

# **University of Wisconsin-Madison Budget Allocation Model**

## **Past, Present and Possibilities**

White Paper presented by the Budget Model Review Committee

January 2014



### **Executive summary**

In September 2013, Chancellor Blank charged the Budget Model Review Committee of faculty, staff and students with studying the current campus budget allocation model, and to report on the possibilities of selecting and implementing a new model for UW-Madison. The new model would make allocations to campus units more transparent, allow resources to shift based on objective measures of activity, provide incentives for innovation and entrepreneurial activities aligned with campus priorities, and be implemented in a manner that avoids large or discontinuous shifts in budget allocations.

The committee's work focused on the following issues:

- Articulation of principles that should guide the distribution of base budget resources;
- Documentation of the current budget model and identification of its inherent strengths and weaknesses;
- Peer analysis of budgetary approaches from a best-practices perspective;
- Identification of cultural, historical and political barriers that may impede the development of a new approach to budgeting.

To help provide a framework for thinking about more transparent and activity-driven alternatives, the committee reviewed a range of budget models used by universities similar to UW-Madison in size, complexity and mission. The committee was assisted in this effort by the Education Advisory Board higher education research firm, which reviewed budget models at six peer universities.

In conversations with faculty, staff, students and campus leaders, the committee heard considerable agreement our current budget allocation model is no longer meeting our needs, and that the time for change is now. The modest growth in the campus core (i.e., Fund 101) budget over the last decades has been eclipsed by increasing costs. We now struggle to compete for and retain the best talent with universities that already have aligned budget and strategy.

While we must continue to expand resources by increasing both tax support and private philanthropy, this alone will not suffice. It is clear that we must also align and optimize our planning, budgeting and allocation processes. We must make the most of what we have, and we must be able to clearly demonstrate to our stakeholders and critics that we have done so. We believe a budget model that incentivizes activity aligned with our mission holds the greatest promise for achieving these goals and adhering to principles and guidelines identified in this report.

The work of the Budget Model Review Committee is an initial step in what may be a series of efforts to improve UW-Madison's budgetary practices. The transition to a new budget model will be challenging and will take time, effort and commitment. The committee is confident that the campus community will rise to this challenge. To do otherwise is to choose a future in which UW-Madison no longer serves the citizens of Wisconsin well and loses its position among the preeminent institutions of higher education in the nation and around the world.

## Introduction

An effective financial management and budget system is essential for the University of Wisconsin-Madison to implement its overarching strategy and achieve its mission and vision. In the competitive higher education environment that exists today and in the foreseeable future, resources must be carefully aligned to the campus strategic focus. However, the current financial management and budget system, as well as the model used to allocate resources from central campus administration to units on campus, is not as effective as it could be in supporting the missions of UW-Madison.

An effective financial management and budget system provides information to support strategic resource allocations and tracks the financial consequences of such actions using pre-defined metrics. We believe that implementation of an activity-based allocation model will provide incentives leading to new, high-quality, high-demand educational, research, and outreach programs while maintaining support for existing programs commensurate with the level of activity and alignment with strategy.

There is a clear and growing sentiment on campus that changes in the financial management and budget system are necessary. To that end, we have identified the following **principles and guidelines** that should be used to guide the selection and implementation of a new budget allocation model:

1. The budget allocation model should recognize, accommodate, and complement external fiscal parameters imposed by the State and the UW System Board of Regents.
2. The budget allocation model should align funding with the University's core missions of teaching, research and outreach, creating incentives for the success of the university as a whole, and allowing for investment in new campus-wide initiatives.

A new budget allocation model should be part of a transparent budget development and allocation process; such a process will help UW-Madison maximize support of campus stakeholders and private donors – support which is critical to maintaining the excellence of UW-Madison.

The budget allocation model should support entrepreneurship and innovation that lead to outcomes that are consistent with campus strategy, and mission. Specifically, the budget allocation model should encourage growth in revenue.

3. The process for developing, implementing and evaluating a new budget allocation model should acknowledge the tradition of shared governance, recognizing the cultural differences across campus.
4. The budget allocation model should allocate resources to schools, colleges, and campus-level units but not allocate resources within those schools, colleges and campus units. Deans and Directors remain the primary arbiters of school, college, and campus unit strategy.
5. The budget allocation model must ensure good stewardship of resources, align resources with activity, and be flexible, simple, transparent, easily understood.

The new budget system and allocation model should provide the information necessary for sound decisions about the types, amounts, costs, and charges for research and educational

programs, and provide sub-unit information that supports decentralized (school and college level) decision-making about instructional programs. This is critical if the University is to compete successfully in a dynamic higher education environment.

6. The budget allocation model should reflect institutional priorities and strategies. In addition to objective metrics, the budget allocation model should allow discretionary distribution of resources to support qualitative measures of success and respond to special needs and new opportunities.

The budget system and allocation model should provide information to encourage campus units to increase the quality and innovation of the education they provide. This can be accomplished by allowing units to retain a larger share of the tuition revenue they generate and allowing demand to influence other resource allocations.

7. The budget allocation model should be implemented in a way that avoids large or discontinuous shifts in allocations, recognizes the time horizons of existing commitments, and aligns with the pace of operational change.

We believe that a new, transparent budget development and allocation process will provide the information necessary to guide sound decision-making, support innovation and entrepreneurship, and ultimately help UW-Madison maximize support from campus stakeholders and private donors. This report is intended to be the first step in achieving that goal; here, we outline the major elements of our thought and discussion since the committee began its work in September 2013. In the sections that follow, we (1) describe the **current budget allocation model**, (2) develop a **case for change** to an activity-based budget allocation model, (3) identify possible **allocation models** (including a summary of best practices, with benchmarking to peer institutions), (4) identify **cultural/historical/political challenges** to implementation of a new allocation model (as well as strategies and action steps that will support successful implementation of a new allocation model), and (5) offer a **roadmap of next steps** for a follow-on budget model selection committee.

### The current budget model

The following section describes how the current UW-Madison operating budget is derived and provides background on the various parameters and constraints, both internal and external, within which the current (or future) campus budget model must operate. The focus is limited to UW-Madison's "general fund" budget, which includes state tax support, tuition, and indirect cost revenues. This budget does not include, for example, auxiliary funds, sponsored research funds, or gift funds, or the capital budget process.

#### **Basic external parameters**

To fully understand the current budget model, several budget-related organizational parameters must be recognized:

- UW-Madison is one of 13 campuses comprising the University of Wisconsin System, which is governed by a single board – the Board of Regents.

