Minutes*

Senate Committee on Finance and Planning
Wednesday, August 7, 2013
3:00 – 4:30
300 Morrill Hall

Present: Russell Luepker (chair), Gary Cohen, Catherine Fitch, Lincoln Kallsen, Jill Merriam, Fred Morrison, Richard Pfutzenreuter, S. Charles Schulz, Pamela Wheelock, Aks Zaheer

Absent: none counted for a summer meeting

Guests: Julie Tonneson (Office of Budget and Finance)

[In these minutes: (1) FY2015 budget framework; (2) enterprise tax; (3) Huron report (administrative costs) implementation]

1. FY2015 Budget Framework

Professor Luepker convened the meeting at 3:00 and welcomed Vice President Pfutzenreuter and Ms. Tonneson to present the FY2015 budget framework.

Mr. Pfutzenreuter began by noting that last summer, and again next summer, the University will prepare a financial framework for the budget simultaneous with the preparation of the biennial request. The administration tries to ensure that the two are aligned. The overview today is at the 30,000-foot level, a look at the broad categories of expected revenues and expenditures. As they approach actually setting the FY15 budget, the framework will narrow and they will have a better idea of costs, and they do know the amount of the state appropriation.

Ms. Tonneson explained the incremental resources in the FY14 budget as well as the planning estimates for the FY15 budget.

Tuition: FY14, the increment was $8.7 million over the previous year, composed of a 3% increase in graduate tuition, various increases in professional and non-resident tuition, enrollment changes, and surcharges, and a 0% increase for resident undergraduates. For FY15, the planned increment in tuition revenues (over FY14) is $4.5 million, which excludes enrollment-based increases, surcharges, and includes a 3% increase in graduate tuition, mixed increases in professional and non-resident tuitions, and again a 0% increase for resident undergraduates. Mr. Pfutzenreuter commented that the administration is responsive to regental concerns about tuition increases in professional schools.

Appropriation: The incremental appropriation in FY14 was $31.4 million, which included tuition relief as well as the MNDRIVE support. For FY15 the increment will be $14.3 million.

Internal University Resources: The amount necessary to balance the budget by internal reallocation for FY14 the amount is $19.7 million in recurring funds, or 1.17% of the budget. These are primarily expense reductions. For FY15 the projected internal resources needed will be $24.9 million, or an estimated 1.47% reduction.

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The total increment needed for new expenditures in FY14 was $59.5 million; for FY15 the planning estimate is for $43.7 million.

On the incremental expenditure side, in FY14 the compensation increase was $13.2 million; for FY15 it is projected to be $27.2 million. In both cases, the compensation increase is projected at 2.5%. Ms. Tonneson explained that the large difference in the amounts is due to an over-recovery in fringe benefits in FY12, which created a surplus, which federal rules require be applied to the calculations two years later (FY14). (There was discussion about the complicated federal rules governing fringe benefit costs.) Mr. Pfutzenreuter observed that this would not be the way the University would handle fringe benefit costs, if left to its own devices, but it has to follow federal rules. The surplus reduced the net cost of the compensation increase for FY14. The FY15 projections are for flat fringe benefit costs (and they, along with salaries, are also subject to collective bargaining for unionized employees).

In response to questions from Professors Luepker and Schulz, Vice President Pfutzenreuter affirmed that the projected $13.2 million increase in compensation costs includes the 2.5% increase but it is only on O&M and state special funds. The total actual increase, when positions on sponsored and gift funds are included, is about twice the $13.2 million.

Normal bills and investments: For FY14, the increment was $46.3 million; for FY15, the increment is projected to be $16.5 million.

Professor Cohen asked whether the category includes, for example, projected utilities and energy costs. Ms. Tonneson affirmed that it does. Mr. Pfutzenreuter noted that the University is helped by the fact that natural gas prices are at an all-time low. He also explained, after Professor Cohen inquired, that the amount projected for "bills and investments" varies considerably from year to year and can depend in part on how much a president wishes to have available for investments. The funds are eventually committed almost to the last penny.

