Minutes[*]

Senate Committee on Finance and Planning
Tuesday, February 4, 1997
3:15 - 5:00
Room 238 Morrill Hall

Present: Fred Morrison (chair), Catherine French, Jason Frick, David Hamilton, JoAnne Jackson, Gerald Klement, Gary Malzer substitute, Richard Pfutzenreuter, Charles Speaks, Craig Swan

Regrets: Thora Cartlidge, Benjamin Senauer, James VanAlstine

Absent: Bruce Bromberek, Robert Kvavik, Patricia Ferrieri, Peter Robinson

Others: Susan Nemitz (Office of Planning and Analysis); Julie Tonneson (Office of Budget and Finance)

[In these minutes: Incentives for Managed Growth (IMG) and associated budget projections]

Professor Morrison convened the meeting at 3:20 and said the meeting would be devoted to Incentives for Managed Growth (IMG) and the fiscal year 1997-98 budget data.

Meetings in the near future will turn to public/private partnerships (a separate corporation for support services), systems (human resources, the Denny report), benchmarking for support services, and telecommunications and rates. The last is raising its head in the form of memos asking why the rates are higher than what one can get from AT&T "on the street"; one question is whether the University is thinking about how most economically to run an obsolete system?

Ms. Jackson started with IMG; she said she wanted everyone to understand that IMG is still being discussed and reviewed and that it is critical to get questions resolved before the next phase of budgeting. They wanted to have an open discussion with the Committee before anything is put into final form.

Mr. Pfutzenreuter distributed two handouts, a set of slides and two spreadsheets of budget data. He began by reviewing the advent of IMG.

-- It began several years ago, but only received serious attention last spring and summer; there were work groups and an advisory committee that devised a report the President had requested on Responsibility Center Management

-- They traveled to institutions that had adopted RCM, listening to what was said about it; it is an approach to allocating resource and controlling costs.

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

-- The purpose of the initiative is partly predicated on a need for the University to grow its way to financial stability; declining state resources have forced continual reallocation; IMG is intended to assist the University GROW into financial stability, rather than just CUT its way there, by providing incentives for revenue-generating units to control costs, to decentralize decision-making, and to clarify the current cross-subsidies in the budget in order to make clearer choices about where funds should go.

-- The unit of analysis is either a collegiate/academic unit (which generates tuition), or a support unit (which does not generate tuition); a list of the units was provided.

-- One criticism of RCM has been that it is "every tub on its own bottom," and every unit must live or die on its own revenues; that is NOT true in the Minnesota IMG plan, and the spreadsheets demonstrate it is not.

-- The initial transition to IMG is to revenue- and cost-neutral; that is the status of the spreadsheets, as the starting point of IMG. It was also decided, from the outset, that the transition would not try to deal with historical inequities that have developed over the last 100 or more years, but that those needed to be addressed in the future as resources are allocated.

-- A major assumption was that University leadership would retain sufficient fiscal leverage, with the state subsidy, to facilitate achievement of institutional goals.

-- IMG focuses on four issues: attribution of tuition income, attribution of ICR income, how to provide incentives to control costs of space, and to decommission space, and how to distribute the state subsidy. Mr. Pfutzenreuter reviewed the major elements of each of the four.

1. TUITION will be attributed 25% to the college of enrollment of the student and 75% to the teaching unit; this is not a scientific number, and the group examining it reviewed a number of considerations. Other institutions adopting variants of RCM are using a similar split in attribution of tuition income. One Committee member reported that Illinois chose an 80-20 split, acknowledged it was arbitrary, and thought about using 75-25; it gives one confidence to know that others examining this could independently select the same numbers.

One Committee member noted that one assumption is that "each course generating tuition will be associated with a single collegiate unit." What does that say about interdisciplinary graduate programs? Ms. Tonneson reported that those courses are assigned to the Graduate School, and affirmed that the Graduate School would receive 25% of the tuition revenue; that is the only time it is considered a collegiate unit.

