YSU 2020: A New Approach to University Budgeting

May 14, 2012

Background

The YSU Budget Task Force was assembled in response to the YSU 2020 Strategic Plan, which included as a key initiative the creation of a "transparent and responsive budget system." Recognizing that the University's budget will continue to face increasing pressure, the Strategic Plan states, in part:

> "[T]he process by which the University budget is developed and implemented is a critical element of the strategic plan. The process needs to align budget priorities, recognize revenue and spending needs, and provide stability in the face of short- or long-term interruptions in revenue sources. Analysis of current resources and spending patterns will lay the foundation for an improved budgeting process. Ideal outcomes may include enhanced effectiveness of spent dollars and incentives for resource growing."

Task Force membership was designed to have broad representation from diverse perspectives, and included individuals who might have a significant role in the implementation of a new budget model. The Task Force was also intentionally small in number to allow the group to function productively. Membership included:

- Becky Geltz, Director, Institutional Research
- Eugene P. Grilli, Vice President for Finance and Administration (ex-officio)
- Peter Kasvinsky, Associate Provost and Dean of Graduate Studies and Research
- Paul Kobulnicky, Executive Assistant to the Vice President for Finance & Admin.
- Rick Marsico, Director of Computer Services
- Neal McNally, Budget Director and Interim Treasurer
- Tod Porter, Chair and Professor, Department of Economics
- Lisa Reichert, Associate Director, General Accounting
- Elaine Ruse, Director, Office of Financial Aid and Scholarships
- Marilyn Ward, Assistant to the Provost for Academic Budget

The charge of the Task Force was threefold: (1) examine the strengths and weaknesses of YSU's existing budget process; (2) research alternative budget processes; and (3) make recommendations for an improved University budget process that is consistent with the goals of the 2020 strategic plan.

Existing Budget Process

For the past decade or more, the University has operated under a traditional incremental (or decremental) budget model in which, generally speaking, annual increases (or decreases) are adjusted by a uniform percentage. YSU has used this model largely due to the fact that there has been a consistent absence of any additional resources to allocate through a more strategic approach that might include budget hearings, for instance. Even in years when YSU was experiencing net revenue growth, these resources were mainly committed to personnel costs, largely driven by negotiated labor agreements.

YSU's budget process is not unusual among universities, and despite the rise of alternative budget models, the incremental budget model is still in use today at many higher education institutions. This is because it is a relatively efficient approach that is simple to implement, more adaptable and flexible due to a lack of emphasis on analysis and integrated planning. Since units are generally treated equally under this model, the incremental budget process minimizes conflict by precluding the need to make difficult decisions. Because this approach circumvents meaningful analysis, it can oftentimes obstruct the achievement of strategic objectives. In short, the weaknesses of the incremental budget process tend to outweigh its strengths, especially in an environment of change.

YSU's current budget process, however, does deviate from a strictly incremental model in some notable ways. For instance, a very top-down, cabinet-level decision process has been frequently employed when significant budgetary decisions are required. This has frequently created concerns over transparency and exclusion. Additionally, YSU's current budget process exemplifies some characteristics of responsibility centered management, especially with respect to course fees, college fees, information services fees, and certain other fees, which are allocated directly to the organizational units that are responsible for generating revenues from such fees.

Alternative Budget Processes

Since November 2010, the Task Force frequently convened to research and discuss alternative budget models, which included both a review of available literature and direct communication with other universities, including the University of Cincinnati, Kent State University, and Stanford University. Additionally, the Task Force sought and received an impartial assessment of YSU's budget process from an external advisor whose report is attached in the appendix. The Task Force formulated eight guiding characteristics that a new YSU budget model would ideally emulate:

1. Align resources with institutional priorities
2. Improve budget transparency
3. Reward entrepreneurial efforts
4. Reconcile program costs and revenues
5. Enhance local autonomy
6. Encourage better methods for assessing the costs of programs
7. Promote improved fiscal stewardship and accountability
8. Illuminate and eliminate bad management processes

To foster buy-in and to solicit feedback and input, these characteristics were shared with key campus stakeholders, including the President's Cabinet and the Deans Council. The Task Force then weighed each characteristic against various budget models, which in addition to a self-examination of the incremental model used at YSU, included six other models defined as follows:

