Minutes[*]

**Senate Committee on Finance and Planning**
**Tuesday, October 30, 2007**
**2:00 – 3:45**
**238A Morrill Hall**

Present: Judith Martin (chair), Rose Blixt, David Chapman, Steve Fitzgerald, Darwin Hendel, Lincoln Kallsen, Thomas Klein, Joseph Konstan, Russell Luepker, Michael Rollefson, George Wilcox, Aks Zaheer

Absent: Jon Binks, V. V. Chari, Mikael Moseley, Kathleen O'Brien, Kathryn Olson, Richard Pfutzenreuter, Justin Revenaugh, Terry Roe, Gwen Rudney, Thomas Stinson, Michael Volna, Warren Warwick

Guests: Julie Tonneson (Office of Budget and Finance)

[In these minutes: (1) budget framework for 2008-09; (2) financial principles]

## 1. Budget Framework for 2008-09

Professor Martin convened the meeting at 2:05 and turned to Ms. Tonneson for a preview of the 2008-09 budget. Ms. Tonneson distributed a one-page handout to Committee members and explained it.

Resources (new, incremental for 08-09)

| | |
|---|---|
| 14,310,000 | new state funds |
| 39,300,000 | student tuition and University fee (assumes 7.5% tuition increase) |
| 8,500,000 | University internal reallocation |
| 4,836,979 | balance from 07-08 (set aside during the current fiscal year) |
| 66,946,979 | Total New Resources |

Investments

| | |
|---|---|
| 6,300,000 | student aid (includes Founders free tuition and 2% break for MN residents) |
| 34,700,000 | general compensation |
| 15,300,000 | facilities (debt, utilities, leases, new building operations) |
| 13,646,979 | available for investment |
| 66,946,979 | Total Investments |

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

Ms. Tonneson noted that several of the figures are subject to updating. She also observed that the University's biennial request proposed a 4.5% tuition increase, but since the state did not provide the funding that was requested, the proposed tuition increase has been adjusted to 7.5%.

Professor Martin commented drily, apropos the $13.6 million available for investment, that there will be a lot of arguing over a small pool of money.

Of the $8.5 million in internal reallocation, the plan is to divide it $6.3 million to academic budgets and $2.2 million to support budgets, Ms. Tonneson explained. On the support side, the amounts are not being allocated to units but to the cost-pool owners; each has been asked to identify how he or she will accomplish the savings or reductions. These plans are expected to be completed by early November. Professor Martin said she has heard that in the case of one vice president, two staff positions will not be filled in order to meet the reallocation target. The single largest amount on the support side, $680,000, is allocated to administrative services; there is no single cost-pool owner in that category and the three senior vice presidents will act as a group to develop a proposal.

They expect to have recommendations for the President by the end of November, Ms. Tonneson said, so that cost-pool figures can be known by the end of December. At that point academic budget instructions will be prepared (that will include a compact update and financial data). They plan to meet with academic units the last week in January and during February and to bring a budget to the Regents in April for review. Throughout this period, the administration will be planning the process and strategy for the next biennial request and will be communicating with groups along the way.

Mr. Klein asked if the conversations with the support units included both investment ideas as well as reallocation ideas. Ms. Tonneson said they have, and have identified the categories in which additional funds could be requested: contractual or legal obligations, continuing seed money with anticipation of future income, and items that are absolutely necessary and essential for operation. They are also stressing that there are few dollars available and are examining balances, revenues, expenses, etc. Mr. Klein said he hoped there are also discussions about operating metrics and what units have done with the funds they were provided earlier (although it is only three months into the 2007-08 fiscal year).

Professor Martin speculated that the support units could be challenged by having to cut or reallocate $2.2 million. Ms. Tonneson agreed it is a lot of money, but there are a lot of support units, although no one big place that can be a source of reductions. It may be that positions will be cut and there could be restructuring. Some units could propose to cut the proverbial Washington Monument, Mr. Klein said, although he was not suggesting any would do so; how will the senior officers look at the proposed cuts? In the past they have not received good information about proposed cuts, Ms. Tonneson said, but this year (so far) they have received better responses that are reasonable, responsible, and doable.

Professor Martin thanked Ms. Tonneson for the information.

