requirements. Some goods, services, and activities are necessary to meet the legal requirements of operating the University (e.g., data collection as required by law; disability accommodations; hazardous waste disposal; the Office of Equal Employment Opportunity and Affirmative Action; the General Counsel's Office). These are outside the control of local units, and the University is obligated to provide them. They should be considered a shared responsibility.

University Enhancement. Goods, services, or activities that enhance University values (e.g., museums, signage, landscaping in common spaces designed to ensure that the campuses are accessible to students, faculty, staff, and the community) should be considered a shared responsibility. Decisions about shared responsibilities must recognize that the University community has a long-term shared responsibility to preserve and enhance the University's capital assets (e.g., buildings, facilities, landscaping, library collections, classrooms, and other infrastructure). Over time, some investments may benefit particular units more than others, but the cumulative value to the institution over the long term is maintained. Investments that preserve and enhance the University's capital assets are the shared responsibility of the University community.

Targeted Academic Investments. The University may choose to fund a specific set of activities to encourage investment in the intellectual future of the University. Many of the University's greatest opportunities in future years may well be in initiatives that cut across collegiate units and that will require presidential and provostal leadership. The president and provost must be in a position to respond quickly and effectively to sudden opportunities, to new discoveries, and to changes in fields of inquiry. Targeted academic investments should be considered a responsibility shared by the entire University community because they are designed to enhance the vitality of the University as a whole.

Efficiencies. When there are substantial cost efficiencies from economies of scale or standardization, and when it is impractical or cost-ineffective to calculate or distribute costs (e.g., central accounting system, centralized heating system, standardized library catalogues), the item should be the shared responsibility of the University community.

Campus Differences. Because the University of Minnesota has four campuses and some programs based off campus, decisions about shared responsibility should recognize the fact that some activities are system-based and are hence a shared system-wide responsibility, while others are campus-based and should be funded at the campus (not system) level.

Consultation. Significant changes in the assignment of responsibility for costs (whether direct, through the shifting of administrative responsibility, through taxes, or through rate changes) should be consistent with the above criteria and should be made after appropriate consultation with the University community (described in section IV, below).

III. How should the funding ofcommon goods and core administrative activities be balanced with unit priorities? Under what circumstances should responsibility be shared by central administration and units (campus, colleges, etc.) for all-University costs and investments?

The intellectual vitality of the University of Minnesota requires continuous reinvestment to maintain the strength of outstanding academic programs and to support expansion into emerging and promising fields of inquiry. Targeted academic investments must draw upon the internal reallocation of resources and the prudent investment of new state resources and private giving.

Targeted academic investments must occur at the collegiate, campus, and University levels. The increased share of University resources under the direct control of deans and chancellors as a result of IMG has increased the ability of these academic leaders to respond to strategic initiatives within their units. It is important that deans and chancellors continue to have the discretionary resources they need to advance the academic priorities of their units. However, local reallocation is alone insufficient to support many important, emerging opportunities in areas that will advance the frontiers of science and the state's economy and quality of life. Many promising new initiatives cut across collegiate units and require presidential and provostal leadership. For example, developments in plant genomics, biomedical technology, cognitive sciences, and medical anthropology are cross-college ventures. The provost and senior vice president for health sciences must be able to use the compact process to target University resources to such strategic academic investments.

The task force recognizes that a portion of the University's budget must be dedicated to providing basic services and operations, to meeting legal requirements, and to providing goods, services, and activities that enhance University values and preserve the University's capital assets. All units must participate in the funding of these shared University responsibilities. Moreover, the University community needs to recognize that expenditures for many of these activities and services (e.g., technologically adequate classrooms, modern research facilities, up-to-date library collections, cutting-edge information technology) are essential costs of academic programs achieving their academic priorities.

Given scarce resources, an inevitable tension develops among the provision of discretionary resources at the collegiate and campus level to support targeted academic investment; provision of discretionary resources at the central level to support broader, targeted academic investments; and provision of resources to cover the costs of basic University services and operations. The task force believes that academic programs must have priority in the allocation of resources.

