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TO: Reed Polakowski, Minnesota Legislative Reference Library

FROM: Keeya Steel, University of Minnesota Office of Government and Community Relations

DATE: February 1, 2016

RE: University of Minnesota Budget Allocation Report

Enclosed are two copies of the mandated report, University of Minnesota Budget Allocation Report, pursuant to Laws of 2015, Chapter 69, Article 1, Section 8.

This report may also be found online at http://govrelations.umn.edu/mandated-reports.html.

If you have specific questions regarding the contents of this report, please contact Keeya Steel, 612-625-5512. To obtain additional copies of this report, please contact the Office of Government and Community Relations at 612-626-9234.

cc: Senator Terri Bonoff, Chair, Senate Higher Education and Workforce Development Budget Division
Representative Bud Nornes, Chair, House Higher Education Policy and Finance Committee
Senator Jeremy Miller, Ranking Minority Member, Senate Higher Education and Workforce Development Budget Division
Representative Gene Pelowski, Ranking Minority Member, House Higher Education Policy and Finance Committee

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February 1, 2016

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Representative Bud Nornes, Chair
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Representative Gene Pelowski, Ranking Minority Member
House Higher Education Policy & Finance
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Dear Senators & Representatives:

This letter is pursuant to Laws of 2015, Chapter 69, Article 1, Section 8:

The Board of Regents of the University of Minnesota shall report by February 1, 2016, to the chairs and ranking minority members of the legislative committees with primary jurisdiction over higher education finance on the factors it considers to allocate funds to separate campuses. The report must specifically, without limitation, address the issue of whether non-Twin Cities campuses are treated as single units for budget allocation purposes or treated as comprised of multiple units. The report must discuss the effect of treating a campus as a single unit and the reasons for that treatment.

A. Overview – Primary Elements of Budget Allocation and the "Budget Model"

The University of Minnesota manages it annual budget under a "Responsibility Center Management", or RCM, budget model. As opposed to a "traditional" higher education budget model in which the most significant discretionary funds available to the institution (primarily tuition and the state appropriation) are co-mingled at the central level and allocated annually by the President and the Board to each of the academic and support units, an RCM model attributes earned revenues out to the units as they are generated and then allocates any discretionary state appropriation and all costs, including all overhead costs, out to those same revenue generating units. From the mid-nineties through today, many large, complex higher education institutions have migrated to an RCM budget model. The University implemented its RCM model over time, beginning in FY98, and it has evolved to be one of the more sophisticated models currently in use.

The remainder of this report, in response to the specific questions in law, is focused only on the revenue aspects of the budget model.

Specifically under this budget model at the University of Minnesota, all revenues generated by the institution through its regular activities are automatically attributed to the units. For example, tuition revenue flows to the units based on where the students are enrolled and the courses that they register to take; philanthropy flows to the units based on their ability to generate gifts for their programs and students; sales income flows to the units based on the unique services or products they sell to the public or other institutions; grant awards flow to the units based on successful proposals to granting agencies, and so forth. The revenues flow 100% to the units that "earn" them. Because the state appropriation to the institution is not directly related to specific revenue-generating actions within individual units, it is allocated to units in one of two ways.

1) State special appropriations are directed in law toward specific units, programs or activities, so those funds flow to the units directly responsible for the identified purposes. For example, the Agriculture and Experiment Station State Special appropriation is identified in law "for the Agricultural Experiment Station and the Minnesota Extension Service" so the funds automatically flow to the colleges doing the Experiment Station work and University of MN Extension.

2) The Operations & Maintenance (O&M) appropriation is generally not identified in law for a particular unit and thus the University allocates those funds through the annual budget process using a base +/- methodology – much like the state of Minnesota uses in determining funding levels for state agencies.

The distribution of these revenues is only one component of the annual budget process. Additionally, there are oversight meetings in which all fiscal activity (all funds) is reviewed and the units have an opportunity to discuss significant financial concerns and proposals or opportunities for University investment. There are decisions about levels of administrative, academic or student support that are necessary and the distribution of those costs across units. And ultimately there are decisions about if and where reallocations or budget cuts will be necessary, in combination with the resource and other cost changes and investment decisions, to balance the budget. In building the final approved budget for the University, each of these components is first addressed at the unit/designated RRC level (described below) so that the total University budget (summarized at the institutional level) accurately reflects the resource and expenditure plans of each unit.

