UNIVERSITY OF MINNESOTA

Crookston • Duluth • Morris • Rochester • Twin Cities

Office of the Senior Vice President for Finance and Operations

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January 31, 2017

Senator Michelle Fischbach, Chair
HE Finance & Policy Committee
2113 Minnesota Senate Building
St. Paul, MN 55155

Representative Bud Nornes, Chair
HE & Career Readiness Policy and Finance
483 State Office Building
100 Rev. Dr. Martin Luther King Jr. Blvd.
St. Paul, MN 55155

Senator Greg Clausen, Ranking Minority Member
HE Finance & Policy Committee
2233 Minnesota Senate Building
St. Paul, MN 55155

Representative Gene Pelowski, Jr, DFL Lead
HE & Career Readiness Policy and Finance
295 State Office Bldg.
100 Rev. Dr. Martin Luther King Jr. Blvd.
St. Paul, MN 55155

Dear Senators and Representatives:

This response is provided pursuant to Minnesota Laws of 2016, Chapter 189, Article 1, Section 30, part (a):

> *(a) The Board of Regents of the University of Minnesota shall report by February 1, 2017 to the chairs and ranking minority members of the legislative committees with primary jurisdiction over higher education finance on the factors it considers when allocating funds to system campuses. The report must specifically, without limitation, address the following questions:*
> *(1) what circumstances would lead the university to adopt an alternate budget model to the Resource Responsibility Center (RRC) model for a system campus;*
> *(2) what were the rationale and factors considered for the initial base budget allocation to system campuses when the RRC was first established; and*
> *(3) what factors would lead the university to consider adjusting the initial base allocation model.*

(1) To address the first question, the University of Minnesota manages its 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 these 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-1990s through today, many large, complex, higher education institutions have migrated to an RCM budget model in order to increase incentives for effective and efficient use of University resources at the level of the institution that can best make strategic and timely decisions, and to increase transparency of decision making. Under this model at the University of Minnesota, the revenue-generating Resource Responsibility Centers (RRCs) are defined as the colleges, major

academic units and "auxiliary businesses" (Athletics, Housing/Parking/Bookstores etc.) located on the Twin Cities campus along with each of the four system campuses.

Accountability for financial management and results has been assigned to the leaders of each of these RRCs: to the System Chancellors, the Twin Cities collegiate deans, and the system Vice Presidents. These leaders are ultimately responsible for managing the financial activity and are held accountable by and must report to the President and Provost on the financial status of the unit. In the case of the four system campuses (Crookston, Duluth, Morris and Rochester), each is treated as a single RRC within the University's budgeting structure due to the President's direct 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 consistent with that delegation of responsibility. By giving responsibility and authority to the Chancellors, the President's delegation permits prompt and more informed 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. The Twin Cities campus does not exist as a unit of budget management; there is no "chancellor" or similar position on the Twin Cities campus for delegation of financial responsibility.

At this time, and under the general principles of RCM, there is no circumstance under which an alternate budget model would be created for the system campuses. The University would not implement a separate, distinct budget process for a portion of the University system. It would not be desirable for the President to bypass the Chancellors and make decisions centrally about funding levels for the colleges and departments of these campuses. Such an effort would decrease the Chancellors' autonomy and flexibility and undermine their ability to shape priorities, activities and outcomes of their campuses. Each Chancellor has the discretion to implement a budget model for her/his campus that coordinates with the University's overall processes, but that best addresses their individual needs. If the University were to significantly modify or move away from an RCM budget model at some point in the future, which would likely be driven by significant changes in the overall funding environment for higher education, then the entire decision making process would be reevaluated for all units within the University.

