BALL STATE UNIVERSITY BUDGET REDESIGN INITIATIVE

Campus Open Forum

February 27, 2019

HURON

Draft: For Discussion Purposes Only
Deliberative Document

Discussion Topics

Meeting Agenda

1) Overview budget redesign initiative and key milestones completed

2) Present the project guiding principles

3) Provide background on university budgeting

4) Discuss key components of incentive-based models

5) Outline next steps

Project Goals

BSU hopes to develop a new budget model that will help align its financial resources with the new strategic plan. In doing so, the initiative aims to:

1. Promote student success, stimulate strategic-growth, encourage innovation and entrepreneurship, and support institutional excellence

2. Create a “desired future state” for budget development and management policies, practices, and processes that align with the resulting budget development and governance models

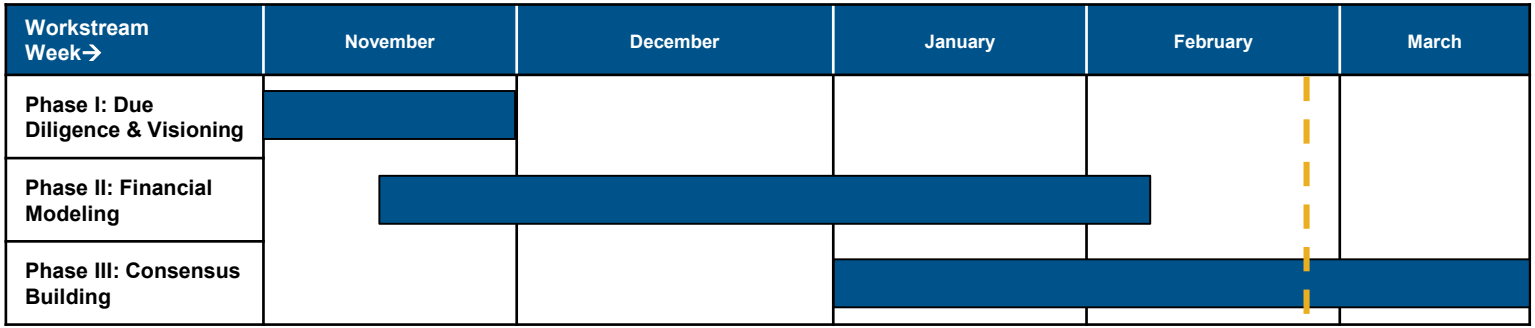
3. Help to allocate funds in a manner that aligns with the University’s core mission and strategic priorities

To support meeting these project goals, Huron was selected as BSU’s budget redesign partner.

Project Timeline (Phases 1 – 3)

Highlights:

- Interviewed 45+ stakeholders as part of our assessment of the current state of budgeting at BSU
- Engaged the Academic Leadership Group (ALG) in November and December to introduce the budget model redesign initiative and collect broad institutional feedback
- Introduced the budget redesign initiative to the Board of Trustees in December
- Developed a “baseline” financial model that depicts direct and allocable revenues and expenses by operating unit
- Presented two working drafts of the new financial model to Academic Deans and their Budget Directors
- Facilitated five meetings with the Steering Committee to establish preliminary model decisions



Steering Committee Membership

The University established a Steering Committee to provide guidance for the initiative, to review project status reports, and to validate the opportunities presented.