- The Board of Regents establishes budget-related policies and maintains a central administrative function which implements, monitors and enforces Board of Regent policies, procedures and guidelines. The Board determines how new funds received from the State and/or required budget reductions are distributed by campus. The Board determines the priorities for new funding requests to the State.
- The University of Wisconsin System is part of the State of Wisconsin and operates as a state agency. As such, much of the budget for UW-Madison (and the UW System) is governed or determined by State of Wisconsin law and administrative policies and guidelines. For example, UW-Madison as a campus does not have independent tuition-setting authority.

### State budget process

Wisconsin has a biennial, or two-year, budget. The state budget is proposed by the Governor in January of every odd-numbered year and enacted by the Legislature in the early summer of that year. In the biennial budget, authorized expenditures are established by appropriation, and those expenditure limits are “written into law.” Appropriation levels for the UW System are established at the system level; they are not established by campus. The most important constraints established in each biennial budget are:

- The appropriation level of state tax support or general purpose revenue (GPR) for the UW System for each year of the biennium.
- The amount by which resident undergraduate tuition can increase in each year of the biennium, either through an appropriation limit or other specific language.

Generally, new appropriation levels are established to fund the UW System for anticipated or past inflationary cost increases for such categories as compensation increases—pay plan and fringe benefits costs—and other “cost-to-continue” items such as debt service, utilities, and financial aid. In addition, new funding may be provided for new initiatives, such as the operating costs for the Wisconsin Institute for Discovery at UW-Madison.

Each category of new funding (e.g. pay plan, fringe benefits, utilities, new initiatives) has a GPR component and a tuition component. The new appropriation levels for the biennium for GPR and tuition are established in this manner. This process does not create any new discretionary funding for the UW System; it only provides funding to cover anticipated on-going costs at the current level of operations or additional funding for specific new initiatives. In addition, as we have experienced over the past decade or more, biennial budgets may include specific reductions in GPR for the UW System.

When new appropriation levels are established through the biennial budget process, the Board of Regents determines how changes in funding are distributed by campus. That process is discussed below.

### UW System budget process

For more than 30 years, the UW System has used a “base-plus” approach to budgeting, meaning that the budget for a campus starts with the previous year’s base and is then adjusted based on executive,

legislative and/or Board of Regent action. The current base budget for each institution is an accumulation of individual allocation decisions made by the Board of Regents over the history of the UW System. There have been periodic studies of alternative approaches to resource allocation within the System. However, the Chancellors have consistently agreed that the base-plus budgeting is the best approach. In December 2013, UW System President Kevin Reilly charged a new System-wide working group with reviewing the current methodology used to allocate general purpose revenue and tuition among the campuses and determining whether changes are needed.

Over time, the UW System and Board of Regents have followed these principles in allocating resources by institution:

- The tuition generated by each institution should remain at the institution that generated it.
- Funding for inflationary cost increases should be distributed in such a way that makes each institution whole for these cost increases.
- When UW System institutions face sizeable GPR base reductions, resource allocations should attempt to make the impact of these reductions proportional to every institution's base budget.
- In the process of setting tuition, and in determining what tuition increases are required to fund the tuition share of inflationary cost increases, all resident undergraduate tuition should increase by the same percent at each institution.

The categories of cost for which each institution has been fully funded (or proportionately funded when full funding is not available) have included the following general categories: utilities, debt service, fringe benefits, compensation plans, financial aid, and budget reduction offsets. This approach has meant that:

- UW System allocations to institutions mirror changes in funding that have been established for the UW System as a whole in the biennial budget;
- Each institution is fully funded (or equally funded if full funding is not available) for anticipated inflationary cost increases at current operating levels;
- No new "discretionary" funding is provided to any institution.

The only exception to this last point regarding new discretionary funding or new budget authority relates to institution-specific entrepreneurial programming and initiatives. Institutions can "grow" their budgets through: (1) tuition differentials; (2) tuition from students in self-supported programs; (3) tuition garnered from enrollment growth; and (4) tuition above the regular graduate rate for students in professional schools.

### **UW-Madison budget model**

Like the UW System budget approach, UW-Madison's budget model has been a "base-plus" or incremental model for the past 30 years.

Fund 101 is UW-Madison's base budget or general fund. Fund 101 consists of two primary revenue sources: state general purpose revenue and student tuition. Fund 101 also includes approximately \$57 million (2013) in federal indirect cost reimbursement.

The annual budget development process consists primarily of the allocation of current year unclassified pay plan and allocation of the continuing costs of prior year(s) classified pay plans. Central campus administration fully funds fringe benefits costs and does not withhold any amount of either unclassified or classified pay plan funding for "reallocation." As previously noted, UW-Madison does not receive any allocation of new base funding for discretionary purposes as part of any biennial or annual budget exercise. The only exception to this basic rule relates to any material changes in enrollments. If enrollments grow, or residency patterns shift in a way that generates a sustainable increase in tuition revenue, then that additional revenue can be converted into the campus discretionary base budget authority.

All changes (whether distributing new funds or distributing reductions) in allocation levels to schools and colleges are managed through the annual budget process. As referenced above, examples of changes to "base" funding to campus units include allocations to fund pay plans and distribute budget reductions, as well as campus support for targeted salary costs such as standard promotional increases for faculty and other recent salary initiatives including the High Demand Faculty fund, the Provost's initiative for Post-Tenure Review and Compression Equity, and the Critical Compensation Fund (CCF).

Other relatively recent campus initiatives, including the Cluster Hiring Initiative (CHI) and the Madison Initiative for Undergraduates (MIU), have directed new funding to various units from a combination of external and internal sources; these types of initiatives generally involve a competitive process including submission of proposals by individual departments, review and prioritization at the school/college level and subsequent review and approval of successful proposals by campus leaders, with additional levels of review and approval as necessary (by internal as well as external stakeholders).

Periodically, the campus has engaged in reallocation exercises to internally fund new programs and initiatives. This approach is the only method available to generate discretionary base funds that can be directed to new programming. The most recent example is the "overcut" in the 2011-13 budget reduction exercise which generated funds for reallocation. In many budget reduction years, reallocations are implemented through differential reductions by unit, whereby some units may be exempted from reductions and other units subjected to greater than average reductions. Although common, this technique does not generate new discretionary base funding unless an "overcut" is employed. Other examples of reallocation include a Program Development initiative which the institution conducted as part of every annual budget process from approximately 1974 through 1989. The exercise required all units to lapse 1-2% of base funding annually back to a central account, which was then available for potential reprogramming and/or reallocation.