What about courses that carry two designators and are carried by two different colleges, asked another Committee member? That remains a problem, Mr. Pfutzenreuter said; there is a workgroup trying to ferret out the problem. At present, Ms. Tonneson said, the model attributes one course to one place; they are trying to identify standard methodology for sharing revenue. Committee members posed additional questions about this issue, and wanted it clear there is a problem. One observed that people may be less enthusiastic about teaching in a graduate course if they will not receive the credits for it. Mr. Pfutzenreuter cautioned that the money will flow to colleges, not departments; it is not designed to go farther than the provosts and deans. That will arose the ire of a number of people in departments, responded one Committee member, and is wrong. Ms. Jackson pointed out that the Committee could take up the issue with the provosts and deans; they are trying to be sure they are cognizant of, and examine, the problems the Committee identifies.

The propositions that associating each course with a college and that colleges may collaborate to share revenue are an attempt to make the University think explicitly about things that have been done without regard for financial consequences, observed one Committee member. Those things may be valuable or worthless; whether they are valuable or worthless must be given thought. Under the old system, they did not have to be thought about; under this system, they will.

Another Committee member commented that there are people who believe this will lead to competition among the colleges, and all of a sudden every biology program will have a course in gross anatomy. What has happened under the old system, rejoined one Committee member, is that every college has a biology department; the old system did not lead to cooperation, either.

Ms. Jackson emphasized that IMG will force the University to look at problems that were easy to ignore in the past. IMG will highlight the problems, although will not solve them.

One Committee member related experiences in three different organizations, a university, a firm where time and costs are allocated, and the federal government; cooperation was highest in the firm, because everyone was given credit for effort and no one felt guilty asking for assistance. People were recognized for their work, leading to cooperation; the way of the University is to say that everyone's time is a free good. That worked at the individual level, pointed out another Committee member, but it will not work for departments--they will not get paid.

2. ICR INCOME will be allocated 49% to central administration for building depreciation, general administration, libraries, sponsored project administration, and building operations--all components of the ICR rates. The remaining 51% would be allocated to provosts; they and the colleges would have to decide how to allocate the money to departments (for departmental administration and equipment depreciation). Earlier, Mr. Pfutzenreuter said, the percentage going to units was larger because there was a more ambitious facilities plan; since it is smaller, building depreciation has stayed central.

One Committee member suggested not using the term "departmental administration," since there is no guarantee the provosts or deans will allocate any ICR funds for that purpose. The term comes from ICR negotiations, reported another Committee member; the University has also encouraged the money to be returned, and is a component of the rate.

3. FACILITIES plans have been scaled back from original concepts. College and support units will be provided a recurring allocation of $5 per assignable square foot; they would then be charged by Facilities Management for that square footage, perhaps quarterly. The $5 would be taken from the Facilities Management budget, delivered to the units, and Facilities Management would send a bill for space. If a unit gets out of space, it gets to keep the $5 per square foot; this is an incentive to decommission space, more than anything else, Mr. Pfutzenreuter said. It puts a

carrot out, for space to be given up; ultimately, the goal is to take buildings off line; it is hoped this will provide an incentive to consolidate space. There is a provision in the biennial request that is related, requesting funds for moving people/units out of decommissioned space. (One Committee member reported that Illinois, confronting the same issue, decided to charge $6 per square foot.)

That is part 1; it is hoped that this will evolve into a larger set of incentives across the University, but that step has not been taken.

One Committee member asked at what point a department's net space will be determined. The information on assignable square footage is a database kept by Facilities Management; the date is past, Mr. Pfutzenreuter said. The report was run and has been submitted to colleges for verification, and they are aware that not all space is properly assigned (he pointed out that much space assigned to his office is not used by his office). One Committee member reported having gained new space, and plans for remodeling it, but having no formal document saying it belongs to the department--and if it is not, the department will have to buy it, for $5 per square foot per year. Questions should be raised with college offices.

One Committee member said that if the goal is to get rid of poor space and decommission buildings, why not target that space and pay users to get out of that space? Rather than set up this complicated program, when 90% of users are doing fine and are not part of the long-range goal? Getting one person out of space is more complicated than just paying them, Ms. Jackson said, because they have to move SOMEWHERE. The University has no vacant space, so there is a difficult domino effect. She agreed that IMG would not make it any less difficult, but if there were a good methodology to decommission space and logical plans to move people all the way along, then it would make sense to pay people to get out of space. Sometimes the units may be more creative in finding space if money is dangled in front of them, Ms. Jackson said, but it is not just HER dangling money; the units must want to take the space or give up the space.