Recommendations To Guide the Balance of Support Between Shared University Responsibilities and Collegiate and Campus Priorities

1. The president—in consultation with the faculty, deans, the President's Executive Committee, and other relevant staff councils and committees—should establish targets for the resources that should reside at the collegiate, campus, and University levels to fund targeted academic investments and the resources that should be devoted to cover the costs of basic University services and operations.

2. Significant recurring funds must be budgeted that will allow the provost and senior vice president for health sciences to make targeted academic investments each year through the compact process.

3. The compact process should identify for each unit the resources that will be set aside within the unit for the unit leader to make targeted investments, respond to unit emergencies, and contribute to the costs of shared University responsibilities.

4. The annual compact process for support units should identify standards for the quantity and quality of services provided. Executive management and users should have input into the development of those standards, and annual budget development for support units should acknowledge the standards and the success in meeting them.

5. Care must be taken to avoid the passing down of previously centrally funded services down to the units as unfunded mandates without full consideration of the impact of the action. While it may be appropriate for units to assume the provision and cost of some services, particularly those that are not used equally by all, it should be done consciously with recognition of the impact on the unit. Ordinarily there should be a transfer of funding from the central unit that previously supported the costs to the units now responsible for providing the service.

Recommended Criteria for Deciding Whether Specific Costs Should be Distributed to the Unit Level Rather than Funded Exclusively by Central Allocations

<u>Expensive Marginal Costs</u>. When there are marginal costs from increased consumption *and* increased consumption is potentially expensive (e.g., unlimited use of ITV, unlimited modem use, unlimited appetite for new and renovated buildings), a user fee or some other form of cost sharing or distribution should be applied.

<u>Unit Revenue, with Shared Costs</u>. When a revenue stream is controlled by an individual or unit, but the operating costs are subsidized by the University community (e.g., a unit facility that is rented out to generate income), some or all of the operating costs should be paid for by user fees.

<u>Increased Accountability and/or Efficiency</u>. When a charging mechanism clearly increases accountability and efficiency without creating increased administrative costs and workload, a user fee or some other distribution method may be implemented (e.g., long distance charges). When charging mechanisms are used, they should be clear and simple to implement, with

minimal transaction costs.

IV. What governance strategies should be considered to evaluate costs, expenditures, and budgeting strategies in relationship to University-wide costs and investment needs and the costs and investment needs of the colleges and campuses?

The University needs a more formal and consultative process by which deans, chancellors, faculty, and staff are consulted about whether a particular cost should be treated as a shared responsibility of the University community or whether a particular cost should be incurred, and if so whether all or some of that cost should be distributed to the unit or individual level. This consultative process should ensure that all voices, including those representing the University Libraries, Facilities Management, Campus Health and Safety, and Classroom Management, are represented in the discussions.

The task force recommends two consultation strategies for improving the development of long-term, substantial budget priorities of the University. They could be adopted singly, or in combination, to address the issue of governance. Enhanced consultation would focus on broad policies, principles, and strategic directions rather than on individual allocation decisions. It should help to frame broad strategies rather than guide tactical decisions. It should focus on the tradeoffs and opportunity costs that come from decisions.

<u>Strategy #1</u>: Strengthen consultation with existing leadership organizations of the University, including the Faculty Senate, Deans' Council, President's Executive Committee, and other relevant staff councils and committees. This option would establish a schedule for advanced consultation for the major budget processes of the University. Consultation should occur before substantial new costs, before commitments are made, before cost allocations are changed, and before new levels of debt are incurred.