The only other mechanism through which individual schools/colleges are generally able to secure additional allocations of 101 funds is through ad hoc requests by Deans/Directors, typically to support specific and targeted short-term needs. These types of ad hoc allocations are generally made on a revolving basis and depend on a variety of factors including availability of funds; new funds are made

available as old short-term commitments are retired or eliminated. This minimal level of “one-time” renewable funding cannot be used for permanent commitments.

Historically, a small subset of tuition-funded programs has resided “outside” the budget model (i.e., in Fund 131). These include cost-recovery and self-support programs whose enrollments are outside the tuition pool. Like other UW institutions, UW-Madison has a tuition revenue target that it must meet to sustain the Fund 101 budget. The revenue requirement and production for the tuition target relate to UW-Madison’s “base” enrollments – undergraduate students, graduate and professional students, and most special students.

UW-Madison has had relatively limited activity in cost-recovery and self-support programs. In FY12-13, approximately \$10 million was generated in Fund 131 programs. Successful examples of such programs include the Evening and Executive MBA program, the Masters in Biotechnology program, and the Master of Engineering in Professional Practice. Since the introduction of the Educational Innovations initiative, there has been vigorous interest in the Fund 131 model. The fundamental requirement of such programs is that they result in net new enrollment and revenue growth to the campus. If that requirement is met, the business model from the institutional perspective is sustainable, meaning UW-Madison can both meet its tuition pool revenue target and allow the programs to directly retain the tuition they generate.

In addition to these programs, some schools and colleges generated tuition revenue (or budget authority) through differential tuition rates for undergraduate students and augmented tuition rates for professional school students.

The current budget model does not charge school and college budgets annually for costs associated with central campus administration and related infrastructure, including utility costs. Campus administration has historically provided funding to support Accounting Services, Enrollment Management, Legal Services, the Office of Human Resources, Facilities Planning and Management, etc. The only campus-wide assessments that apply to all units and that are not based on a fee-for-service activity are the Common Systems/IT Licenses chargeback, and the 21<sup>st</sup> Century Network fee.

Fund 150, or UW-Madison’s federal indirect cost reimbursement, is handled in a different manner. Annual commitments and allocations are set at a level equal to projected revenue. The fund is essentially managed on a cash basis. A contingency balance is maintained to protect against years (like the past several) in which projected revenues do not materialize at a sum equal to actual expenses and commitments.

There are four sequential “draws” (i.e., sets of commitments or expense categories) for Fund 150, as follows:

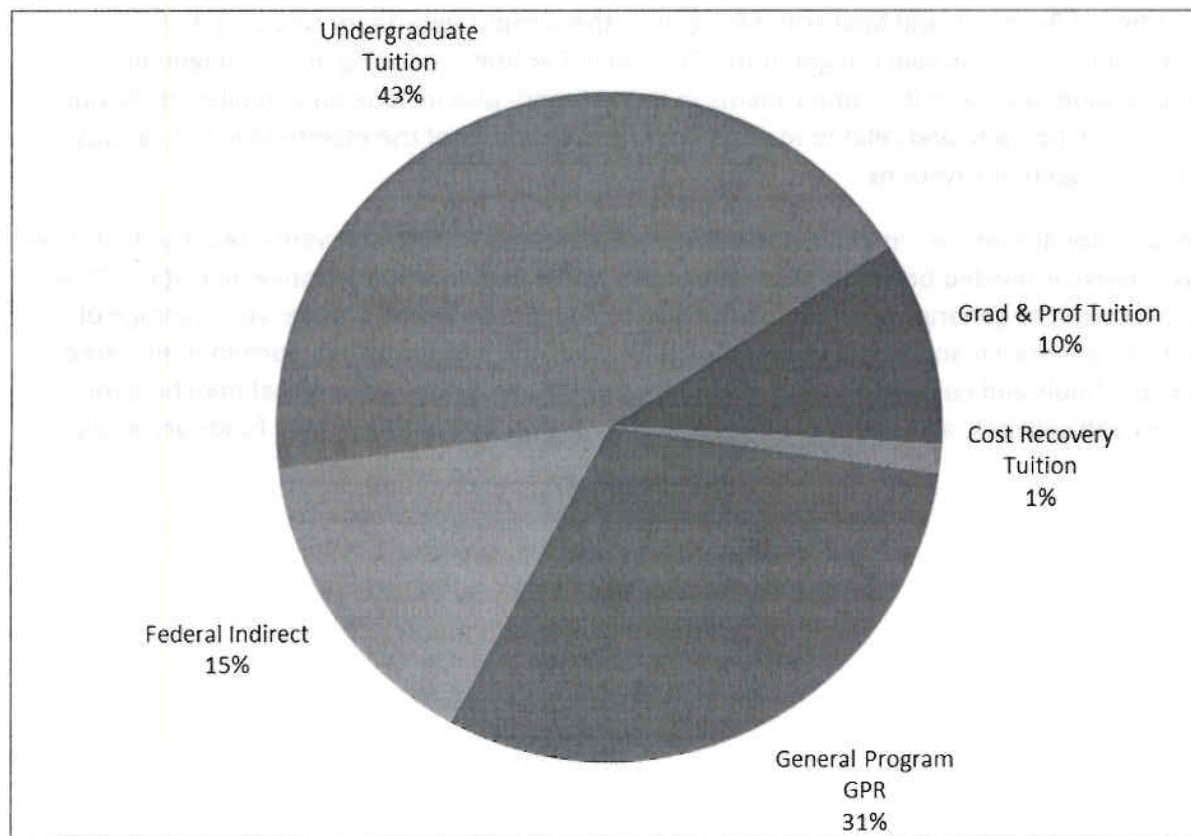
- A group of payments or assessments associated with federal research activity that the institution is required to remit.
- \$57 million that has been built into the Fund 101 base since UW System merger in 1973-74. The Fund 101 pool is considered a second draw against Fund 150 because withholding any or all of this annual contribution would be tantamount to a base budget reduction to campus units.

Approximately 75% of the amount has been built into the base budgets of generating units (schools and colleges); the other 25% has been built into the base budgets of critical research support units (the Division of Information Technology, General Library System and the Division of Facilities, Planning and Management).