## 2. Transforming the U: Financial Principles

The Committee turned next to the DRAFT financial principles prepared by the President's office, which read as follows:

**1. Strong and consistent state support** to retain the University's quality and provide the investment needed to advance the University's strength and comparative advantage in advancing Minnesota's economic competitiveness and quality of life. This assumes that the University will vigorously reduce and contain costs, continue to aggressively revise priorities and continue an entrepreneurial culture to grow non-state resources through grants and contracts, private support and transfer of technology.

**2. Retain a stable tuition level** as a proportion of the University's core budget to help support the educational and core costs of the University. The University of Minnesota has acted with vision, purpose and creativity in addressing the rising costs of education for our students. Two years ago we began the Founders Free Tuition Program, providing free tuition for low-income students and emphasizing access and affordability as primary concerns of the University. In October, our Promise for Tomorrow private scholarship drive reached its initial three-year goal of $150 million in endowed scholarship and fellowship funds. The University must continue to make private fundraising and the reallocation of resources to support the educational expenses of students from families with modest incomes a long-term strategy. Combined with the other budget strategies, this gives the University a reasonable chance of maintaining a high level of access and affordability for students to our educational programs.

**3. Strengthen the level of sponsored funding** to support the University's distinctive culture of discovery, innovation and application to improve our society.

**4. Private Support must continue to grow** as a part of the University's budget to support quality and excellence at the University. A long-term assumption is that private support will need to grow from approximately 10% to approximately 15% of the University's overall budget in the next 5 to 10 years. Moreover, a greater proportion of private support must be more flexible or more fungible (e.g., funded in support of all-University scholarship and fellowship strategies, all-campus and all-college academic priorities [e.g., professorships and chairs] that can be shifted in accordance to important trends in academic fields, etc.).

5. **Leverage and grow the value of existing assets**, including the University's intellectual capital, to address rising costs and strengthen our quality, productivity and investments. NOTE: This is a broadly based strategy. One priority of this strategy is to develop new, entrepreneurial lines of work by expanding partnerships with the private and non-profit sector **-** lines of work that grow resources through expanding national and global partnerships with private and non-profit organizations, expansion of proposals to philanthropic foundations, and the leveraging of real estate assets to produce a far greater rate of return for the University's core academic enterprises (e.g., the leveraging of assets in UMore Park and other lands, better use of facilities and locations of the University of Minnesota to address other needs in non-peak time periods, etc.). A second priority is to continue expanding the leveraging of the University's intellectual capital through more productive mining of ideas and transfer of technology (the University now ranks 6th nationally in royalties from its discoveries and inventions) and the development of new lines of activity to increase revenue in a broad number of areas. A third possible priority is to expand our market share of services, including lifelong learning for part-time students, expanding and improving the return on sales and services (e.g., environmental testing methodologies, clinical trial programs in animal and human health, plant disease protection and production, etc.), and better marketing of University venues open to the public (athletic events, museums, exhibitions, etc.).

6. **Disciplined cost reduction and service improvement strategies** to reduce expenditures, (e.g., capital, utilities, purchasing, business process costs, etc.), restrain price increases (e.g., health and related benefits, technology, library and information services, etc.), and increase productivity. NOTE: We need a disciplined strategy that can be used to motivate continuous reform and productivity in the use of

resources. It must be driven by reliable data from self-assessments and external reviews and good stories of continuous, disciplined improvement in quality, service and productivity.

**7. Reallocate University resources according to strategic positioning priorities, including metrics**, with movement of resources from lower level priorities to higher priority investments (e.g., 1%+ per year), to increase fiscal discipline in the use of existing resources, the largest source of renewal and investment. It is also essential to assure public confidence in the University's stewardship of existing resources. I am assuming that colleges and campuses will reallocate more, for example, in replacing 5-10% of the U's workforce each year.

Decision-making criteria should include:

a. Centrality to mission
b. Quality, productivity and impact
c. Uniqueness and comparative advantage
d. Enhancement of academic synergies
e. Demand and resources
f. Efficiency and effectiveness
g. Development and leveraging of resources

Mr. Klein said budget model subcommittee has heard multiple comments on reallocation and it is a source of much discussion. Mr. Kallsen pointed out that over the next ten years, 700-1000 faculty positions will turn over; there is no more strategic investment the University can make than its investment in its faculty. Is that the usual rate of turnover among faculty or is there forced attrition included in the projection. That is normal attrition, Mr. Kallsen said. That has happened over the last ten years as well, Professor Martin responded, and it has been business as usual—except that that the patterns did not follow the priorities of strategic positioning. She agreed that if the turnover is normal, the principles should say so.