Professor Luepker said it appears that units will in effect see a 4% reduction (the 2.5% compensation increases to be paid plus the 1.5% reallocation). Ms. Tonneson said that was not the case; the 1.5% reallocation will pay for the 2.5% compensation increases. Mr. Pfutzenreuter agreed and said that tuition revenues plus state funds plus reallocation will be paying for the compensation increases plus the $16.5 million in "normal bills and investments." So units will be held harmless, Professor Luepker asked? They will not, Mr. Pfutzenreuter said, because differential tuition increases, differential distribution of state funds, and differential cuts across units will have different impacts. Professor Luepker said it would be helpful for the Committee to see where units are in FY14 and where they will be with FY15 budgets. If strategic planning is occurring, one should see that show up in budgets.

Professor Morrison said he thought that the $1.8 million from the cost shift of health benefits costs to employees was still in play, but nothing about that has been mentioned in this discussion of the budget framework. Vice President Pfutzenreuter said it was not part of this institutional budget framework but that it is not off anyone's list. Part of the change could occur during FY14, a premium holiday. That is only a one-time remedy, Professor Morrison said, and employees would still see a cost increase in FY15 since there is no provision for a premium holiday in FY15. A premium holiday, he observed, would contribute to UNbalancing the budget. Mr. Pfutzenreuter said that his office has received no instruction on dealing with the changes in health care costs in the FY15 budget. So, Professor Morrison concluded, a decision has been made to take back the $1.8 million, give a premium holiday in FY14, and then impose the cut on employees in FY15; it appears there is no flexibility in the

FY15 budget framework to address that question. Mr. Pfutzenreuter agreed that there is no provision at this point for dealing with it.

Professor Morrison next asked about "Fitz's list": will there be enough funds to cover all the unusual things that happen during a year, typically around $20 million. Mr. Pfutzenreuter said there hasn't been a "Fitz's list" for a number of years and that what gets done is included in the "normal bills and investments" category of expenditures. He said that at this point he did not know what would be funded.

Professor Morrison said it appears that there is no flexibility in revenues except for cuts to department budgets or compensation cuts. Mr. Pfutzenreuter agreed, unless there is increased revenue from enrollment increases. FY15 will be a lean year. Professor Morrison concurred and said it will be lean because the University has been backed into restrictions on tuition. Mr. Pfutzenreuter said he believed it very important that the University hold resident undergraduate tuition increases to zero; Professor Morrison agreed but said that the decision means FY15 will be lean. Mr. Pfutzenreuter said that the days of doubling undergraduate tuition every ten years are over, and there is also pressure not to increase professional school tuition. Absent tuition revenue increases, and possibly facing flat state support, the University needs to identify new revenue sources.

Vice President Wheelock said she understood the need for parameters and that there is considerable fluidity in the situation, that there appears to be little flexibility in the framework, and that the University will need to self-fund most initiatives. Her orientation is that the University must be an attractive, competitive employer but that one can discuss the appropriate balance between salaries and fringe benefits. She inquired what benchmarks were used to establish the 2.5% compensation increase. Do they know what the CPI estimate is? Mr. Pfutzenreuter said he can check on the CPI but reported that his office and the Office of Human Resources do query peer institutions about compensation plans. Ms. Wheelock observed that when there are no new resources and compensation increases must be funded internally, at some point one must look at the question of FTEs versus the percentage increase in compensation. In cases like this, usually salary increases mean reducing the number of employees, which can mean a degradation in services.

2. Enterprise Tax

Mr. Pfutzenreuter turned next to the enterprise tax. In FY13 the collection totaled $12.2 million; of that, about $2.7 million was transferred to the general University O&M budget, about $2.3 million was transferred to the Office of Information Technology and other offices to support enterprise-related expenses, and about $7.7 million was used for major enterprise projects. Since the inception of the enterprise tax, about $149.7 million has been collected; $31.5 million has been used in the general University O&M budget, $24.5 million has been used for enterprise-related costs, and $93.7 million has been used for prior major enterprise projects approved over the years. In the case of the money transferred to the O&M budget and to enterprise-related costs, the decisions to do so were made years ago, when Robert Bruininks was provost, and those allocations continue today.