> *(2) what were the rationale and factors considered for the initial base budget allocation to system campuses when the RRC was first established;*

(2) In moving to the RCM budget model, there were two fundamental changes related to the allocation of revenues and costs, and each change resulted in a "re-set" of those allocations. The first change occurred in FY98 when the University began to attribute tuition directly to the units that generated it. Prior to that time, each tuition generating unit and each support unit received what was called an Operations and Maintenance (O&M) allocation from the University, which was funded by a combination of O&M state appropriation and tuition revenue. As those two large discretionary revenue sources were co-mingled at the University level, the base funding for each individual unit was the result of annual incremental decisions from the time the University first received state appropriation. There are no records of that allocation ever being done on a formula basis, and the units did not know how much of their allocation derived from state appropriation vs. tuition. In

FY98, when the decision was made to attribute the tuition revenue directly to the units as it was generated – based on their student enrollment and the courses they taught – the shift was made budget neutral. Essentially their O&M allocation was reduced by the amount of tuition they were generating but then they received their full tuition revenue, resulting in the same total. The support units that did not generate tuition revenue continued to receive an O&M allocation, but it was therefore all state appropriation. That was the first re-set of the O&M allocation.

From FY98 to FY07, when the second re-set of O&M occurred, the change in O&M allocation for each unit was done in a base +/- process. In FY07, the University decided to implement the second half of the RCM budget model in allocating all support/overhead costs to the revenue generating units. At that time, the budgets for all support units at the University were converted into "cost pools" that would then be charged out to the revenue generating units based on a variety of different cost allocation formulas. The state appropriation that was going to the support units was eliminated and instead given to the revenue generating units. Along with some changes in internal assessments and central allocation of some fee revenue and some indirect cost recovery revenue (Indirect Cost Recoveries [ICR] – resources from external sponsors of research grants to cover overhead costs), the O&M state appropriation was also re-set for each revenue generating unit such that the shift in the model was budget neutral at that point in time. The colleges and campuses had to start paying their share of the "cost pool" charges for central support services, but each was given increased state appropriation, as well as the central fee revenue and the ICR that the unit generated, in a total amount exactly equal to those new charges.

So for each RRC, including each system campus, the transition to the new budget model was accomplished through a budget neutral initiative and the new base level of O&M allocation was set to achieve that neutrality. From FY07 through the current budget, the changes in O&M allocation for each RRC is the result of a continuing base +/- process, much like the state process for making decisions on appropriations to its state agencies, including the University of Minnesota.

> *(3) what factors would lead the university to consider adjusting the initial base allocation model.*

(3) The base allocation "model" as it was implemented and explained in item (2) above, was an intentional effort. The goal was to implement the new model in a way that was neutral to their budget at that point in time. The model itself does not determine the final budget level for each unit. Instead, the University has a very robust annual budget review and setting process. University leadership makes decisions about certain revenues and investments, in combination with known cost increases, in order to balance the budget for the upcoming year. In addition to those planning assumptions about tuition and fee levels, internal reallocation targets, compensation and facility cost increases etc., each unit then has the opportunity to bring forward requests for initiative funding and to raise any significant financial issues they are facing. University leadership then considers all of those factors for each RRC – looking at the revenue increases to be generated by each unit, the availability of increases in state appropriation, the cost increases each unit will face, the possibility of making internal reallocations within each unit, and the investments the University would like to make in priority programming – before deciding on the final positive or negative changes in the O&M allocation.

Because this process relies on a qualitative and substantive discussion at the unit level on priorities, changes in revenues and costs and so forth, and the connected interplay between the revenue sources, internal reallocations and costs, it would not be beneficial to consider a methodology change in a single component of the model. The combined impact of all of these variables results in what the University believes is the most effective and strategic outcome for all units, given the environment of constrained resources in which it operates. As mentioned in the response to item (1) previously, if the University were to significantly modify or move away from an RCM budget model at some point in the future, which would likely be driven by significant changes in the overall funding environment for higher education, then the entire decision making process would be reevaluated for all units within the University.

I hope that this information and perspective is helpful to you. Please let me know if you need anything further in this matter.

Sincerely,

Brian D. Burnett
Senior Vice President for Finance and Operations

BDB/kl

c: Eric W. Kaler, President
Dean Johnson, Chair, Board of Regents
David McMillan, Vice Chair, Board of Regents