1. Zero-Base Budgeting – Assumes no prior year budget history and requires each unit to annually or periodically justify budget requests.
2. Planning, Programming and Budgeting Systems – A central management approach that uses long-range revenue projections and cost-benefit analyses to link planning with resource allocation.
3. Performance Based Budgeting – A method generally used at the state government level in which budget resources are based on the achievement of clearly defined outcomes.
4. Formula Based Budgeting – Often used at the system-wide or statewide level, this approach uses mathematical formulations to estimate resource requirements in terms of program cost and demand.
5. Responsibility Center Management Budgeting – A decentralized approach in which responsibility centers (e.g., colleges) manage the revenues that they produce and non-revenue-producing units (e.g., administrative support units) are subsidized via a tax on responsibility centers.
6. Initiative Based Budgeting – A centralized approach to establish a resource pool by annually reallocating resources to the central administration, which in turn reallocates resources to targeted, high-priority initiatives.

These exercises lead to the Task Force's formulation of a set of broad, high level considerations for a new YSU budget model:

- Adoption of a new budget model should be a phased-in, evolutionary process rather than a more dramatic, revolutionary shift.
- Some near-term processes need to be adopted to begin to direct increases in *net* revenues back to the responsibility centers that generate said revenue.
- Small or even symbolic changes need to be made within one year to demonstrate an institutional commitment to change.
- The desire and ability to change must be viewed realistically and not simply aspirationally. This means that we must recognize that fixed costs in the form of labor agreements, for instance, may hinder the ability to reallocate resources. We must also recognize that the precipitous declines in both state funding and enrollments have resulted in limited resources with which to implement change.
- A focus must be placed on enhancing transparency around the decision-making process that drives budget allocations.
- Any reallocation of funds should be directed toward initiatives that are consistent with the YSU 2020 Strategic Plan.
- Enhanced budget flexibility should be given to divisions, colleges, departments and/or organizational units.

Recommendations

Irrespective of which model is selected, the University must shift to a decision-making process that is based on reliable data. Therefore, a commitment must be made to invest resources to significantly improve the collection, production, analysis and dissemination of data. Taking into consideration all of the factors and goals identified in this document, the YSU Budget Task Force recommends two options for consideration, as set forth below.

Option 1: Modified Initiative-Based Budgeting

The first option represents a relatively modest change that would nonetheless strive to achieve very clear cut and laudable goals. The foundations of Option 1 come largely from the set of guiding characteristics formulated by the Task Force and shown on page 2 of this document:

1. <u>Align resources with institutional priorities</u>: The 2020 Strategic Plan has already outlined YSU's institutional priorities. Therefore, the Administration should clearly communicate a commitment to support and fund new initiatives that are tied to the strategic goals of the University, even if this means reallocating resources from existing units. As a first step, this must be communicated widely and with unequivocal clarity.

2. <u>Improve budget transparency</u>: Establish a budget committee with representation from all sectors of the University. In order to function efficiently, the committee should be relatively small in number. The committee should implement a budget hearing process and be empowered to make budget recommendations, which may include recommending the allocation of new resources as well as the reallocation of existing resources. Recommendations should be made to the President and Cabinet. Most importantly, the committee should conduct all hearings in an open and public forum, and make available its recommendations to the entire University community.

3. <u>Reward entrepreneurial efforts</u>: In recommending the allocation of new resources and/or the reallocation of existing resources, the budget committee should favorably view and reward proposals that aim to increase net revenues to the University.

4. <u>Reconcile program costs and revenues</u>: In making recommendations, the budget committee should be equipped with standardized and up-to-date data on the expenses and revenues associated with programs and/or organizational budget units. The data should be published in a manner that is widely and easily accessible to the entire University community.

5. <u>Enhance local autonomy</u>: With the approval of the appropriate supervisor(s), financial managers should be given the latitude to develop and present proposals

to the budget committee. Additionally, all funds should be fully interchangeable and available for alternative uses, including dollars associated with vacant faculty and staff positions. For academic departments within a college, this should be at the college level. For all other units, this should be at the division level. This type of enhanced flexibility would promote more thoughtful, efficient and creative uses of University funds.