Professor Luepker said he wondered about the second point. He has heard the goal of a stable tuition level (as part of the University's budget) over the years, but earlier in the meeting they are informed the proposed increase will be 7.5%. Is this an aspiration which the University continuously fails to meet? If the goal is to grow the University budget in other areas, it is not clear that the goal should be stable tuition, Professor Konstan said. If state or private funds increase 10%, the University doesn't necessarily want tuition to increase 10% as well; it should have as a goal that tuition will increase at the rate of cost of living increases or at the rate of peer universities. The linkage is odd, he concluded. There has been talk about linking tuition to the Higher Education Price Index, Mr. Kallsen said, but it is also linked to state support. Professor Martin agreed the two should be linked; unless the University wants to follow the Michigan model, with high tuition, low state funds, they will be linked, and the Regents want to keep the University affordable for Minnesota students.

Professor Konstan said that point seven is also odd. There is no mechanism specified, so the result could be to slowly strangle everything. He said he could support it if there were a target set.

The University loses money on every sponsored dollar it brings in, Professor Konstan observed. Who is it the University is expecting to pay those costs? The legislature? Private funds? Or will they fall back on tuition? The University can make the argument to the legislature that sponsored funds are a net good for the state because they bring in jobs. And since no units cover their costs, Mr. Klein said jokingly, fortunately the University loses money on all of them..

Professor Martin said she had been struck by point three. The Committee has received a report from Professor Pardey and colleagues about the relative decline in the University's competitiveness in obtaining sponsored funding. To accomplish the third point will require a huge step in a direction the University is not now going. She said she likes the goal of top three as aspirational but she said she is not sure how it will get there.

Professor Luepker said he has heard that the University loses 25 cents on every dollar of sponsored research it obtains. Where does that number come from and who is paying? Should he stop seeking grants? Mr. Kallsen pointed out that the University also loses money on instructing students. That is subsidized by the state, Professor Luepker pointed out. The inadequate indirect cost recovery on research is why private support and other revenues need to grow, Mr. Kallsen said, and why the senior officers need to make hard decisions. Ms. Blixt said the University loses money on sponsored research because some grants do not pay indirect cost funds; the units provide space, etc., and pay cost-pool bills, but receive no break from the University. Even when indirect costs are paid, the rates are invariably lower than the University's actual indirect cost rate of 58%. Moreover, she said, private funds are not usually for operations.

Professor Chapman said he did not find this discussion credible. Mr. Kallsen, he said, has said that if the University grows, it needs more money. The question is how it can lose money on everything it does and stay in business. It cannot be losing money on everything it does or it would have closed 50 years ago. That line of argument undermines confidence in the University's ability to manage itself. Mr. Kallsen agreed; he said that some research and instruction make money and subsidize other activities.

Professor Martin asked if the current budget model is clear enough to be transparent about where subsidies come from and go to. One has a much better opportunity to understand them within colleges, Mr. Kallsen said, since all costs and revenues are pushed to them. What about across collegiate units, Professor Martin asked? The data are there, Mr. Kallsen said, and they know broadly the costs and revenues, but he could not provide an analysis across colleges without additional work.

If some version of these principles go forward, Professor Martin said, more people than Mr. Kallsen have to understand the budgets. Deans will be unhappy to learn they subsidize other units, but there is also a common good concern.

Local decision-making is not necessarily optimal for the institution, Professor Konstan said. A unit receiving sponsored funds could be charged 40% and receive 48% indirect costs, while the actual total cost to the university is more like 56%. In this case, the unit has every incentive to receive more grants like these (even if they don't otherwise advance the university's mission), but the University is harmed.