Common spaces are subtracted out of the assigned square footage, and units may not return closets to central administration.

The $5 per square figure comes out of the Facilities Management; it is currently provided about $75 million in O&M allocations annually for management of the square footage, or an average of $9.40 per square foot, across the campus. $5 of that will be distributed to collegiate and support units.

It will be interesting to see the extent to which tuition revenue STOPS at the collegiate unit but charges AGAINST the $5 dip down to the departments, said one Committee member; one suspects they will be uneven.

4. THE OPERATING SUBSIDY (the O&M fund) includes state appropriations, tuition, and a small amount of other income, and allocations are made from it. The IMG proposal is that tuition would not flow through the O&M budget and be commingled with the state appropriation, and would flow 75/25 to the colleges. The residual to be allocated would be, essentially, the state appropriation, or the operating subsidy.

At present, tuition is approximately $196 million; the state funds are about $440 million.

To create a revenue-neutral situation for the starting point, the change in tuition and in ICR and operating subsidy must net to the same number as the college budgets at present, in order to start the next part of the budget process as well as discuss historical inequities.

What is it about tuition revenue, conceptually or philosophically, that makes it broken out and sent straight to collegiate units, while state funds should not be, asked one Committee member? One of the fundamental assumptions, Mr. Pfutzenreuter said, is that the leadership will retain resources to attain institutional goals; the state subsidy becomes the lever that the president, provosts, deans use as the way to achieve goals. That does not mean provosts and deans are not responsible for ensuring revenue estimates and that revenue is expended according to University policy.

It also goes to the base formula, Ms. Jackson said; it is trying to achieve a relationship between action taken and revenues allocated. Teaching of more students is a definite factor that can increase earnings for a unit. The state allocation is more related to a lobbying effort, not a specific action. One Committee member commented that if the money were all allocated to collegiate units, there would be a series of universities sharing the same campus. This is one way to help preserve a single institution.

One thing that moved the University in this direction was the Waseca experience, Professor Morrison said. When it was closed, there was an initial expectation that the University would realize the gross dollar amount spent on the campus. It was later realized that tuition revenues from Waseca also stopped, so the savings were less than anticipated; very few of the Waseca students transferred into another University program.

The tuition is associated directly with the instructional or advising effort of the unit, while the appropriation must be allocated among the units. The latter is something that keeps it as one University; the state appropriation SHOULD be allocated to support units essential to maintaining a university, but which are incapable of financing themselves. Some, like the Law School, Professor Morrison pointed out, are capable of coming closer to financing themselves, and don't have as much claim on state funding.

He continued by saying that one thing that comes out of this--it has always been in the statistics, but has not shown up as clearly--is how poorly the University treats CLA. That is an historical fact that must be dealt with, and the subsidy must be adjusted.

Asked what the "other" income in the O&M funds is, Mr. Pfutzenreuter explained it is a transfer from central reserves that pays for expenditures that had been paid from those reserves for many years. The Regents did not want recurring expenditures out of the reserves, so both the income and the expenses were moved to the operating budget; it amounts to about $15 million. If the central reserves go broke, that will be a problem.

On the issue of space charges and transfer of money from Facilities Management to colleges, said one Committee member, it would be "terrible" if any of that money were used for any other purpose. Ms. Tonneson said the instructions to colleges will be to create a separate account, at the college level, that will be charged for facilities; the money should not be budgeted for anything else. The only time a change would be permitted, added another Committee member, is when space is released and the release is recognized by Facilities Management.

The comment about the possible asymmetry between revenues and charges, said one Committee member, is that there is great potential that tuition dollars may or may not filter down to the departments, while charges for space are much more likely to be charged to the department. The point made, it was said, was that the colleges will charged to sequester the funds and pay the expenses. Most colleges, Ms. Tonneson said, have indicated they do not wish to create an internal bureaucracy to begin charging departments for space. But the central administration will never see what the colleges do, pointed out one Committee member.

The Committee reviewed the history of the offset of the state appropriation against ICR funds; Mr. Pfutzenreuter reported that that is a "myth"; there is no longer any state formula or law or accounting for ICR funds. Once there was such an offset, but it disappeared years ago.