6. Promote improved fiscal stewardship and accountability: Organizational units that end a fiscal year with a positive fund balance should be permitted to carry-forward to the following fiscal year some portion of the prior year balance. While the carry-forward amount would depend on the overall financial position of the University at year-end, the goal would be to allow as much carry-forward as fiscally possible. Likewise, an organizational unit that over-spends its budget should be held accountable through some commensurate penalty, such as reducing the unit's budget in the following year.

Strengths of Option 1

- Because it would minimize the need to invest additional resources in the budget process itself, Option 1 recognizes the ongoing financial challenges facing the University.
- This option is practical and could be implemented in the very near-term, within one year.
- By improving transparency and allowing for broader participation in the budget process, this option is highly responsive to some of the most widely-held criticisms of YSU's existing budget process.
- This option represents an effective way to encourage evolutionary change in budgetary allocations.

Weaknesses of Option 1

- This option does not provide the type of revolutionary change that much of the University community may desire or expect.
- The human element that is inherent in committee structures could heighten political conflict.
- Even though Option 1 seeks a more data-driven approach, the degree to which decisions are truly driven by data would depend on the evidence required by the committee.
- Although relatively modest, this option would nonetheless require additional time and resources to function as intended.

Option 2: Responsibility Centered Management

The Task Force has been impressed with the potential of responsibility centered management (RCM) budgeting. If there is a “movement” in models of resource allocation in higher education it is certainly a movement toward RCM. In northeast Ohio alone, Kent State University has recently implemented RCM; and the University of Akron has recently begun a serious examination of RCM. The Task Force’s in-depth discussions with senior staff at Kent State provided much insight into the implementation and benefits of the RCM model.

There are many decisions to be made in implementing RCM and those decisions cause RCM to have many subtle flavors. One has to decide the organizational level at which a responsibility center is defined; it is typically a school or college but can be a large division or a small department. It can be an institutional budget philosophy or an approach taken only at the provost’s level. One must also decide how to allocate funding to support service units, which can be accomplished via a general tax on revenues or by detailed consumptions analytics. Tax levels have to be set, evaluated, and when necessary, modified. Seed funding for new programs has to be set aside at some predetermined funding level. Procedures for making such decisions define management responsibilities and levels of empowerment. These types of decisions have resulted in countless variations of RCM implementations. YSU would have to carefully consider and define its own variation.

Because of the difficulties in implementing RCM and the dramatic cultural shift it produces, the decision to implement any variation of RCM requires strong and direct leadership from executive management.

Strengths of RCM - Option 2

- By its very nature RCM ensures budget transparency because all decisions must be communicated openly and much of the decision making is determined by published data on costs, revenues, productivity and quality.
- Program costs and associated resources are either aligned or the lack of alignment becomes visibly obvious.
- Because revenues flow initially and proportionally to units that generate those revenues, attention to revenue generation is encouraged and rewarded at the lowest levels.
- With a high degree of fiscal autonomy at the lowest levels, efficiencies are encouraged.
- Programs that are neither efficient nor cover their costs but are essential to the mission of the institution are visible, and such costs are easily assessed relative to the program’s value to the university.

Weaknesses of RCM - Option 2

- RCM represents a major change to fiscal processes and an even deeper cultural change, especially in an environment where performance data has been historically absent from the decision-making process.
- Based on feedback from other universities, it would likely take two to three years to implement RCM.
- RCM is expensive to implement, both in terms of fiscal and human resources. Many universities have contracted with external consultants to implement RCM.
- For political and financial reasons, RCM is difficult to implement in an environment of declining or stagnating resources.
- RCM is expensive to maintain because it often requires additional, permanent staff. However, these costs can eventually be mitigated by revenue growth.
- YSU’s collective bargaining environment does not synchronize well with budgetary agility that is essential in a successful RCM model. For example, after years of growth, it would be difficult for an organizational unit to reduce staffing levels if revenues declined sharply.