As previously mentioned, within the process to balance the all-funds budget, allocation of the O&M state appropriation follows a base +/- process. A recurring base funding level is carried from one year to the next for each unit and it is adjusted up or down on an incremental basis based on the amount of funding available from the state (is the appropriation flat, decreasing or increasing), the availability of increases in other unrestricted revenues in each unit (tuition, indirect cost recovery funds from grant sponsors, sales income etc.), and decisions resulting from the annual budget oversight meetings (funding of priority investments, the need to cover extraordinary cost increases, potential reallocations from efficiencies or restructuring etc.). Consideration of the combined impact of all these variables is what determines the final allocation of state dollars to RRCs. The goal of this process is to ensure each unit has the resources necessary to maintain or improve quality in what it does, while advancing the priorities of the University – all while controlling the growth in costs and managing in an environment of constrained resources.

B. Unit Structure

The University has assigned primary budgetary responsibility within the institution to the Resource Responsibility Center (RRC) level. There are currently 48 RRCs, which include each of the colleges on the Twin Cities Campus, each of the four other system campuses , the large "auxiliary business" units on the Twin Cities campus (Athletics, Housing/Parking/Bookstore, etc.), and the large support units, most of which have institutional responsibilities (Controller, Vice President for Research, President's Office, Human Resources, etc.). Budget model components/practices to help clarify this structure include:

- Most importantly, the University has assigned accountability for financial management and results to the leaders at the RRC level within the structure: to the System Chancellors, the Twin Cities collegiate deans, and the system Vice Presidents. They are ultimately responsible for managing their financial activity and are held accountable by and must report to the President and Provost on their fiscal status. The Chancellors, Deans and Vice Presidents, in turn, assign subsequent accountability to the leaders within their unit: to the Deans on the Duluth campus, to Department Chairs and Directors, to Associate Vice Presidents and so forth.

Flowing from that principle of fiscal accountability to those individuals at the RRC level, additional characteristics of the budget model and process – **at the RRC level** - include:

- The state appropriation is allocated by the Board of Regents to the revenue generating RRCs.

- The tuition revenue flows first to the Twin Cities college or system campus and not to the individual departments.

- The leaders in each RRC establish an internal, customized, budget process for determining subsequent allocation of resources down to the department level.

- The leaders in each RRC determine which budget issues and proposals to bring forward during the annual budget development process.

- The leaders in each RRC set priorities for investment or restructuring/reallocation within their units, consistent with direction and goals set by the President and the Board of Regents.

- The chief financial manager in each RRC has a dotted line reporting relationship to the University's Chief Financial Officer to ensure consistent application of University fiscal policies.

C. Processes Specific to System Campuses

The Crookston, Duluth, Morris and Rochester campuses are each treated as a single RRC (with all of the accountability and responsibility described above) within the University's budgeting structure. The only one of these campuses that, like the Twin Cities campus, has separate collegiate units is Duluth. Each campus has at least some auxiliary business operations (housing, food service, athletics, etc.), and they each have department designations within their individual structures. In the budget process, each campus:

- Is led by a Chancellor that is accountable for the financial management activity of the campus and reports directly to the President of the University

- Receives a single campus-level allocation of O&M state appropriation

- Receives a campus level tuition attribution

- Receives all the other "other revenues" it generates

- Has the opportunity to determine campus priorities (aligned with University priorities) and propose University funding for initiatives corresponding to those priorities

- Has the opportunity to bring forward and identify "support" initiatives or needs separate from "academic" initiatives so those two categories of need are not prioritized against each other

- Has the flexibility to shape resource allocation requests during the budget process to meet individual campus needs, organizational structures, and priorities

- Has the flexibility to implement investments, reallocations/budget cuts, and structure changes as necessary to result in the best possible outcome

This structure, treating each system campus in the budget process as a single unit, similar to the treatment of colleges and major support units located on the Twin Cities campus, is driven by the President's delegation of authority to each Chancellor. These individuals are responsible for determining the priorities and needs for their campus, and therefore the annual allocation of resources to the campus level is made consistent with that delegation of responsibility. By giving responsibility and authority to the Chancellors, the President's delegation permits prompt and more accurate decisions by those who are fully aware of the realities of the unit's academic priorities and the impact of resource allocation decisions near the point of action. In that regard, the system campuses' budgetary responsibility is exactly the same as that of Deans and Vice Presidents on the Twin Cities campus. It would not be desirable for the President to bypass the Chancellors and make decisions centrally about funding levels for the colleges and departments on each of these campuses. That would decrease the Chancellors' autonomy and flexibility and undermine their ability to shape the priorities, activities and outcomes of their campuses. Thus, each system campus is treated in the budget process like a Twin Cities college or Vice Presidential unit: the leader of each is ultimately responsible for the health of the RRC, and each receives revenues which it uses to support the objectives of their respective unit.

Sincerely,

Richard H. Pfutzenreuter
Vice President & Chief Financial Officer