<u>Strategy #2</u>: Create a University Budget Advisory Committee to provide counsel on the application of the task force recommendations and on the major fiscal issues that the University will need to confront over the years to come. The University Budget Advisory Committee should broadly represent the whole University community—drawing upon faculty, staff, and administrators for its membership. Members should serve for staggered four-year terms, so their cumulative knowledge and understanding can be brought to bear on the complex issues. The president, in consultation with the faculty, the senior officers, and deans, would appoint this committee. The committee would consult on major budgetary requests, substantial long-term investments, and the long-term support of University programs and services. It would likely replace the current ad hoc committee on the biennial budget. Its recommendations would be advisory to the president. The associate vice president for budget and finance would be expected to participate in this group.

V. What funding principles and budget strategies should be used to support current and anticipated obligations?

If competitive compensation, modern research and teaching facilities, cutting-edge technology, and strategic academic investments are University priorities, then recurring revenue streams and/or resource reallocation must be identified to cover the costs associated with these priorities. There are no easy answers here, and the solutions require that the University, the legislature, and the University's alumni and donor community work together to ensure the financial vitality of the University of Minnesota. Within the University, all members of the community—central administration and collegiate and campus units, administrators, faculty, staff, and students—must share in the collective responsibility to meet these fiscal challenges.

Recommendations for Securing Incremental Resources To Address University Priorities

The University must develop new sources of recurring revenue if it is to meet the rising recurring costs of compensation, facilities, technology, and strategic academic investments. All the traditional partners in the funding of the University of Minnesota must share responsibility for providing the incremental resources needed to address these priorities.

1. The state of Minnesota must continue to play a leadership role in ensuring the excellence of the University of Minnesota and enhancing its mission of research and discovery, teaching and learning, outreach, and public service.

2. Philanthropic support of the University of Minnesota must grow if we are to attract and retain distinguished faculty and attract the best and brightest students to the University and to the state. The capital campaign is critical to the University's vitality.

3. Tuition revenue must continue to grow beyond the rate of inflation. The primary revenue growth will be through rate increases. (Resident tuition on the Twin Cities campus is $1,500 less than that of Michigan, Michigan State, and Penn State. Resident tuition at Minnesota has increased at a lower rate than at most other public top-30 research institutions.) A 5% increase in tuition revenue, using FY99-00 projected revenues of $234 million, yields $11.7 million. Additional small amounts of tuition revenue growth can be realized through increases in average student credit load, selected increases in student headcount, and a change in the out-of-state/in-state mix to attract more nonresident students and broaden the geographic diversity of our student body.

4. Sponsored grant and contract activity must increase to generate new revenues needed to cover a larger share of the direct costs of faculty research and to increase the indirect cost recovery required to sustain the University's research infrastructure.

5. Faculty research in applied areas is important for generating new revenues through technology transfer, patents, and royalties. When the University materially benefits from intellectual property it owns, both the inventor and the institution share the income.

Recommendations Concerning the Internal Funding Mechanisms To Meet the Costs of the Shared Responsibilities of the University Community

Currently, commitments are made, obligations accumulate, and then a collection of ad hoc methods is used (including targeted reductions, taxes, passing expenses from central down to units, and raising rates) to piece together the resources needed to meet those obligations. A more stable, predictable, controllable, and transparent system is needed to budget and fund these expenses.

For FY99-00, the $32 million resource gap was covered in the following way:

- The Institutional Revenue Sharing (IRS) plan was instituted to generate a net increase in revenue of $5.4 million. (See Appendix D.) The assessment of academic units equaled 1% of total nonsponsored revenues for the fiscal year. The total assessment on support units equaled 2% of "sales and services" revenue for the fiscal year.

- In addition, an Enterprise Assessment was levied, based on 1% of each unit's salary expenditures, to generate $6.1 million.

- Increased state appropriations, internal unit reallocations, some ISO rate and fee adjustments, and some targeted base reductions funded the remainder of the $32 million shortfall.

Because the majority of the funding gap is recurring costs, recurring reductions in expenditures and/or additional recurring revenues are needed to fill it. The use of central reserves or other soft balances is a stopgap method.