- Susana Rivera-Mills, Provost and Executive Vice President, Academic Affairs (Co-Chair)
- Sue Hodges Moore, Chief Strategy Officer, Office of the President (Co-Chair)
- Bernie Hannon, Vice President and Treasurer, Business Affairs
- Bill Jenkins, Chairperson, Department of Theatre and Dance (Dean Designee for CFA)
- David McIntosh, Chairperson, Department of Special Education (Dean Designee for TC)
- Hank Gerhart, Statistical Data and Asset Control Specialist, University Libraries (Staff Council Rep.)
- Jennifer Christman, Lecturer, Criminal Justice and Criminology (Faculty Council Rep.)
- Jim Lowe, Associate Vice President, Facilities Planning and Management (University Council Rep.)
- Kay Bales, Vice President, Enrollment Planning and Management
- Loren Malm, Vice President and Chief Information Officer, Information Technology
- Manoj Athavale, Interim Associate Dean, Miller College of Business (Dean Designee for MCOB)
- Maureen McCarthy, Dean, College of Sciences and Humanities
- Mitch Whaley, Dean, College of Health
- Paaige Turner, Dean, College of Communication, Information, and Media
- Scott Stachler, Interim Associate VP for Budgets, Finance and Assistant Treasurer
- Tarek Mahfouz, Interim Associate Dean, College of Architecture and Planning (Dean Designee for CAP)

Guiding Principles

The Steering Committee developed and confirmed a set of guiding principles to be used to inform decisions surrounding the development of the new budget model.

1	Develop a dynamic budget model that aims to stimulate intentional growth and advance the University's mission and strategic plan
2	Align resources with institutional priorities through broader participation in the budget development process to incentivize instruction, scholarship, and student success for all units
3	Reward performance, creativity, innovation, and collaboration and hold units accountable for resource stewardship to contribute to the University's collective fiscal health
4	Provide a transparent metrics-based approach to resource allocation that also generates discretionary funds to be used for mission critical areas and strategic priorities
5	Use a simple methodology that enhances management decision-making, accountability, and long-range planning
6	Leverage valid, reliable, and verifiable data so that the budget model serves as a strong predictor of positive operating performance

Shifting University Budgeting Focus

In order to optimize the benefits of effective planning and forecasting, universities are transitioning to a more strategic form of budgeting.

Traditional Budgeting

- **Inventory** of anticipated expenditures
- Mechanism to **control** expenditures
- **Independent activity** performed by department managers
- **Backroom operation** performed by accountants
- **Spreadsheet** indicating resource availability
- Performance measures that **reset annually**

Strategic Budgeting

- **Plan** for developing resources
- **Prioritization** of resource allocations for strategic initiatives
- **Explanation** of the internal economy
- Mechanism to create institutional **incentives**
- Tool to empower departments to engage in **entrepreneurial** activities
- **Predictor** of annual financial statements
- Baseline measure of **accountability**

Overview of Budgeting Alternatives

Incremental budgeting is the most common approach to university resource allocation, though an array of alternative and hybrid models exists.

Common Budgeting Models			
Incremental Budgeting	**Formula Funding**	**Performance Funding**	**Incentive-Based Models**
▪ Centrally driven ▪ Current budget acts as "base" ▪ Each year's budget increments (decrements) adjust the base ▪ Focus is typically placed on expenses	▪ Unit-based model focused on providing equitable funding ▪ Unit rates are input-based ▪ Annual fluctuations are driven primarily by the quantity of production and not from changes to rates	▪ Unit-based model focused on rewarding mission delivery ▪ Unit rates are output based ▪ Annual fluctuations are driven primarily by changing production and not from changes to rates	▪ Focus on academic units ▪ Incorporates a devolution of revenue ownership to local units ▪ Allocates costs to revenue generating units ▪ Utilizes a centrally managed "subvention pool" to address strategic priorities

It is very common to find institutions that are utilizing multiple budget models simultaneously, either as hybrid models or models to facilitate various university missions.

Note: Adoption rates from the 2017 Inside Higher Education Survey of College and University Business Officers; Percentages do not add to 100% due to hybrid budgeting models.

Spectrum of Incentivized Models

While incentive-based budgeting is commonly perceived as an entirely decentralized budget model, several incentive-based iterations exist.