- Base budget commitments for separately budgeted Fund 150 units or programs, and high priority campus-wide commitments which are directly associated with the research mission, including the Office of Research and Sponsored Programs, the campus veterinary care unit and the maintenance and custodial budget in the Division of Facilities, Planning and Management. Campus-wide, high priority commitments in this category also include an annual contribution for the network upgrade and related maintenance, and the costs of the maintenance of various grants management systems.
- Annual “capital exercise” in which the balance of projected Fund 150 revenue less the first three draws above is divided between generating units (80%) and an administrative allocation (20%). The allocation to generating units (schools and colleges) is based on a three-year average of overhead generated and direct expenditures. Much of the administrative portion is allocated back to schools and colleges through the Strategic Hires Program, lease rental matching for schools and colleges, and startup and retention packages, to the extent that funds are available.

## Sources and allocation of the 2013 Budget

The process described above provides the core budget of UW-Madison. As noted at the outset, this budget does not encompass all expenditures at the University, but is the foundation for our ability to achieve the institution's multiple missions. The graph below illustrates the sources of the core budget for 2014, equal to approximately \$870 million in total. This represents about 30% of UW-Madison's \$2.8 billion budget.



### Making the case for change

We are entering an era that requires universities to find innovative solutions to tight budgetary environments. Economic shifts, globalization, and technological innovations have substantially changed our world. These changes bring both opportunities and challenges. Opportunities are created for higher education institutions as the value of what we provide – research that helps create knowledge companies, education that develops workforce for those industries, and outreach that disseminates knowledge and expertise – increases on the world stage. Challenges have emerged as these changes bring into question the traditional delivery mechanisms of higher education, and the economic compacts that institutions of public higher education have traditionally had with state governments. Universities like ours are at a point when nimble changes and future investments are necessary not only to maintain and strengthen our national and international reputation, but also to reinforce our value to the state and its taxpayers.

The modest growth in the campus core budget does not come close to keeping pace with the rate of growth of expenses during recent decades. Most of UW-Madison's competitors (other strong public institutions and nationally recognized private institutions) have broader and more flexible financial bases. This external competition has caused our costs, particularly the cost of nationally recruited faculty and staff, to rise rapidly. As a result, UW-Madison faces a reduction in scale and/or loss in quality at a time when investment and innovation is critical to maintaining competitiveness.

If the declining growth rate in the core budget is not addressed, UW-Madison will lose its position among the preeminent institutions in higher education, nationally and globally. UW-Madison currently cannot compete for the best talent due to resource constraints, and is becoming unattractive for the first-rate academics on our faculty and staff. Addressing this issue is critical for a state trying to re-position its economic base and to develop the human capital necessary to compete in the "new economy" of the nation and the world.

One near-term means to address the shortcomings in the core budget is to reconfigure the allocation process on campus to ensure that resources that are available are invested as efficiently as possible in a manner commensurate with the strategy and missions of the institution. In this context, the committee focused its analysis on two central questions:

- Does the current budget model meet UW-Madison's needs today, and for the foreseeable future?
- Does the current budget model align with principles deemed to be important and with prevailing campus values in regard to the management and allocation of resources?

#### **Does the current model meet our needs and fit with campus values?**

UW-Madison has maintained the incremental budget model over many years, in part, to provide schools and colleges with predictable funding in favorable and unfavorable economic times. However, this budget approach allows for only limited reallocation across units, and typically does not generate sufficient resources to support new initiatives and programs. In addition, faculty, staff and administrators across campus indicate that the current budget model does not consistently and transparently align with campus values in regard to resource allocation and management, and has led to the following undesirable practices and outcomes:

- Units have no incentive to engage in financial planning;
- Resource decisions are not transparently connected with academic decisions or outcomes;
- Resource allocation and reallocation becomes a political process;
- There are few clear financial incentives for improvement or innovation;
- There is no sense of shared accountability for budget management and outcomes;
- When a resource allocation decision is made, the rationale or basis for the decision may not be clearly explained;

- The budgeting process has little transparency, sometimes even to those directly involved.

The committee has concluded that the current incremental budget model does not meet UW-Madison's current or projected needs, for the following reasons:

- The current budget model does not align resources to activity, and therefore responding to shifts in educational demand is difficult. There is no incentive to encourage better instruction, innovative instruction, or enrollment of more students. Successful innovation in an existing program or development of a new program does not attract continuing funding, even when it draws significant enrollment. This means that teaching staff are given no incentive to innovate, grow, and improve. In fact, programs that grow too large are penalized because there is no assurance that funding will be sufficient or sustainable. In contrast, producing more research can generate more resources for the faculty member through their grants, and for departments, schools, and colleges through indirect funds (although the indirect cost allocation remains insufficient to maintain the existing research enterprise, or to support growth). Improving instructional productivity does not yield similar gains.
- The current model allocates core funds on the basis of history, not productivity or centrality to mission. However, there are areas outside of the core budget where there is a financial incentive for innovation and enrollment, such as through program-revenue activity (i.e., outreach or approved program revenue degrees). The establishment of program revenue degrees (in which units can retain tuition revenue) that then operate alongside conventional degree programs (where funding is not linked to enrollment) can distort resource allocation and offer perverse incentives. For example, if a school can establish an "evening/weekend" program from which it can capture tuition revenue alongside a core program from which no tuition revenue is captured, there is a powerful financial incentive to divert instructional resources into revenue-generating programs to the detriment of core programs. This incentive is extremely strong when units face serious financial pressures.
- The current model lacks transparency and does not objectively allocate core funds based on program quality. The current system takes program quality into consideration only in the allocation of flexible resources available for distribution by central administration. The allocation of these funds is done through individual negotiations rather than through a more transparent process that links allocation with strategy and metrics.

While we must continue efforts to expand our financial resources by increasing tax support, generating and reinvesting research overhead, and increasing private philanthropy, we must also focus on how to make the most of what we have. This requires a budget model that aligns resources with our core missions, creates incentives for sound decision-making and careful use of resources, rewards innovation and quality, and provides flexibility necessary to accommodate change and growth. The committee has concluded that this is the right time for a change in our campus budget model. We believe the risk of erosion of the quality of the institution is too great to accept the status quo.

In the following section, we review a range of university budget models now in use among universities similar to UW-Madison in size, complexity and mission.

### **Identification of campus budget models and best practices/benchmarking**

According to the 2011 Inside Higher Ed Survey of College and University Business Officers, the most common campus budget models are incremental, zero-based, formula, performance-based, and incentive-based budget models. Incremental, zero-based, and formula budget models are typically in use on centralized campuses, whereas performance-based and incentive-based budget models are being adopted on decentralized campuses.

#### **Budget models: advantages, disadvantages**

*Incremental Budgeting:* This is the oldest and most common budget model used in higher education, where budget proposals and decisions are largely based on funding levels of the previous year. The underlying assumption is that the institution's fundamental goals and objectives will not change markedly from this year to the next.