The mechanisms used to pay for commitments that are deemed shared responsibilities of the University community should be *simple, fair, and transparent.* The mechanisms and their budgetary impact on units should be predictable a year or more in advance so that units and central administration can plan.

1. Central administration should levy an overhead charge on all incremental programmatic legislative funds to cover the overhead costs associated with implementing new programs.

2. A single tax applied to all University units should be implemented based upon an all-funds framework of nonsponsored resources to meet all other shared University responsibilities. This framework provides equity in the impact of the assessment across units and ensures that the entire University community contributes a proportionate share of resources to help cover the cost of commitments. Taxes should not involve complicated systems of attribution formulas tied to particular goods (e.g., one tax for the libraries, another tax for the office of the general counsel, etc.).

   In FY99-00, there are two taxes, with different rate structures and different tax bases. In the interests of predictability, those separate taxes should continue into FY00-01.

   For FY01-02 and following years a new strategy should be adopted to levy only a single tax. Specification of the tax base and other issues should be discussed through the consultative strategies identified above.

3. The University should make targeted reductions in activities that are ineffective, inefficient, or deemed to be of lower priority. Consolidation, streamlining, or elimination of activities should be considered. This is both a University-wide and an individual unit responsibility.

The task force considered a number of other mechanisms: changes in the distribution of tuition, including implementation of a base tuition that is distributed to central administration rather than collegiate units; implementation of a system-wide or campus-wide student technology fee that would be distributed to central administration; and changes in the funding mechanisms for compensation increases, including the possibility of instructing units to draw upon their tuition and ICR revenue to fund a larger share of the centrally mandated compensation increases. These mechanisms are not among those recommended by the task force.

Recommendations To Increase Accountability and Efficiency in the Use of Scarce Resources

The University of Minnesota needs to build into the budget framework better incentives to encourage decision-makers at all levels to act in an efficient and cost-effective manner, guided by the core values and priorities of the institution. Although IMG has created important new incentives for colleges to monitor closely their instructional costs and tuition revenues, additional incentives are needed to improve accountability and increase efficiency for all units, with all funds.

1. Systems of accountability must be developed to reduce the opportunities for units to make, independently, decisions that generate fiscal consequences for other units and for the University as a whole. Decisions made by a unit, which have fiscal consequences beyond the unit, must be approved explicitly by the president or the executive vice president and provost.

2. Because most units tend to overestimate the proportion of their budgeted expenses that will actually be spent in a particular fiscal year, better financial tools and incentives are needed to help units project their actual expenditures and thus free up resources that can be used to meet priorities.

3. Administrators who are in positions to make decisions about resources (from unit chairs, heads, and directors to deans and vice-presidents) need more and better fiscal management training. Staff who work in support of these decision-makers should have access to frequent training and upgrading of their skills and knowledge.

4. The University should continue to monitor any deficits and maintain strong incentives for units to avoid deficits.

5. The University should explore a broad range of strategies for achieving collective efficiencies—including considering economies of scale, eliminating redundancy, streamlining operations, and reducing transaction costs. Some possible areas that surfaced in the task force discussions included these areas:

    - Better coordinate the use of space over time of day and time of year (particularly classrooms and conference facilities).

    - Establish more self-service options, with lower transaction costs.

    - Set a higher level of performance standards for centrally provided services in some areas (e.g., custodial services, classroom maintenance).

    - Eliminate multiple options for basic services (e.g., the current option of either direct deposit or paper payroll checks).

    - Examine business processes and streamline where possible (e.g., reduce the more than 250 official University of Minnesota "forms").

- Explore out-sourcing of selected functions.
- Continue working for greater energy efficiency and utility cost savings (e.g., should portions of the various campuses be closed for 8-10 days in December and January?).
- Analyze the benefits of centralization or decentralization of selected activities.
- Devise a more cost-effective timing of external reviews of graduate programs.