The Committee then turned to the "Work in Progress" spreadsheets. Ms. Jackson said that these sheets are the write-up of the theory; the theory had to be applied to something, and it became a difficult discussion over what the base numbers the theory was to be applied to, and how it was to be applied in order to remain revenue-neutral. The data have undergone significant revisions over the last several weeks, as base numbers in each column changed.

The important assumption to bear in mind is that the original recommendation of advisory committee, and the approach to the numbers, was to maintain a revenue-neutral status, NOT to fix all the historical problems the transition to IMG would reveal at the same time the transition is occurring, Mr. Pfutzenreuter cautioned. The repair of inequities should occur in a second phase. As people have looked at the numbers, because they set a base, they have realized there are advantages and disadvantages to certain sectors of the University; the debate is over how to reach agreement on the advantages and disadvantages. The numbers continue to be revisited, which is why they are labelled "work in progress."

Mr. Pfutzenreuter then reviewed the rows and columns on the spreadsheets, which set out base budgets and adjustments, ICR base and adjustments, inload funds, and final adjusted O&M base, tuition income, ICR income, and state subsidy required to maintain revenue neutrality. There was also a column for facilities allocation, and a final base number taking into account all the prior data. Committee members asked a number of questions about the meaning or construction of the numbers.

An important element of the data is the tuition forecasts, based on the approved budget. It would be possible to update those estimates, and adjust the numbers accordingly. It is also possible to base the numbers on something other than the approved budget. The result is that the estimates are in flux. The same is true for ICR projections. If tuition and ICR estimates change, then the amount of the state subsidy for the units would also change, to maintain revenue neutrality.

One column of numbers indicates the percent of unit budgets that comes from the state subsidy; it is in those numbers that one can identify historical inequities, reflecting evolution of budgeting over a longer period of time. For example, only 24% of the Law School's O&M allocation comes from the state subsidy, compared to the Medical School, which receives 70%. Ms. Jackson pointed out that if these data represent the base year, and tuition is over-estimated, the unit would not receive the same share of the state subsidy that might have been provided under a different allocation method. Since the state subsidy number is also a base, that would mean the unit was not starting from the right base. This is the critical element, said one Committee member.

Professor Morrison pointed out that these numbers point out that there is no "tub on its own bottom"; no collegiate unit is supporting itself from tuition, or tuition plus ICR. They ALL receive a state subsidy; the question is only how much of a subsidy.

After the final base is set, the budget process moves into the next phase, which is about the next year's budget and the amount of money the state appropriates and tuition and ICR estimates for next year.

This information is being sent to the colleges to see if they agree on the percentages from tuition, non-tuition sources, asked one Committee member? It is still a work in progress, Mr. Pfutzenreuter repeated, and they have made a commitment to work with the provosts and colleges to ensure that everyone understands the tuition and ICR estimates and the methodology. They hope for agreement, but do not expect that everyone will agree. The President and Executive Council will need to determine if the data become the base for moving forward. They have seen the numbers, several times; it is still under review to try to decide what the base will be.

Professor Morrison said that this is a base on tuition, calculated out, produces the amount of tuition that was projected in this year's budget. If colleges believe they will receive less tuition than projected, either this year or next, that means there will be less revenue, so there will be a deficit, because one cannot simply add a larger number to the state subsidy column--that number is fixed. If there is a bigger number in the state subsidy column somewhere, there must be a retrenchment to get it down to the total funds available.

What will be done if colleges say their revenue is down during this transition year, asked one Committee member? Given history, it would not be appropriate to penalize a particular unit because of one year's figures. The numbers must be taken into account, but should a unit be penalized? Mr. Pfutzenreuter said he could not predict how provosts or the administration would deal with that situation. He said he was hoping tuition would not be down in 1997, that they had made conservative enough estimates, and that the trend would be up. When he assembled the report, he was being told credit hours were up; they must have declined in the fall. It may be that revenue is down, which is an issue that will have to be discussed. In the future, however, the risk will fall to the units.

This is the problem in setting the tuition and ICR bases, Ms. Jackson commented; if they know, at the point they set the base, that the numbers will be different from the budgeted amount, do they adjust the base now? Or do they make it part of an adjustment to budgets later on?