Conclusion

The options presented above can be viewed as a sequence or as distinct choices. Option 1 could represent a short-term solution that might gradually evolve into an RCM model, after the University regains its financial footing. On the other hand, either option could represent a permanent change in budgeting philosophy. As next steps, this report will be communicated to the Deans Council; and then to the Executive and Administrative Staff Council, leading to a final decision by the President and her Cabinet.

Appendix

Independent assessment from Ralph Harker Associates

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VISIT TO ASSESS READINESS, NEEDS, AND PROGRESS TOWARDS INSTITUTING A NEW BUDGET MODEL AT YOUNGSTOWN STATE UNIVERSITY

Background

I was invited to visit Youngstown State University (YSU) to meet with administrative and academic staff to provide guidance to the budget taskforce in its goal of recommending a new "budget model" to replace the existing incremental process that has been in use over the past decade or more.

Visit

The goal of the visit was to meet with the finance staff in charge of the budget model review initiative, as well as with institutional leadership and the task force developed to guide the process. Through conversations, as well as sharing broad budgeting concepts, my observations from working in the field, and organizational behavior and decision-making theory, I strove to understand the current institutional budgeting and decision-making culture, as well as people's thoughts about what did work and did not work currently, what people hoped to achieve through a budget reengineering process, and what were challenges people identified that would impede such a process.

It was not the purpose of this initial visit to recommend a particular budget model and implementation schedule that would work best for YSU, nor was it to recommend a particular budget or resource allocation decision-making process.

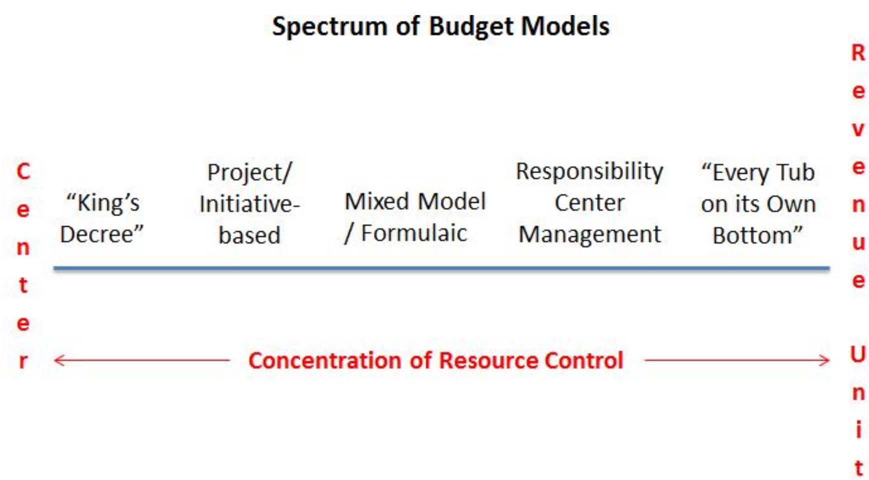
Current State

YSU's current budget model appears to be wholly driven by how much unrestricted revenue changes year-over-year, with that percentage increase (or decrease) being applied to the amount of funding allocated to each cost center (college, department, or division) in the current year. The allocation each unit receives has not been closely examined in relation to either year-end actual results or to some methodized examination of true costs (e.g. zero-based budgeting). In terms of budget models, YSU appears to exhibit behavior characteristic of the highest level of control, being a variant of the "King's Decree" budget model (see figure below), where the control over the allocation of resources is very highly controlled centrally. In YSU's case, the calculated percentage change each year is playing the role of "king", as no other player or players within the institution are inserted into the allocation process to alter the flow of resources.

At one time, more than 10 years ago, the budget process at YSU appeared to be much more proactive and decision-based. It involved budget units making presentations to the university leadership with proposals for new initiatives, and the institution's leadership was more deliberative about how resources should be used and where. Significant funding constraints led to a budget process which eventually dropped any proactive proposal presentations or deliberations, ending up with the percentage incremental (or decremental) allocation process in place today.

Other Budget Models

Different budget models vary in where lies the level of control over how resources are allocated within an organization. One way of thinking of budget models for higher education institutions is as the model's location on a continuum:



"King's Decree" budgeting process: This is a process where all or most of the revenues come into the institution at the center, and an individual or a body of individuals is responsible for determining how the resource allocation process works and how a unit's budget resources are made available from one year to the next.