6. The cost of goods and services provided by internal service organizations, auxiliary units, and central service units should continue to be carefully analyzed. Mechanisms need to be enhanced to ensure the cost competitiveness and quality of these goods and services.
7. Support units throughout the University should guarantee that best practices are employed to minimize the University resources required to provide the services. Performance and efficiency benchmarks should be established to measure the use of resources in service units. Before any costs for services are allocated to other units, there needs to be a clear model that defines for the support unit its roles and responsibilities, the revenues and expenses it will bear, its accountabilities, and the process for setting performance standards.
8. The University of Minnesota spends more per square foot to operate and maintain its physical plant than do comparable public universities. Efforts must be made to identify more cost-effective ways to manage this space.
9. The president should appoint a "Best Practices Team" comprising faculty, staff, students, and administrators charged with identifying practical efficiencies each year. The team should have a goal of identifying ways to save the University at least $1 million recurring each year. Identified savings should be reinvested in key areas of the University so that faculty, staff, and students can share in the benefits of the cost savings.
10. Students on the Twin Cities campus take much longer to complete their degree programs than do students at comparable public universities: the Twin Cities four-year graduation rate of 17% is less than half that of peer institutions. When students take five, six, or more years to complete their degree programs, they use libraries, computer facilities, laboratories, advisors, administrative services, and the like for a longer period of time than do students who graduate in four years, all at significantly increased costs to the University. Vigorous efforts must be made to create further incentives for students to take full course loads so they will graduate in four years. A dramatic increase in four-year graduation rates will allow the University to educate more students more cost effectively while at the same time providing each student a better educational experience.

Conclusions

Although the immediate fiscal challenges framed the work of the task force, the task force recommendations are designed to offer a broader, longer-term view and to provide principles and strategies to guide University budget planning and fiscal management now and into the future. There are no easy solutions or quick fixes for the fiscal challenges facing the University. A mixed strategy must be followed that improves the University's budget and planning processes, increases revenues, reduces costs, and internally reallocates resources.

Process Improvements. Although many features of the University's current budget and planning systems work very well, we need to improve these processes to ensure that they are grounded in core principles; better interconnected so that they make more explicit the opportunity costs and trade-offs of various investment decisions; involve enhanced consultation and communication processes in which deans, chancellors, faculty, and staff advise on the broad policies, principles, and strategic directions that inform the University's fiscal strategies; improve forward-year financial planning to document and analyze the impact of future commitments and the specific plans for the resources to cover them; and improve risk management strategies to provide appropriate levels of protection against risk.

Strategies for Increasing Revenues and Reducing Costs. All of the traditional partners in the funding of the University must share responsibility for providing the incremental resources needed to address the University's priorities: there must be increased state and philanthropic support; increased tuition revenue; more grant and contract activity; and new revenues from technology transfer, patents, and royalties. On the cost side, we must increase the level of accountability of financial decision-makers (from unit chairs, heads, and directors to deans and vice-presidents); increase the accountability of support units by monitoring the costs and quality of services and by setting performance standards; and create a "Best Practices Team" to identify strategies for achieving collective efficiencies.

Strategies for the Internal Allocation of Resources. The University should implement specific criteria for deciding which costs are the responsibility of individual units and which are the shared responsibility of the University community, and then implement specific criteria to guide decisions about whether particular costs should be distributed to the unit level or funded exclusively by central allocations. To meet the funding gap for costs residing with central administration, the task force recommends that the central administration continue an overhead charge on all incremental programmatic legislative funds to cover the costs associated with implementing new programs; implement a single tax on all nonsponsored funds applied to all University units, to meet shared University responsibilities; and make targeted reductions in activities that are ineffective, inefficient, or deemed to be of lower priority.

Together, these recommendations will set the University on a course that should, over time, provide adequate ongoing support for key University priorities, allow for new strategic academic investments, reduce fiscal uncertainty, more closely align priorities and spending, and make more efficient use of scarce resources. Together, these recommendations will ensure the vitality of the University of Minnesota for years to come and will ensure that the University continues to excel its missions of teaching and learning, research and discovery, and outreach and public service. We urge the president to implement the task force recommendations in a timely fashion and to report back to the University community within six months on the actions he has taken.