Incentive-Based Budget Model Iterations

More centralized ⟵ ⟶ *Less centralized*

Customized Incentive-Based Budgeting	Traditional Incentive-Based Budgeting	Each Tub on its Own Bottom (ETOB)
▪ A higher degree of central control ▪ Local units keep a majority of their revenue but give up more than in the traditional incentive-based budgeting model through a higher subvention "tax" paid ▪ Through increased tax revenue, central administration has greater ability to subsidize colleges, fund strategic initiatives, and support mission-related programs	▪ Some centralized control ▪ Local units keep most of the revenue they generate, but give up some to a central pool through a subvention "tax" paid ▪ Taxes generated can be used by the central administration to subsidize colleges, fund strategic initiatives, and support mission-related programs	▪ Extremely de-centralized model; Academic units essentially operate as their own financial entities ▪ Very little strategic control held by the central administration ▪ No sympathy for market forces - under-performing units must cut costs or generate more revenue to cover any losses incurred ▪ Only three U.S. institutions use this extreme iteration, one of which is shifting away

In order to optimally tailor a budget model for a given institution, it is critical to identify and create an appropriate balance of centralized and decentralized control.

Incentive-Based Budgeting

Incentive-based budgets are generally considered as models that incorporate the elements of revenue devolution, cost allocation, central subvention funding, and localized accountability.

Benefit	Description of Benefits
Devolution of Revenue	• Models devolve ownership of revenues from central administration to centers which generate them • In particular: tuition and fee revenues, direct research revenue, indirect (F&A) research revenues, and endowment and gift revenues • The majority of models also devolve state appropriations based-on agreed upon methodologies
Allocation of Costs	• Optimal decision-making requires that the full costs of activities be understood, not just direct costs, but also those associated with facilities usage and central services provided • Understanding how indirect costs are allocated enables planners to estimate full marginal costs • Each center pays for its total costs with the revenues it owns plus a share of centrally owned revenues
Creation of Subvention and Strategic Funding Pool	• The provision of direct resources for strategic initiatives benefits the whole of the institution • Allocations from central sources to responsibility centers called “subventions” are used to offset mission-critical units with high operating costs. In part, this addresses the economic problem of the commons
Financial Accountability	• In exchange for devolving revenue ownership, the system requires bottom-line responsibility and rewards strong fiscal performance: Centers retain positive operating margins and repay negative ones • Financial accountability is a means, not an end in universities, and annual budget plans must still be reviewed and approved by university leaders

Model's Impact On Decision-Making

Incentive-based models have the potential to materially transform institutions over a 5-10 year period as they change the culture of decision-making.

▪President's Cabinet

▪Remove luxury of "all things to all people" by forcing difficult decisions

▪President, Provost, and VP for Business Affairs

▪Force clarity regarding priorities and strategic initiatives

▪Deans

▪Know the full-cost of activities and prioritize them through cross-subsidies between revenue generating activities and mission-driven activities

▪Administrative Units

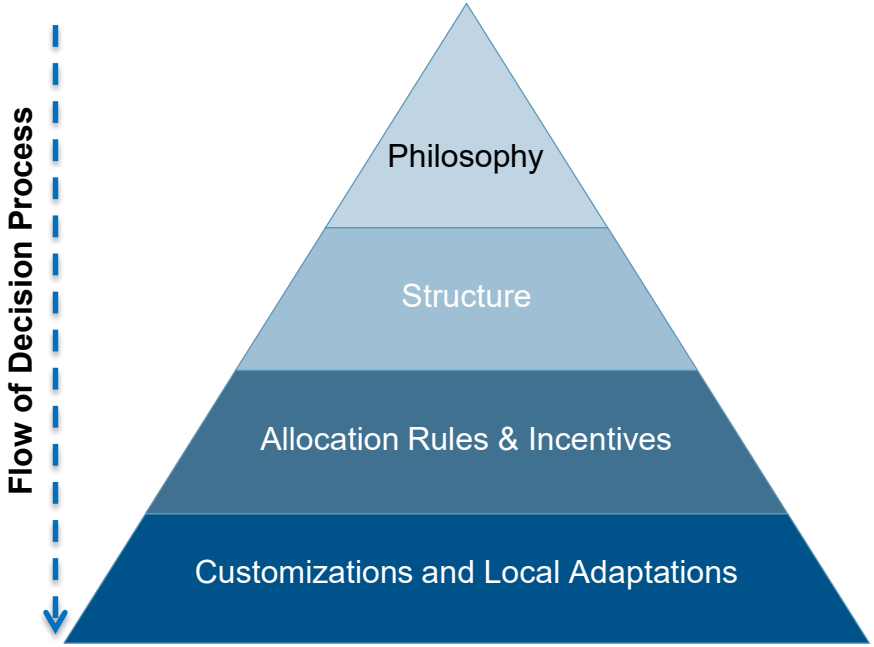
▪ Connect service levels and resource levels