Responsibility Center Management budgeting process: This is a process where, broadly speaking, revenues are identified with, and allocated to, the units that are responsible for generating those revenues (tuition, indirect cost recoveries, etc.). The units have control over the use of these revenues to cover both direct expenses (course instruction, departmental and school administration) and indirect expenses (the costs of central and university-wide administration and services, like financial affairs, operations and maintenance, human resources, university-wide IT services, etc.), which get "charged back" to the units based on some costing basis or allocation methodology.

Initiative-based budgeting process: This is a process where resources are identified from within the institution (for example, via a "tax") that are held centrally but competed for in order to inspire innovation and initiative in development of new programs. Funding would be made available to "jump-start" a new program which might require more up-front funding than the program will be able to cover in its first year or years.

Project-based budgeting process: This is a process where new revenue-generating programmatic ideas are evaluated and given authorization, where-by some predetermined revenue-sharing agreement is approved and, importantly, is honored by all parties. The program needs to have a positive cash-flow in order to cover its expenses (since no institutional resources are made available), but the unit taking the initiative will be able to rely on and have at its disposal some share of the excess of revenues over expenses.

Assessment

A theme which was addressed throughout the visit was "budget transparency". As this in itself is a vague term, my assessment is that the YSU community feels there is little or no communication about budget resource allocation decisions (or lack thereof), with the secondary concern that how available resources are calculated is not readily consumed by campus financial managers. There also was a perceived concern about "budget flexibility", or, more accurately, the lack thereof. There clearly is strategic thinking going on within the institution about how resources could be realigned, even within a budget unit, but the institutional practice of "line-item budgeting" constrains any local manager's ability to act on such realignment. There needs to be a tempering of expectations that "budget transparency" in and of itself will lead people to perceive that "everybody is being treated fairly."

It was very apparent that there is a widespread desire for some type of exercise examining what current costs are and how they align with revenue streams, as well as an active process to evaluate and make decisions on how available resources should be realigned with activities.

It is also important to realize the constraints under which YSU's budget process have to operate. Although the share of the expense budget that is tied to compensation at YSU does not appear to be out of line with other similar institutions, collective bargaining's influence on the flexibility of strategically re-examining and realigning resources behind compensation have to be recognized.

One aspect of the organizational behavior I tried to observe was whether it mattered who within the organization was making resource allocation decisions, or whether the subtext was simply a desire for more clarity about the resource allocation decisions. There appeared to be a general consensus that the academic division of the institution should have primary responsibility for making budget decisions. It was also put forward that most of the faculty of the institution were unaware of this budget examination process or even of the goals of the strategic initiatives recently developed by the university.

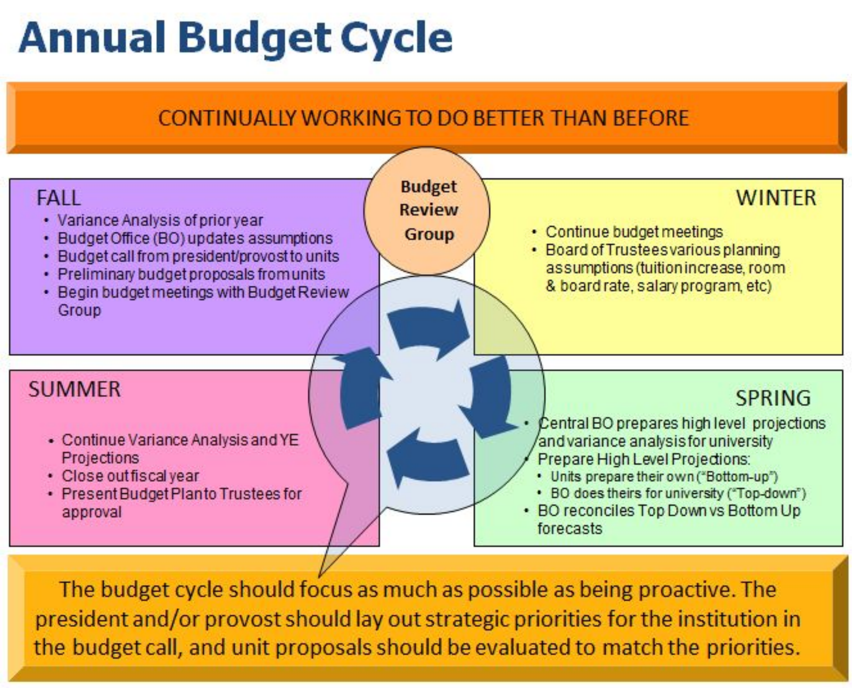
The institution has developed a strategic plan, but there is no perceived linkage between funding decisions and their impacts on achieving the goals of the strategic plan. Any and all resource utilization decisions should tie to one of the four cornerstones of the strategic plan: financial and other accountability and sustainability of the institution; student success; transition to the urban research mission; and regional engagement