Appendix A
Charge to the Budget Management Task Force

MEMORANDUM

May 27, 1999

TO: Steven Rosenstone, Dean--CLA (Task Force Chair)
Marilyn Speedie, Dean--Pharmacy
Al Sullivan, Dean--CNR
Gail Skinner-West, Dean, UC
Steve Gudeman, Faculty--CLA
Fred Morrison, Faculty--Law
Carl Adams, Faculty--CSOM
Charles Campbell, Faculty--IT
Katherine Johnston, AHC Administration
Eric Kruse, VP for University Services
Greg Fox, UMD Administration
Richard Pfutzenreuter, Associate VP for Budget and Finance
Robert Bruininks, Ex Officio
Frank Cerra, Ex Officio

Committee Staff:
Suzanne Bardouche, Chief Financial Officer—CLA
Julie Tonneson, Assistant Budget Dir., Budget & Finance
Tom Cook, Associate to CLA Dean

FROM: Mark G. Yudof

RE: Budget Management Task Force

I am asking you to serve on a task force to review and make recommendations with regard to possible improvements in the University's budgeting framework, and the organization and allocation of costs to address University-wide needs and obligations. Since the 1996 implementation of the IMG system of revenue allocation, several concerns about its impact and operation have been expressed. One of these is ensuring that there are adequate funds to support "common goods" and costs to maintain University-wide resources and services, and to provide critically needed investment in long-term academic needs. Another concern is the allocation of "common good" investments in an environment in which most new revenue is directly attributed to coordinate campuses, colleges, and other units with very limited resources outside the biennial budget allocations to address system obligations and investments. The biennial budget allocations are increasingly targeted to address specific priorities, providing little flexibility and insufficient resources.

When the decentralized IMG budget system was implemented in 1996, it was recognized by members of the original committee that no provision, other than the biennial budget, was made to address increasing University-wide costs (e.g., debt, utilities, libraries, technology, etc.) or valued academic investments (i.e., strengthening specific campus and unit programs). The Regents, central administrators, chancellors, deans, faculty leadership, and a special joint-University Senate committee have expressed concerns about these issues. Various background materials on the University's budget context are attached in a report I presented to the Regents in May, and further analyses will be conducted as part of this study process.

Although I remain committed to the basic concept of the allocation of revenues found in the IMG model, I do believe that some aspects of the budgeting framework and system need to be reviewed and improved. I am asking the task force to consider the following questions and other issues that should be considered in revising the University's budget framework and processes.

1. What revisions are needed to the University's budgeting framework and processes?
    - How should University budget priorities be defined, and communicated to the broader University community?
    - How is the total amount of institutional risk (including future financial obligations) established?
    - What are the boundaries of fiscal responsibilities in central units and in collegiate units?
    - What principles, assumptions and guidelines should be developed to govern the decentralization of decision making in establishing budget priorities and to provide a reliable funding base for campuses and colleges?
2. How should we conceptualize and organize the various costs, expenditures and investments of the University?
    - What types of investments and expenses should be considered common expenditures of the University? What characteristics define "common good"?
    - How can the University establish a realistic, longer-term financial framework to guide budget decisions?
3. How should the funding of common goods and core administrative activities be balanced with unit priorities? Under what circumstances should responsibility be shared by central administration and units (campus, colleges, etc.) for all-University costs and investments?
    - What principles should help guide how common goods and core administrative activities on the one hand are balanced with unit priorities on the other? How are priorities set?
    - Should some of those traditionally described as "common expenditures" be assigned as unit responsibilities?
    - Are some of the expenditures common only to a single campus or other grouping of units, and, if so, should they be charged on that basis?
    - Capital, facility operations and technology costs are rising rapidly on all campuses. Should capital costs for facilities and the operating costs of facilities be allocated to users, in whole or in part? Should more technology infrastructure costs be allocated to users?
    - Should the initial and maintenance costs of the Enterprise Business Systems be folded into a charging system or should they remain a separate charge for the development and implementation cycle, and a part of overall University costs for ongoing maintenance?
4. What governance strategies should be considered to evaluate costs, expenditures, and budgeting strategies in relationship to University-wide costs and investment needs and the costs and investment needs of the colleges and campuses?