- Advantage: Easy to implement, provides stability, and allows campus units to plan.
- Disadvantage: Little incentive to create new programs or means to evaluate resourcing of existing programs.

*Formula Budgeting:* This is a strong central-campus budget model in which funding is computed by applying selected measures of unit costs to selected output measures.

- Advantage: Depoliticizes the appropriations process by relying on quantitatively-oriented agreed-upon algorithms for distributing funds.
- Disadvantage: Formulas can be ineffective in incorporating quality in resource allocation.

*Zero-Based Budgeting:* At the beginning of every budget planning period the previous year's budget for each campus unit is cleared. Every campus unit must re-request funding levels and all spending must be re-justified.

- Advantage: Focuses on outcomes and results and perceived as a highly rational, objective approach.
- Disadvantage: Assuming no budget history runs counter to continuing commitments, such as faculty tenure; highly time-consuming; potentially volatile and subject to capricious decisions.

*Performance Budgeting:* In this model, decisions are made centrally and are based on policies that relate inputs such as enrollment or research volume to determine funding levels. Units must perform in certain ways and meet certain expectations to receive funding.

- Advantage: Focuses on accomplishments and results rather than on inputs and processes; once defined the approach is relatively simple.

- Disadvantage: Difficult to define performance criteria and appropriate measures; tendency to measure only that which is most easily measured.

*Incentive-Based Budgeting (IBBS):* This model delegates significant operational authority to schools, divisions, and other campus units, which allows them to prioritize their academic missions. A significant portion of the unit's revenue and income, including student tuition, is retained. Each unit is assigned a portion of government support. Units are responsible for their own expenses, as well as for a portion of expenses incurred by the university's general operations. This model allows support units to charge for their services, and some academic units can tax others for the service instruction that they provide.

- Advantage: A more rational approach to budgeting; operating units have greater responsibility for budget development and control; academic priorities are made closer to the instructional level; tuition resources are moved in relation to the institution's enrollment patterns; incentive to enhance revenues and manage costs.
- Disadvantage: Academic programs may become budget-driven at the risk of sacrificing academic performance, priorities, and innovation; local services that duplicate those offered elsewhere may be expanded to generate revenue; developing equitable cost algorithms for taxing units can be problematic.

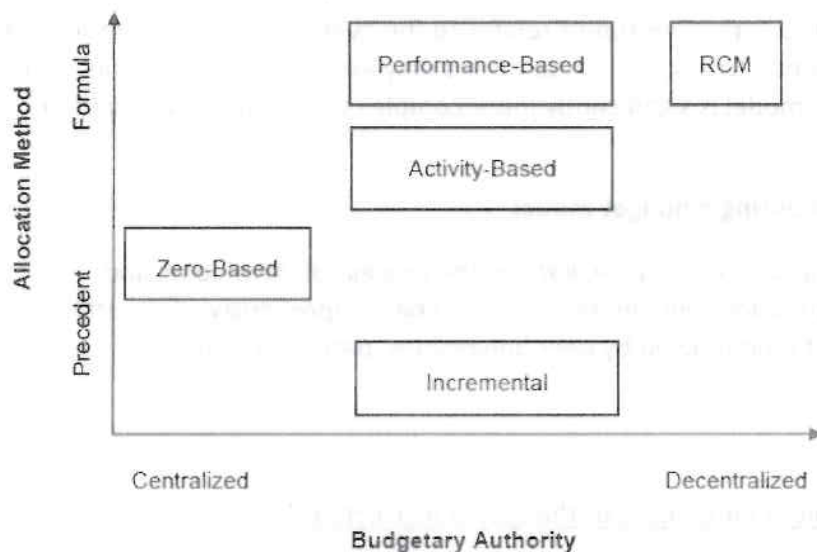
Recently, more colleges and universities have begun to transition to incentive-based budget systems, which include responsibility-based budgeting and activity-based budgeting. The shift toward incentive-based budget systems in higher education may be driven by the need to address rapidly changing financial and political conditions proactively, and to integrate planning, budgeting, and management decision-making more fully at the level of individual campus units while decreasing levels of central campus budget authority.

To support this committee in its work, campus leadership commissioned a report from the Education Advisory Board (2013) focusing on budget models currently in use among peer universities. This report organizes the spectrum of budget models in peer universities slightly differently than the Inside Higher Ed survey cited above. The EAB cites the following as the most common models, ranging from most centralized to least centralized: incremental budget models, zero-based budget models, performance-based budget models, activity-based budget models, and responsibility center management budget models. According to the EAB, activity-based and responsibility center management budget models are regarded as specific types of incentive-based budgeting.

In addition to differences in terms of centralization or decentralization of budgetary authority, budget models also vary by how funds are allocated, as seen in the following chart:

Figure 1 from Page 7, EAB research brief

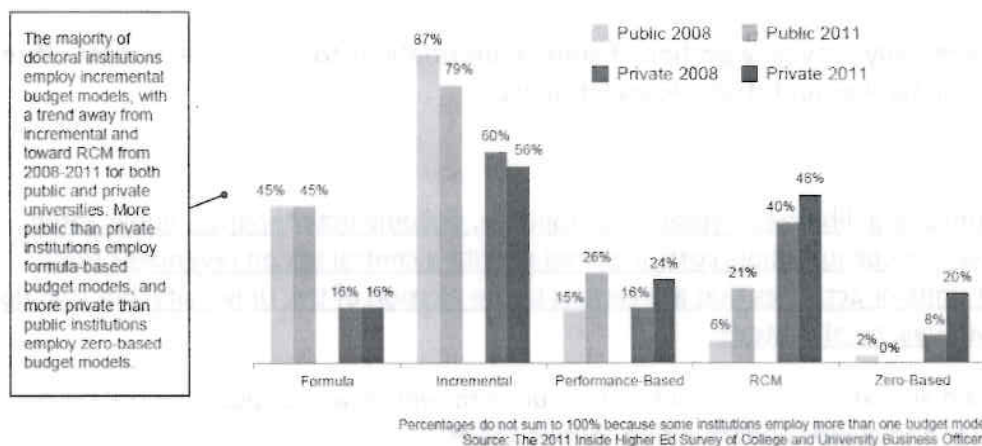
### Budget Model Framework of Allocation and Authority



Most public peer universities employ an incremental budget model, as we do; however, between 2008 and 2011, there has been a slight shift away from incremental models toward performance-based, and responsibility centered management models, as shown below.