The discussion has supposed that adjustment to the base is a critical point, one Committee member said. If something happens on tuition, plus or minus, the formula will take care of the allocation--everyone will know the rules, and attention is on the initial distribution. Mr. Pfutzenreuter has said the plan is deal with the situation now, and that there are inequities to be dealt with in the future. If those inequities ARE to be dealt with in the future, then the base numbers presented here do not matter so much, because they will be revisited. But the discussion has been that the base numbers are so important.

The bigger concern is that the political dynamic to get IMG off the ground will be so horrendous that NO ONE will revisit the inequities; this will be the start of a race where the rules are different. Some units start with high average costs and low marginal costs, while other units will have very high marginal costs and very low average costs. Those differences ARE reflected in one of the columns, but nothing is being done about it. If the base is important because it will be there from now on, that is SAYING that historical inequities will not be addressed. That is a political question about how much will the University has to do these things; it would be better to have a clear plan on how those issues will be addressed, even if not all the changes are made in the first year.

In addition to the political question, there is a practical question, said another Committee member. When one talks about assignable square footage and transfer of money to colleges, and the starting date was last November, that is easy to understand. These data include tuition generated during 1996-97, in order to set a base; that fiscal year will end on June 30, 1997 and it will be a long time before the actual base is known. Why not use fiscal year 1995-96? Those data are known, and could be used to establish the base.

In tuition, the model uses 1995-96 and translates the numbers to the 1997 estimate, Mr. Pfutzenreuter said. If using 1995-96 proportions, it was then said, one could expect 100% agreement that the numbers are right. This provoked chuckles. Mr. Pfutzenreuter said the issue of winners and losers arises; Ms. Jackson said it also goes to the issue of whether there is another methodology or base that a provost or dean believes would provide a more satisfactory state subsidy, and would argue for. IMG is not a simple model to manage under, she said. Having about 100 people who are all now going to manage as if their units are tubs on their own bottom--even though the model does not create that situation--makes management more difficult than when one argues allocation every year. In the latter, they all argue for their share of tuition, ICR, the state subsidy, of facilities.

One of the hopes is that after the transition, the only argument will be about the state subsidy. It is also the hope that there will be only one cross-subsidy, rather than many, it was said. Ms. Jackson agreed, but observed that facilities may be an ongoing issue. It will also be about conflicting courses, when each unit wants to offer a course, in order to obtain the tuition revenue.

One Committee member said this discussion has been about academic units will be affected, but pointed out that half or more of the budget is not in academic units. How will this affect those units? (In response to a specific query about why the Senior Vice President for Academic Affairs has a large amount of money for facilities, Ms. Tonneson reported that the general purpose classrooms and general use space are allocated to that office.) Does it have any impact on those non-academic units? Or is it a given that the numbers are fixed?

Ms. Jackson said this sets the base; there has been no determination of how reallocations will be distributed in the future. It could be a reduction in both Academic Affairs and Finance and Operations, establishment of new bases for them, and reallocation spread to the collegiate units.

This produces, for the revenue-generating (collegiate) units, both a strong incentive to produce revenue and to manage their budgets well, Professor Morrison said. It does not necessarily create ANY incentive for the non-revenue producing units. One of the next items the Committee will have to look at is benchmarking; those units will not be expected to generate money, but they will be expected to spend it as efficiently as possible. That has not always been the case, either in Academic Affairs or Finance and Operations. Asked who is working on benchmarking, it may be no one. Some of the support units have been doing it themselves, Mr. Pfutzenreuter said; Facilities Management has done a lot. The Committee may want to encourage this. In payroll, for example, the University pays X thousand people, 3M pays Y thousand people: does the University do it as efficiently as 3M? In facilities, it costs Towle so much to maintain a class B office building; how much does it cost the University?

Ms. Jackson said Facilities Management has done a lot of work, and that is about 80% of the Finance and Operations budget. As they let contracts for services for facilities, they go specifically learn what things cost at other organizations; there was benchmarking in evaluation of the steam plant. Another large part of the budget is in debt, and the debt costs are benchmarked, and increasingly so.

One Committee member inquired about space rental; that, it was said, is a program to impoverish the poor. One department in IT is trying to raise money for a new facility; once it gets built, where does the money for space rental come from? Would it be a new addition to their budget, or does the department have to find the money? The assumption in the model is that the institution will pick up--off the top of the appropriation--debt service (the one-third required by the state) and the operating costs. The four-year financial framework has base adjustments for new buildings.