5. What funding principles and budget strategies should be used to support current and anticipated obligations?

    - What mix of resources (e.g., state allocations, modification to IMG, assessments for common goods or overhead, unit assessment, targeted reductions, revenue measures, changes in rate structures for central services, etc.) should be used to address this problem?
    - Should a formula allocation of costs be employed, and if so, what formula best meets the test of clarity, equity, and simplicity?
    - Should all funds and units contribute to the shared responsibility? Should the providers of central services contribute to these charges?
    - Should the providers of central services continue to receive O&M allocations or should their budgets be based entirely or partially on a cost allocation methodology?

You may find other questions that require discussion. I urge you, however, to concentrate your attention on these questions in developing alternative strategies to meet the common needs of the University, and not to seek a fundamental review of the entire budgeting system. Although you may wish to review the "common good" investments for the current year to understand the nature and scope of the problem, I am not asking you to make recommendations with regard to these specific costs.

The administration will implement a temporary solution to address the significant problem in recurring costs (about $30 million) for FY2000. However, the task force is intended to consider the broader issues facing the University, and to formulate a longer-term solution.

I would like the task force to begin its work during this academic year, continue work through the summer, and provide a final report by November 1, 1999. I am proposing a meeting in June to begin the process, identify the questions to be addressed, and more fully develop the scope of our work. I want to thank you for your willingness to serve on this committee.

cc: Board of Regents
Chancellors
Deans
Tonya Moten Brown, Chief of Staff

Appendix B
Budget Management Task Force
Consultation Meetings with the University Community

University of Minnesota Chancellors and Deans Retreat	October 11, 1999
Joint Meeting of Faculty Consultative Committee & Senate Committee on Finance and Planning	October 28, 1999
University of Minnesota - Morris: Area Managers Group Vice Chancellors and Deans Group	November 2, 1999
University of Minnesota - Crookston: All-campus open meeting	November 5, 1999
Representatives of Teamsters Local 320, AFSCME Council 6, UEA	November 10, 1999
University of Minnesota - Duluth: Chancellor's Group, Deans & Directors; Assembly Executive & Budget Committees, Area Class Managers	November 16, 1999
Resource Responsibility Center Managers (TC)	November 17, 1999
Senate Committee on Educational Policy	November 17, 1999
Civil Service Committee	November 18, 1999
Academic Staff Advisory Committee	November 19, 1999

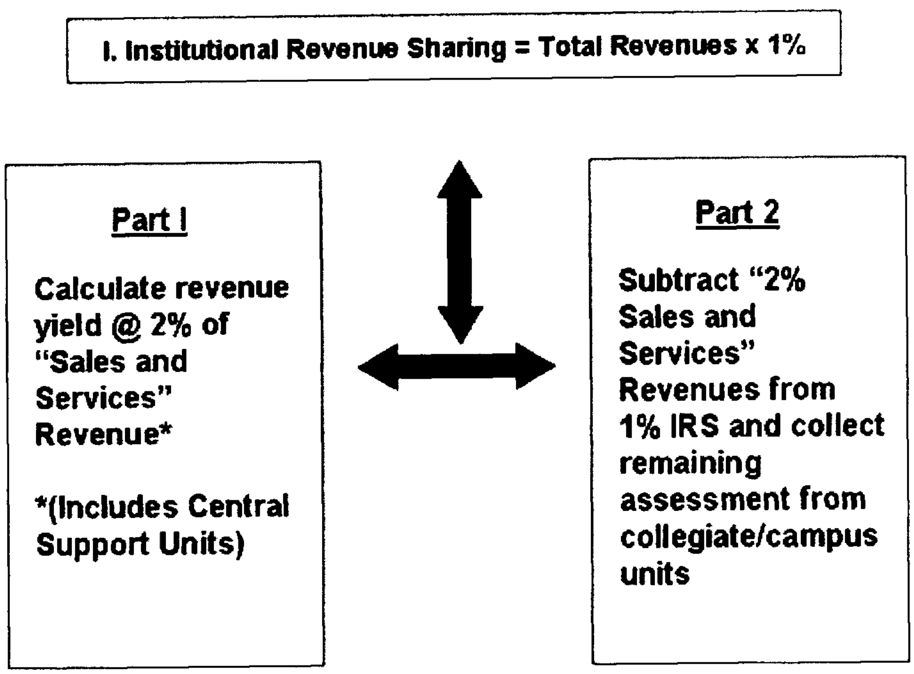
Appendix C
Comprehensive Summary – Central Budget Processes & Cycles