Advice

A budget model fundamentally is a resource allocation decision-making process. At the heart of the issue with which YSU is struggling is determining exactly what decision-making process should take the place of that currently in place. The specific "form" that a budget model will take (centralized allocation, formula driven, Responsibility Center Management) will all need a proactive intervention by decision-maker(s). How competing budget priorities are ranked and allocated for, likewise, will require the passing of judgment on by someone or some people. Even if YSU chooses some form of an RCM budget model, decisions will need to be made about how to identify and allocate for "indirect expenses and revenues", how improvements are funded in non-revenue generating budget units, and how resources get realigned towards institutional strategic goals and directions.

The initial undertaking for YSU is to identify exactly what decision-making process, in the form of an individual or a body of individuals, will act on information made available (through a process yet-to-be identified) in order to determine how incoming resources will be directed amongst the varied budget units that make up YSU.

While not a specific recommendation, the following figure demonstrates one example of a dynamic interactive budget cycle:



At the heart of what YSU seems to be struggling with is making difficult decisions about how to reallocate existing resources. Particularly with an environment of shrinking revenue streams, if any changes (increases) in support for certain existing or new initiatives or programs are to be effective, decisions will need to be made as to from where these resources should come. It is always difficult to decide what an institution is no longer going to be in the business of doing.

As this fundamental "trade-off" decision making process will take time to establish, any fundamental "shift" of budget models should be done over a defined yet realistic time period (perhaps five years), rather than completely overhauling the process and implementing fully in one year. That being said, it is vitally important that some immediate change to existing processes is begun, to demonstrate a clear commitment to change by the institution and to begin a cultural change process. This could be the implementation of either an Initiative-based budgeting process or a Project-based budgeting process.

A reengineered budget process needs to:

- Reflect strategic priorities of the institution,
- Reward successful initiatives and risk-taking,
- Demonstrate accountability and linkage between funding and expenses, and
- Instill confidence in the financial management of the institution.

There was, as expressed, by those I met with, a feeling that at least letting units present themselves and bring their cases forward would increase the perceived level of budget transparency and involvement in the decision-making process. I strongly recommend that YSU initiate this part of the budget decision process, even if at first there are no significant additional budget resources to bring to bear to address proposals. Even if none of a unit's proposals were given funding, it would improve morale for unit managers to be able to demonstrate that they went forward with suggestions and tried to make a case for the priorities of the budget unit.

As part of the reengineering process, the institution will need to decide what data it needs to collect, from where, how it should be used in calculations and analysis, and how it should be communicated. This is a process that will need to happen in parallel with other steps in the reengineering process. To what degree resource allocation decisions and determinations will be driven by aligning revenue streams to operational and programmatic costs will unfold as the decision-making process is established and exercised.

The most immediate course of action recommended is four-fold:

(1) **Decision-making:** YSU needs to address head-on an evaluation and initial determination of who is going to take ownership for the resource allocation decisions, if indeed it no longer is going to be the passive process it is now. This determination will need to include:
   a. A decision-making process,
   b. A theory underpinning it (e.g. all budget decisions will be directly identifiable with one or more of the institution's strategic goals, new resources will only be directed towards initiatives or programs that increase the institution's resources),
   c. Data necessary in order to inform the decision-makers, and
   d. Inputs (e.g. budget calls, budget presentations) will be solicited to help inform the decisions.