Figure 2 from Page 7, EAB research brief

### Distribution of Budget Model Types at Public and Private Doctoral Universities 2008 and 2011



The EAB report noted that in reality all universities use a hybrid model, not a pure form of any of the models described above. Also, it should be emphasized that regardless of the model a particular university follows, most if not all universities retain a margin of discretionary resources that can be distributed for new initiatives and opportunities.

Another important concept highlighted in the EAB report relates to the overall complexity of the model. Some models may only attribute revenue to units, whereas others may attribute both revenues and costs. Including cost allocation in the model is significantly more complex than revenue attribution alone.

### **Key issues in developing and implementing a budget model**

Some key issues must be addressed and choices made, early in the process of developing and implementing a new campus budget model. Our aim here is not to be comprehensive, but rather to highlight key points regarding budget models used by peer universities, particularly those which have adopted incentive-based approaches.

#### *Allocating Revenues:*

##### Should tuition be allocated to the unit of enrollment or the unit of instruction?

- Allocating tuition to the unit of instruction compensates units for costs of instruction, but creates an incentive for units to teach popular courses outside their area of expertise. Allocating tuition to the unit of enrollment reduces the incentive to reach beyond core competencies, but creates an incentive to enroll students in programs that rely on courses taught in other units.
- Peer institutions have generally adopted a variety of weighting systems that allocate a portion of tuition to the unit of enrollment and a portion to the unit of instruction.

##### Should state appropriations be fully or partially allocated in proportion to tuition?

- State appropriations may be tied to tuition allocation, if largely meant to support instruction.
- Peer institutions generally provide a portion of state appropriations to the central budget office to support campus initiatives and strategic investments.

#### *Allocating Costs:*

##### Should costs of support units (e.g. libraries, research compliance, building maintenance, public safety, utilities) be allocated based on consumption/costs incurred or with a central tax on revenues? How should the costs of other units or activities that are central to the mission of the University, but that do not directly generate revenues, be allocated?

- Consumption-based allocation of costs incentivizes units to reduce waste, but a central tax is easier to administer and avoids underfunding “public goods.”
- For support services, some peer institutions have a general tax in the range of 20-25%; others allocate expenses, for example charging for utilities and maintenance by square footage.

### *Implementation:*

#### How will competing initiatives (e.g. to offer a given program of study) be regulated?

- Coordination is necessary to avoid inefficient duplication and to support sustainable innovation (why develop a new program if it will be quickly undercut?), but regulation can discourage innovation if coordination is too cumbersome.

#### How quickly can the campus transition to a new model, and how quickly will allocations respond to changes in activities?

- Deans and directors need more data on costs, additional staff expertise, and time to make adjustments – especially given long-term commitments to faculty and staff. But, incentivizing and sustaining innovation is difficult if revenue is substantially delayed.
- Some campuses have approached this change by first allocating budget resources based on measures of activity. Later, costs such as centralized services, space and utilities can be allocated after the campus community has achieved a sufficient level of sophistication and comfort with the new model.

#### What mechanisms should be developed to assure resources for important priorities that are not reflected in the budget model metrics?

- To be tractable and transparent, the budget model requires a relatively simple set of metrics. Even a very complex set of metrics cannot capture every important aspect of our mission.

### **Ensuring an effective transition to a new budget model**

Because the campus has been working under the current incremental budget and allocation system for many years and given natural concerns about the potential impact of transitioning to a new model, a change to a different system will meet challenges. The committee recognized this challenge and sought to identify issues and strategies necessary to ensure successful implementation of a new budget model.

### **Process**

The committee interviewed key stakeholders who have knowledge, experience and valuable insights about budget issues on campus. The committee began with a facilitated focus-group interview. Committee members also met with the Deans Council. The following additional groups were identified as important stakeholders, and were invited to participate in interviews:

- Academic leadership: Three former Deans or Associate Deans and three former University Committee Chairs were identified as suitable candidates for one-on-one interviews. To date, four of these individuals have been interviewed. Department chairs will be invited to participate in focus group interviews during the next stage in this process.

- **Staff leadership:** The committee interviewed leaders of academic staff governance (Academic Staff Executive Committee) and members of the Administrative Council, which includes associate deans for administration from schools and colleges and numerous central campus administrators. The committee was unable to meet with classified staff governance representatives because their governance group was in the process of formation.
- **Student leadership:** The committee met with the Associated Students of Madison to understand the student perspective on campus budgeting and thoughts about future changes.

## **What we heard**

Discussions with the stakeholders demonstrated that there is a strong level of interest in the future direction of the campus budget model. Overall there is general agreement that a new budget model is needed for campus to remain competitive in the changing academic landscape, although perspectives on how the budget model should be designed vary considerably. The following is a summary of the common elements identified by the stakeholder groups as being essential for an effective transition to a new budget model.

*Defining Campus Values* – A new budget model must honor campus values. As part of designing and implementing a new budget model, campus values must be discussed, evaluated, and identified, and consensus must be built about how these values should be honored in any future campus budget model.

*Accountability and Authority* – The budget model must be based on campus strategy, and must ensure accountability to the strategy. Stakeholders agreed that our campus has a long history of budgeting approaches that protect the status quo, and that no unit should be “protected” as a matter of course in a new model. Stakeholders also indicated that those with budget responsibility and accountability must also have the authority to make decisions in a timely manner consistent with the budget model and strategy.

*Communicating Strategy* – Our campus has long operated without a clearly articulated central strategy, and a culture of independence and entitlement is commonplace. If an overall campus strategy is to be deployed, and budget is to be allocated in ways consistent with that strategy, then campus leaders must clearly and repeatedly communicate this message so that all affected by the new budget model understand expectations and have access to information resources. For example, if innovative and entrepreneurial educational programs are considered important objectives in the overall campus strategy, then this must be clearly articulated by campus leadership, with explanations about how budgets and resource models can be created to support achievement of these objectives.

*Transparency* – The process used to create and implement a new budget model must be fully transparent and should be articulated broadly and repeatedly. Any new budget model will have proponents and detractors. Transparency will demonstrate that the perspectives of both groups have been considered when making decisions about resource allocation. Without transparency, the detractor group may feel justified in creating “headwinds” as a tactic to resist change, even if they are clearly in the minority. These headwinds can delay progress or derail a transition.