Months	Biennial Budget	Annual Budget	Compact Cycle	Capital Budget
June	**Even Yr. - Budget Instructions From the State to Each Agency** Begin Proposal Dev.	President's Budget Reviewed and Approved by Board Final Budget Prep Entry into CUFS	Post-budget Allocations of Academic Initiatives Finalized Edit Draft Compacts	Board Approcves Annual Budget, 5 Yr. Plan & Preliminary State Capital Request for Even Yr. Session
July	Internal Development of Budget Proposal	New Fiscal Year Begins	Finalize Compact Documents for President's Review	Legislative Visits
August	Agency Base Adjustments Loaded into State System			Legislative Visits

September	Conceptual Framework to Board - Agency Submits Preliminary Plan to State	**Phase I Budget Instructions to RRCs**	**Compact Instructions to RRCs**	Board Reviews State Capital Request
October	Board Reviews Biennial Proposal	Base Budget Established - ISO Rate Development Begins	Compacts Finalized in July/August - Reported to the Board	Board Approves Final State Capital Request - Submitted to State for Even Year Session
November	Board Approves Biennial Proposal - Submitted to the State	Planning Estimates of Revenues & Expenses Created	Submittal of Initial Compact Responses by RRCs - Compact Review Meetings Begin	**Capital Budget Instructions to RRCs for Annual Budget and 5 Year Plan**
December	State Revenue Forecast, Final Tax & Budget Decisions Made for Governor's Budget	Phase II Budget Instructions to RRCs Prepare for Financial Oversight Meetings	Compact Review Meetings Continue	Unit Submissions Due
January	Governor's Budget Submitted to the Legislature - Odd Year	Submittal of Phase II Response - Oversight Meetings Begin	Compact Review Meetings Continue	
February	Legislative Hearings	Oversight Meetings		CIAC Hearings
March	Legislative Hearings	Phase III - Budget Prep Beings Refine Planning Estimates of Revenue & Expenses	Refined Compact Submittals from RRCs with Timelines, Budgets, Etc.	CIAC Hearings
April	Legislative Hearings Legislative Targets Set - Conference Committees Begin	Continue to Refine Planning Estimates of Revenues and Expenses	Review and Edit Draft Compacts	CIAC Develops Recommmended Annual Budget/6 Yr. Plan & State Request Consultation Occurs
May	Legislature	Package Budget	Review and Edit	Board Reviews

Passes Appropriation Bill & Governor Signs it into Law	Decisions - Await Final State Appropriation	Draft Compacts	Annual Budget, 5 Yr. Plan & State Request

Appendix D
FY99-00 Budget Framework
Institutional Revenue Sharing



Page URL: http://budoff.umn.edu/budget/bmtfrpt.htm
This page was last updated on: Friday, 15-Jun-01 15:47:27

Mail comments to Cynthia James Murdoch at: macal001@umn.edu