(2) **Data-gathering:** In order for changes in the way resources are allocated to be effective, YSU will need to embark on a data-gathering initiative, regardless of whatever ultimate "budget model" methodology is used. Information about current budget structures, comparison to actual results, actual spending differences versus budget, any reserve balances, etc.)

(3) **Calculation:** To start, someone will need to develop a "costing-methodology". Whether that is some modification of OMB Circular A-21 methodology, activity-based costing, developing a preliminary set of rules and methods for an RCM matching of direct revenues (and indirect revenues) with direct expenses (as well as indirect expenses), some person or persons should be entrusted with developing calculations to present to the academic and administrative leadership of the institution. Some evaluation of the current "footprint" of funded expense will need to be developed and this evaluation will have to lead to a decision on whether to shift funded expense patterns or not.

(4) Development of an allocation model (or models) to share with the decision-maker or decision-making body:

a. To what level are allocations made and where is accountability to be held?
b. What will be determined formulaically and how?
c. To what degree will there be reservation for discretionary funds, and at what levels? Will there be discretionary funds for administrative initiatives (towards achieving efficiencies, for example) or will there only be funds in the academic division? Will the president and/or provost have discretionary funds for institution-wide or interdisciplinary initiatives?

It is important that there is a clear demonstration to the YSU community that rules are being put in place and are being followed (to demonstrate this as an institutional value). Budget units need to start relying on data, understand how to use it, and decide how much and when to rely on it to drive decisions. YSU should find a way to tie allocation of existing and new resources to established plans, as well as how to measure progress towards and effectiveness in achieving those plans. It was expressed during the visit that faculty currently do not have active involvement in student recruitment, retention efforts, or program development, in part because there is no perceived investment return for their efforts. A visible demonstration on the part of university leadership in rewarding entrepreneurial initiative would go a long way toward gaining the confidence of the faculty.

Conclusion

Youngstown State University is at a crossroads:

1. The institution feels there is a fundamental imbalance in the way budget resources are allocated currently.
2. The institution also has developed a strategic plan through 2020, with institutional initiatives towards which it wishes to direct resources strategically.
3. An initiative has been undertaken to begin a budget process reengineering, trying to address concerns and priorities of members of the university community.
4. The institution operates under heavy constraints of decreasing state appropriations, current decreasing projections of student enrollment,

and a compensation component of its budget which is made more inflexible by the collective bargaining of its faculty.

But I perceive that the institution has a great advantage in its current state: a tremendous desire to change. If YSU can muster the will and organization to address some fundamental issues, such as investing decision-making authority in someone or somebody and figuring out how to go about cutting out certain programs and expenses in order to redirect them to other current and future strategic priorities, then the reengineering process, and whatever subsequent budget model is chosen, should be able to unfold over the next five years.

Respectfully submitted by:

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Director of Budget Management, Stanford University

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Responsibility Center Management: http://www.stcloudstate.edu/adminaffairs/budget/documents/RCM.ppt

The General Budget Model, http://cfo.ufl.edu/present/BOT061209.pdf

Why Not Responsibility Centered Management Budgeting? Principles and Concepts http://cfo.ufl.edu/rcmc/RCMconcepts.pdf
Site with many links, http://www.kent.edu/about/administration/business/rcm/links.cfm

Appendix

I visited YSU on March 19 and 20, 2012. I had an initial meeting with Vice President for Finance and Administration Gene Grilli, Executive Assistant to VP for Finance and Administration Paul Kubolnicky, and Budget Director Neal McNally to gather background information for meetings to be held over the next day and one half. I attended a subsequent meeting with President Cynthia E. Anderson and president's cabinet, followed by a meeting with Provost and Vice President for Academic Affairs Ikram Khawaja and the Dean's council. This was followed by a lunch meeting with Trustee Scott Schulick, along with Gene, Paul, and Neal. The afternoon was spent with the Budget Task Force, followed by a brief meeting with Board Chair Dr. Sudershan K. Garg. The next day began with a meeting with the VP for Finance and Administration direct reports, followed by another meeting with the Budget Task Force.