The balance (collections versus allocations) stands at ($34,987,741).

The current enterprise assessment plan at 1.75% plus projected costs through 2025 mean the "balance" in the enterprise costs will reach nearly ($100,000,000) before gradually approaching zero by 2025. The projections include $181 million in enterprise system needs through 2025, $83 million for the current upgrade project plus about $100 million over the next dozen years or so. The projects would be paid off by 2025 because Vice President Studham (Chief Information Officer) believes that by that time the University will need to switch to some other kind of technology. There would be no major upgrade similar to the $83 million project now under way, but instead there will be smaller improvements over time—and then a major change around 2025. The plan assumes that the transfers to the O&M budget will cease.

Professor Morrison asked about the enterprise tax. Prior to FY14, it was 1.25% on salaries (except those paid by sponsored funds or gifts), Mr. Pfutzenreuter said, and it increased to 1.75% beginning July 1 (FY14). Will it stay at 1.75%, Professor Morrison inquired? Mr. Pfutzenreuter said it is projected to remain at that level through 2025. So, Professor Morrison observed, an additional 0.5% on the O&M salary base.

Professor Cohen said that everyone understands the need for upgrades and the need to find the best prices, about which he does not know enough to have an informed opinion, but there is a case to be made that the cost of these projects should not be paid with an enterprise tax. The $2.7 million diverted to the O&M budget simply pays costs of administration that could be paid through the cost pools (which use more appropriate formulae) and the transaction costs for levying the enterprise tax are higher than the transaction costs for the cost pools (which puts an additional accounting burden on departments). Does the University want to keep on paying for business systems with an enterprise tax when it adds these other costs as well?

What is the ruling principle that says these projects should be funded through an enterprise tax rather than the cost pools, Professor Cohen asked? Mr. Pfutzenreuter said that when the systems were adopted, the enterprise tax was the best proxy the University had, because it did not at that time have the current budget model. They have talked about changing the funding mechanism from the enterprise tax to the cost pools; there are pros and cons to doing so, and there would be significant distribution effects. They have stayed with the enterprise tax because it is familiar, but it could be changed. Professor Morrison said using the enterprise tax permits the University to smooth out the costs over the life of the systems, while the cost pool approach charges units in the year that the expense is incurred, which would lead to very high assessments in years in which major changes were implemented. Mr. Pfutzenreuter said that they could use the cost pool methodology in the same way to smooth out the costs by charging the $12.7 million (actual collections in FY13) to cost pools.

In response to the comment about high transaction costs and additional accounting burden on departments, Ms. Merriam said that at year-end there were issues about the timing of the final enterprise tax transaction and the cleanup of chartstrings. In order to alleviate these issues some of the FY13 year-end deadlines were adjusted to allow departments to more accurately cleanup their chartstrings. Ms. Tonneson said that the clean-up has been the problem.

Professor Luepker commented on the elimination of the transfer of enterprise tax funds to the O&M budget (to be phased out over four years, Mr. Pfutzenreuter said): as the enterprise tax goes up, are other categories adjusted upwards? They are not, they remain fixed, Mr. Pfutzenreuter said. This is a strange, unequal tax in the way that it is applied, Professor Luepker said, and there are hundreds of other University services that are put in the cost pools because it was logical to do so. He said he realizes there is historical tradition behind the enterprise tax but suggested it should be moved to a more rational billing system. Vice President Pfutzenreuter said his office looked at the options and recommended remaining with the status quo.

Mr. Kallsen said that one argument in favor of the enterprise tax is that everyone at the University uses the systems, including auxiliary units and internal sales, but if the enterprise expenses were in the cost pools, the charges would go to the deans, who in turn would have to charge them out. The interest of equity is served by the existing enterprise tax. He noted again that salaries paid from sponsored funds, gifts, and by University of Minnesota Physicians (UMP) are not subject to the enterprise tax.