And the University does not have a clean model with the state, he continued. There could be the opera model: when the money runs out, the performances are no longer offered. Or it could be the start-up model: the dialogue must be continued and the institution may decide to lose money now in order to make money in the future. In either case, however, the expectation is not to make money now. SPA will never say to not submit a grant because of strategic positioning, Professor Konstan maintained, and the faculty would scream if it did. What would be desirable is central leadership about areas that are growing or shrinking so that all decisions are not made at the micro level. Professor Martin agreed but pointed out that colleges are seeing decisions being made in new initiatives and centers. Professor Konstan agreed, but suggested that little was said centrally about where to scale back.

Professor Luepker said that the standard in his college is that a grant must pay 49% indirect costs or it will be rejected. He said he still wondered where the 25% figure came from. Dr. Rollefson said that even 49% does not cover the University's actual costs. He also reported that the new SPA director has been surprised at the number of waivers the University grants for funding that carries less than the University's full indirect cost rate. At Stanford, where she came from, there were no waivers granted. Professor Martin observed that there are entire fields of research that receive no indirect costs. One choice is to say the University will not work in those fields, Dr. Rollefson commented.

It becomes the PI's responsibility to raise the extra funds, Professor Konstan said, often at schools with higher indirect cost rates. He said he was glad that faculty here were not in that position. Ms. Blixt said the cost pools brought the shortfalls to light: researchers brought in money for salaries, fringe benefits, assistants, etc., but no one worried about space, information technology, libraries, and so on. If they do not bring in the funds, they ask the PI how those costs should be paid. They are suggesting to deans that they talk about what research should subsidize, Mr. Kallsen reported.

This is still somewhat disingenuous, Professor Chapman contended. The talk is about losing money everywhere at the same time balances are creeping upward. It hurts the University to have that kind of language out there; it is not out of business when one sees new buildings and a thriving organization. Professor Konstan said the University loses money on operations but receives funding from the state. If there were no state money in the pool, the University would have to charge per student or per grant; he said he prefers that the money be in a big pool and spread around. There is more transparency now, with the budget model, so the University knows the cost of everything—but the value of nothing, such as the value of research or of a student educated. It focuses on costs it can measure rather than values.

That point should be added to the list, Professor Martin suggested. There is an inordinate focus on costs, but the University's programs add value. Professor Konstan agreed. He said he would like to see a measure of the value of college graduation over a life, and the value of inventions; if one measured all of these kinds of things, there would be a tremendous net benefit to the state. The University says it loses money on every doctor it trains, but it does not measure the value of having doctors in society.

Mr. Klein said the Committee could recommend including a principle that there should be more transparency. The goal of the budget model is to do calculations, support the work of the University, and ensure the financial model is understood by those participating in decisions. If the current perception is that it just deals with arithmetic, the Committee could say that part of the expectation of the model is for it to be understood by faculty who are interested in understanding the budget (for example, for consultation purposes).

One example is Art, Professor Konstan said. It would hurt the University not to have art programs. The question is how to measure their benefit. It is a part of the common good. It would more difficult to attract faculty and students to a school without arts and humanities, apart from their value per se. Art will always be a financial sink, Professor Konstan said, and if the University does not identify common goods and externalities, or say that such programs are beneficial to have, it will slip into a model that favors engineering and the sciences. Professor Martin said that one faculty member has analyzed the impact of the arts in society—and it is huge, although rarely aggregated. If the University turns art into a discretionary expense, Professor Konstan said, it will eliminate it. But even many public works expenditures require that a small percentage be spent on art.

Is there anything from this discussion the Committee would like Vice President Pfutzenreuter to consider when he joins the meeting in two weeks, Mr. Klein asked? Professor Martin said the Committee appears to want to emphasize transparency in subsidies and a discussion about a focus on costs so much that value is missed. The Committee should also take a look at the "Lighthouse" report, from the task force chaired by Regents' Professor Ronald Phillips.

No one is opposed to leveraging assets, Professor Konstan said, but there have been discussions at this Committee about making faculty and staff more productive by providing adequate resources. There is nothing in these principles about support. What measures productivity and quality? And how will one measured if resources are being adequately leveraged?

Mr. Klein asked if point six could be elaborated on: what is meant by disciplined cost reduction? Are there examples of this that would help people understand what that term means?

Professor Martin said the Lighthouse report points out that that while there are many things that can be counted, there is much the University does that it does not measure that is also valuable. She adjourned the meeting at 3:15.

-- Gary Engstrand

University of Minnesota