*Predictability* - Most academic units have budgetary commitments associated with faculty salaries, and these commitments change at a much slower pace than shifts in curricular demand or research emphasis. The budget model must be sufficiently predictable so that units can plan effectively to support long-term commitments; therefore, budgetary shifts must occur gradually enough to avoid harmful disruption to the unit's mission. However, units should not be "protected" from the consequences of poor alignment or performance, and resource allocations must be reduced when a unit's contributions to the overall campus strategy and mission fail to meet agreed-upon levels, based on appropriate metrics.

*Campus Level Commitment* – The budget model must honor shared values held across campus in support of the campus mission. The budget model should provide incentives for units to collaborate effectively and to participate in campus-wide strategic initiatives that promote quality and innovation for all (e.g., educational innovation, global health, sustainability). The budget model must specifically address resource requirements of units with broad roles consistent with campus strategy and values, but which may not be seen as central to well-recognized and clearly defined areas of strategic focus, especially when such units are not part of a traditional school or college.

*Research and Outreach* – The budget model discussions to date have focused primarily on the educational mission because that is how the core campus budget allocation (i.e., Fund 101) must be deployed. Nevertheless, our research and outreach missions are equally important and must be taken fully into account. In particular, challenges in the research domain, such as indirect cost allocation and distribution, must be addressed in the new budget model. Transparency in managing indirect costs will be critical.

*Roll-Out Period* – The roll-out period for a new budget model must be carefully considered. The process should be expeditious, but not so rapid that unintended consequences, which are inevitable, cannot be managed effectively.

*Information Infrastructure* – Campus administration must be prepared to invest in the infrastructure, management tools, and human resource training necessary to ensure the transition to a new budget model is as smooth as possible. Since any new budget model is likely to require new metrics as a basis for resource allocation, all campus units must have the information and tools they need to track, document and benchmark their performance against campus strategy. This will help ensure internal controls, ensure accountability, and provide factual information about performance of campus units and about our overall performance as a campus to internal and external stakeholders.

*Commitment from Leadership* – Once the decision has been made, the Chancellor and the Chancellor's leadership team must be fully committed to implementing a new budget model, even if faced with significant resistance from those in disaffected units (e.g., units likely to see budget reductions). The leadership team must be committed to the new model, even if the model reduces budget control by central campus administration. The team must be prepared to implement a change management/communications plan that ensures campus constituents have complete and timely

information about the selection and implementation process, as well as clear channels to communicate with leadership about unanticipated problems and unintended consequences, once the transition has begun.

### **Conclusion: A roadmap of next steps**

As mentioned in the introduction, this White Paper is intended to be the first step in achieving a new, transparent budget development and allocation process for UW-Madison. This process will provide the information necessary for sound decision-making, support innovation and entrepreneurship, and help the University maximize support from campus stakeholders and private donors.

The Budget Model Review Committee believes a model that incentivizes activity holds the greatest promise for UW-Madison. It would provide appropriate incentives, emphasize a high level of transparency and be consistent with principles and guidelines outlined in this report. We also believe additional research and analysis of similar models implemented at peer institutions would be of great benefit. Considering that few universities have a “pure” budget model (EAB report, page 5), other models – their strengths and weaknesses – may help inform the approach that works best for UW-Madison. In addition, greater understanding of the nuances of similar budget models implemented elsewhere would help ease the transition to a new campus budget model. Our roadmap also adheres to UW-Madison’s commitment to shared governance, campus-wide engagement and the sifting and winnowing of ideas.

Specifically, the Budget Model Review Committee recommends the following next steps:

- Chancellor Blank should create and charge a cross-campus committee to conduct a more detailed review of budget allocation models that incentivize activity, develop a proposed model for UW-Madison and recommend action steps for transitioning to the new model. The model should build on best practices at peer institutions but be customized to align with UW-Madison’s operating environment and guiding principles.
- Based on the principles of transparency and simplicity identified in this report and best practices at peer institutions, the committee should develop a model based on a limited number of metrics (or measures of activity) against which budget allocations can be measured.
- In recommending the selection and implementation of a new budget allocation model, the committee should closely follow the principles and guidelines outlined in this report. These principles and guidelines will be critical to the success of the new budget model.
- The committee should take a prudent approach by initially focusing only on budget allocations based on measures of activity. The more complex issue of cost allocation for space, centralized services, utilities and other services can be addressed at a later stage of model development.
- Consistent with the approach of the Budget Model Review Committee, the next committee must commit itself to a broad-based engagement of campus governance groups and stakeholders. This will help ensure an effective transition to a new budget model. Active engagement of stakeholders also is a longstanding component of UW-Madison’s campus culture.

- Campus leadership should continue to devote time and attention to educating the campus community about the current budget model. A clear understanding of the current budget model will be needed before the campus transitions to a new model.
- The committee should develop its work product/recommendations in a timely manner so that the campus community can review the potential impact of the new budget model during the 2015-16 budget development cycle (the spring of 2015). This would establish a “hold-harmless year” as recommended by best practices at peer institutions. The campus could then begin a formal phased implementation of the model, starting in the 2016-17 budget development cycle.
- Building on information provided by the Education Advisory Board, the committee should directly engage and communicate with peer institutions that recently transitioned to activity-driven budget models. Direct engagement would enable the committee and campus community to develop a deeper understanding of transition issues and challenges and to obtain feedback that may be critical to our success.

The Budget Model Review Committee is confident that it has laid a solid foundation for a process that will produce positive results in an area of utmost importance to UW-Madison’s future. Much work remains to be done. But guided by the values that have made UW-Madison one of the world’s great universities, we know the campus community will embrace and successfully complete the important task at hand.

We conclude this report by noting an observation of the Education Advisory Board: Budget models do not make decisions, people do. The impact of the budget model, the EAB said, depends more on the quality of decision-making than on the inherent strength of the model. This observation bodes well for UW-Madison where the quality of decision-making is high in large part because of a campus commitment to collaboration and open and honest communication.