What about the case when a building is not replaced, but nothing has been done to it for 50 years? That is deferred renewal, Ms. Jackson said. What about air conditioning--when new buildings are automatically getting it, but older buildings do not have it? Does this mean they will never be air conditioned, or would it be picked up?

Mr. Pfutzenreuter said that is a hole in the model: who should be responsible? If a college builds a new building, should it also be responsible for the operating costs? Right now, the University pays the costs; the same is true for air conditioning. Unfortunately, the demand exceeds the resources available. They used the Brenner committee report and identified supported and non-supported space; the non-supported units are being billed for their costs while supported units will receive the $5 per square foot. The renewal and painting and carpet and air conditioning and so on remain an institutional responsibility.

If units have received the short end of the stick on space, for whatever reasons, and now told they are in charge of their own future and should not look to the administration for help, that is very unfair. Ms. Jackson said they would not be in that position.

All of this presumes a reallocation; the budget documents call for $21 million in internal reallocation. Is there any plan for dealing with that? There are multiple plans for dealing with it, Ms. Jackson replied. It has been the subject of repeated discussion among the senior officers; "there is not a clarity of direction at this point" on how to deal with reallocation at the senior officer level. There will be discussion over the next several days.

When will the Committee get involved in that discussion, Professor Morrison inquired? It could have been this meeting, Ms. Jackson said, were there time; there are a lot of options. It should not be when the time for the meeting is running out, said one Committee member; it is not fair to the faculty or the administration. This should be discussed in the near future.

This is critical, Professor Morrison said, and the Committee cannot let it go by without talking about it.

Ms. Jackson said she did not know when decisions would be made. She said she is having a difficult time even getting issues framed; she is more than willing to have the Committee discuss them, but she cannot get to the point of having something to discuss. It was agreed that if necessary, there would be a special meeting called to deal with it. Professor Morrison said it is important that the Committee say something. It was agreed that he and Ms. Jackson would talk and decide if and when to have a meeting.

The danger in this is that focus is always on the reallocations and not the investments, Mr. Pfutzenreuter pointed out, and they cannot be disconnected. The only way to look at these is to look at them together, rather than only looking at how $21 million will be reallocated. Neither side of that equation is settled. Investments will not be settled until after the second phase of budgeting, Professor Morrison said, so will come much later than reallocation. The Committee should also be involved in investments, it was said. And the question of the amount of the reallocation is linked to the amount of investments to be made, Ms. Jackson said; that is the problem in framing the discussion.

The leadership of the University has to make a decision, Ms. Jackson agreed, and said she is willing to discuss the issues whenever there is a framework--and NOT when the decision is being made. But the units do need to know this information, Mr. Pfutzenreuter, and it would be desirable to know things from one year to the next--but there is the uncertainty associated with the legislative process.

Could not the decision on faculty salaries await the state's action, asked one Committee member? The problem is that that is what is led to the "disaster" last year, Professor Morrison responded. The University waited and waited and waited, and then the only decision reasonably left was the zero or minimal or temporary salary increases, because all of the other options had gone by the way. The information last year was more timely than it will be this year, pointed out one Committee member, because it was a short session last year. What is of concern to the faculty is that faculty salaries have been seen as the residual balancing item, and not had the priority they should, producing a longer-term slide. Mr. Pfutzenreuter agreed.

The other issue was disparate treatment across the University. Even without that, said another, there would have been a serious problem, because without the disparate treatment, there would have been a gross disparate treatment between faculty and other employee groups--contrary to all promises that had been made. This was all justified by "there isn't anything else we can do."

One Committee member commented on what had been accomplished at this meeting; walking through the spreadsheets was very instructive. But in some quarters there was an expectation that this would be THE meeting about IMG, and some big decision would be made. That didn't happen, and one has serious misgivings on how IMG is getting started. The record should show that there was an explanation of things, but there has been no endorsement of how things are starting; the latter will take another meeting and more discussion.

Ms. Jackson said the record should also show that this was not a decision, but only one of the options.

Professor Morrison then adjourned the meeting at 5:10.

-- Gary Engstrand

University of Minnesota