Professor Schulz pointed out that UMP employees are paid with UMP checks, but there are large transfers from UMP into department budgets; are those funds assessed at that point? They are, Mr. Pfutzenreuter said, if the money is spent on salaries.

Professor Morrison asked if the reduction in the contribution to the O&M budget is in the budget framework. It is, Mr. Pfutzenreuter said, in the $16.5 million in bills and investments. Professor Cohen said he believed that phasing out the $2.7 million contribution to the O&M budget would be supported by the Committee.

Professor Cohen asked how the University benchmarks how much is reasonable to spend on enterprise systems and upgrades. By comparison to peers? How much of the purchasing of these systems is competitive? Vice President Pfutzenreuter observed that the University is now using PeopleSoft systems entirely, with the largest amount of upgrade project spending on the human resources and student systems because they are almost completely new installations. In terms of Professor Cohen's question, he said that Vice President Studham did a lot of work to prepare the plan and could provide a sense for the benchmarks that were used. Mr. Pfutzenreuter said that when he hears from his counterparts at peer institutions, it seems that the University is spending significantly less than many.

Ms. Wheelock said the University also needs to move from an episodic investment in enterprise systems to approaching it as a cost of doing business—and something in which it has been under-investing for a long time. Mr. Pfutzenreuter agreed and said the projections represent a plan so the University is spending money when it is needed. He suggested the Committee might wish to have a discussion with Vice President Studham; Professor Luepker said that one would be scheduled.

Professor Luepker observed that if they were not taking out $5 million per year for other purposes (i.e., the $2.7 million transfer to the O&M budget and the $2.3 million for other enterprise-related costs), the accounts for enterprise systems would not be running a deficit. He agreed the Committee should weigh in on this matter.

3. Huron Report (Administrative Costs) Implementation

Mr. Pfutzenreuter reported that state law requires the University to submit an implementation plan to the legislature 90 days after it received the report from the Huron consulting firm about administrative costs. The report is due to the legislature September 12 and they are working on it. The report will be presented to the Board of Regents at its September meeting as part of "Operational Excellence." Vice President Brown will report on the spans-and-layers report as well, which also must be provided to the legislature. Mr. Pfutzenreuter described the work that is under way, including an initial focus on shared services for central activities with collegiate units coming later, and noted that these efforts are simultaneous with the enterprise systems upgrade, so priorities need to be set.

Ms. Merriam explained that her office, a finance and human resources cluster, provides direct service to over 40 departments within 7 administrative units (RRCs). This cluster model has evolved over time. Mr. Pfutzenreuter said they have to identify units to evaluate clusters and lowering costs, so there will be work yet to do. But these changes will mean fewer people, he said.

Professor Cohen said, using payroll services as an example, that there are two issues at hand, efficiency versus well-informed local service to users. The former means a better use of personnel; the latter means the provision of services that leaves the possibility for errors when staff do certain activities only infrequently. He asked if one should expect more centralization in payroll transactions by fully-trained people, rather than staff in cluster offices who do personnel transactions only on a part-time basis. Mr. Pfutzenreuter said that is a subject the Committee should discuss with Vice President Brown.

Professor Morrison asked that the Committee be provided with the Huron report. Mr. Pfutzenreuter said he would do so.

4. Potential Federal Government Shutdown

Professor Luepker asked for thoughts on a potential federal shutdown. Mr. Pfutzenreuter said he could not imagine that the federal government will shut down—or that if it does, the shutdown would not last very long.

Professor Morrison commented that he did not see that a shutdown would have a big impact on the University if it can finance activities in the interim. Vice President Pfutzenreuter said the University could go for a little while without federal funding. He speculated that the country would face serious problems, however, if a shutdown went on for weeks or months. The leadership in Washington would have to act. Professor Morrison said he believed there will be a shutdown but that it will be short.

On that pleasant note, Professor Luepker thanked everyone for coming to a summer meeting and adjourned it at 4:20.

-- Gary Engstrand

University of Minnesota