### **Appendix 1: Budget Model Review Committee**

- Darrell Bazzell: Vice Chancellor for Finance and Administration (Chair)
- Craig Benson: Professor, Civil and Environmental Engineering, College of Engineering; Director, Sustainability Research and Education, Office of Sustainability
- Maria Cancian: Professor, Public Affairs and Social Work; Associate Dean, College of Letters & Science
- Norman Drinkwater: Professor, Oncology, School of Medicine and Public Health
- Irwin Goldman: Professor and Department Chair, Horticulture, College of Agricultural and Life Sciences
- Anne Gunther: Associate Dean, College of Letters & Science
- Jeffrey Lewis, Student
- Katharyn May: Dean, School of Nursing
- Linda Meinholz: Senior Accountant; Research and Sponsored Programs
- Noel Radomski: Director and Associate Researcher, Wisconsin Center for the Advancement of Postsecondary Education, School of Education
- Ananth Seshadri: Professor and Department Chair, Economics, College of Letters & Science
- Julie Underwood: Dean, School of Education
- Terry Warfield: Professor and Department Chair, Accounting and Information Systems, School of Business
- Alice Gustafson, Director, Administrative Process Redesign and Administrative Excellence (committee staff)
- Tim Norris, Associate Vice Chancellor and Director, Madison Budget Office (committee staff)
- Scott Hildebrand, Special Assistant, Office of the Vice Chancellor for Finance and Administration (committee staff)

## **Appendix 2: Budget Model Review Committee Charge Document**

**Sept. 30, 2013**

The University of Wisconsin-Madison has followed the same approach to the allocation of its base budget for more than 40 years, since UW System merger in 1972-73. At this critical juncture in UW-Madison's history, when we are faced with ongoing changes in our revenue streams and ongoing innovations in our educational and research programs, it is necessary for the institution to re-evaluate its budget practices. The existing budget model is best described as "incremental budgeting." Over the past several decades, many of our peer institutions have moved from the incremental approach to activity driven budget models that provide objective methods for making budget decisions, focus on achievement of university mission, and promote entrepreneurship.

With the goal of looking at alternative budget models for UW-Madison, the Chancellor has appointed a cross-campus committee of faculty, staff and students to study the institution's budget allocation model.

Specifically, the Chancellor charges the committee with developing a paper about the possibilities of utilizing and implementing a budget model that meets the following criteria:

- (a) Budget dollars shift over time based on objective measures of activity, and incentives are provided to encourage entrepreneurial activity;
- (b) Budget allocations to schools and colleges are more transparent, so financial returns resulting from potential programming changes are known;
- (c) Any changes should be implemented in a way that avoids large or discontinuous shifts in budget allocations.

The tasks this working group should undertake include analysis and recommendations to the Chancellor regarding the following budgetary issues and questions:

- Articulation of principles that should guide the distribution of base budget resources;
- Documentation of the current budget model and identification of its inherent strengths and weaknesses;
- Peer analysis of budgetary approaches from a best practices perspective;
- Identification of options that may be considered if UW-Madison were to change its approach to activity driven budgeting and the key information necessary to evaluate the options;
- Identification of both technological constraints and/or data shortcomings that may pose obstacles to the implementation of a new budget approach;
- Identification of cultural, historical, and political barriers that may impede the development of a new approach to budgeting;
- A roadmap for next steps in the development of a new budget approach, assuming the business case for change can be made.

To be clear, the charge to the committee does not involve recommendations regarding specific models. Instead, the committee should focus on identifying the problems in our current system and providing a

framework for thinking about the alternatives that may lead to more transparent and more activity driven budgets. The work of this group is an initial step in what may be a series of efforts to improve our budgetary practices. It should be noted that the intent of this work is to focus on allocating resources to schools and colleges. It does not have a direct bearing on how deans distribute resources within their schools and colleges.

Due to the timing of both UW System and State of Wisconsin budget development cycles, it is important the committee fulfill its charge by the end of November. The work of this committee will be the first step in helping the University create a holistic, coherent, and sustainable budget plan for future years.

### **Appendix 3: Methodology**

The Budget Model Review Committee Group began its work on October 2, 2013 and met weekly through the end of the Fall 2013 semester. This cross-campus committee of faculty, staff and students was charged by the Chancellor to develop a paper about the possibilities of utilizing and implementing a budget model that meets the following criteria:

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- (b) Budget allocations to schools and colleges are more transparent, so financial returns resulting from potential programming changes are known;
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- Peer analysis of budgetary approaches from a best practices perspective;
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- Identification of both technological constraints and/or data shortcomings that may pose obstacles to the implementation of a new budget approach;
- Identification of cultural, historical, and political barriers that may impede the development of a new approach to budgeting;
- A roadmap for next steps in the development of a new budget approach, assuming the business case for change can be made.

The development of principles was the first task undertaken and completed by the committee.

The second was to secure assistance from the Education Advisory Board (EAB) in completing a benchmarking and budget model research study with selected peer institutions. The committee approved the selection of the universities and the questions for the study. The selected universities were prioritized as follows:

- University of Washington
- University of Michigan
- University of Minnesota
- University of Texas at Austin
- University of California-Berkeley
- University of Iowa
- University of North Carolina-Chapel Hill
- University of California-Los Angeles

The final EAB report was received on December 10 and incorporated into various sections of the final paper.

Significant effort and care was given to engaging various campus stakeholders and shared governance groups or representatives to seek input into the questions related to the cultural, historical and political barriers which might impede a new approach to budgeting. Many groups, including the committee, reframed the question to be how we think through success for a new budget model using culture, history and politics as dimensions for the discussion.

The following groups were engaged in preparation for the report\*:

- Deans
- Administrative Council
- Individual faculty including chair/previous chairs of the University Committee
- Academic Staff Executive Committee
- Associated Students of Madison

\* We were unable to meet with classified staff governance since it was in the process of formation.

The paper itself was outlined and each section assigned to a subset of committee members.

| Outline of Paper  | Sub-committee Members                           |
|---|---|
| Executive Summary                                       | Continuity Editors                              |
| Preamble  | Terry Warfield, Linda Meinholz, Katharyn May    |
| Current State – Budget Model                            | Tim Norris, Anne Gunther, Norm Drinkwater       |
| Case for Change   | Julie Underwood, Irwin Goldman, Ananth Seshadri |
| Identification of Models<br>Best Practices/Benchmarking | Maria Cancian, Norm Drinkwater, Noel Radomski   |
| Cultural/Historical/Political Barriers                  | Jeff Lewis, Terry Warfield, Craig Benson        |
| Principles  | Committee                                       |
| Roadmap   | Continuity Editors                              |

A sub-committee of editors (Continuity Editors) was also established to serve as editors for the final paper to ensure it read as a complete document and not a compilation of distinct sub-sections. Craig Benson, Anne Gunther, Katharyn May, Noel Radomski and Scott Hildebrand volunteered for this responsibility.

Drafts of each section were circulated and reviewed at successive meetings. Initially, individuals volunteered to present a section for which he or she was not the author. Following a conversation by the committee as a whole, suggested edits were given to the authoring sub-committee. Ultimately, each section was declared ready for submission to the continuity editors, who were then responsible to transitioning a series of separate sections into a final document.