▪Department Chairs and Faculty Members

▪See how activities drive funding for their respective units

Developing the Model

Effective budget redesigns typically require four stages or elements of decisions, with each element requiring increased levels of institutional insights and customizations.



- **Philosophy** – reflects the university's desired financial management model, considering elements such as centralization, authority, accountability, and responsibility
- **Structure** – reflects the elements of the model with respect to scope of funds, categorization of operating units, presentation of data, etc.
- **Rules** – reflects how the model will portray the institution's internal economy and drive behavior
- **Customizations** – reflects model tweaks to address operational realities, institutional culture, and local unit needs

Organization Overview

An incentive-based model classifies organizational units into three categories based on the key attributes described below.

Primary Units

- Ability to influence revenue generation:
  - Price
  - Quantity
- Cover direct costs with generated revenue
- Fully-allocated central (support unit) costs
- Accountable for performance, retaining both surpluses and losses
- Pay participation fee to support subvention

Support Units

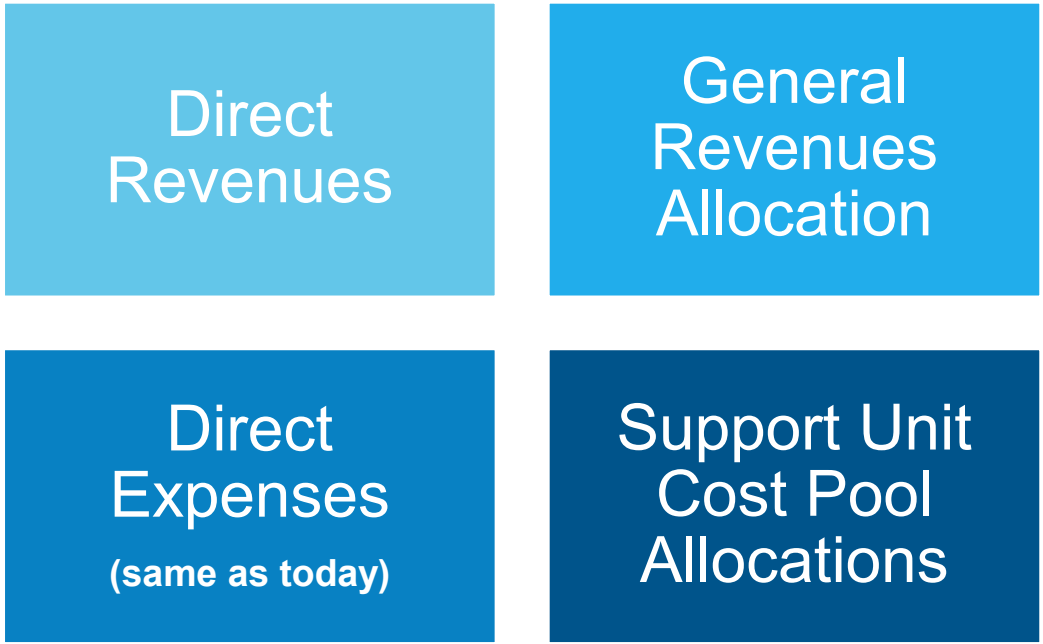
- Limited-to-no ability to influence revenue
- Provide services and/or support to academic, research, and auxiliary units
- No allocation of central costs
- Accountable for optimal service levels
- Encouraged to justify funding levels through benchmarking
- Accountable for fiscal performance

Hybrid Units

- Units that do **not** fall cleanly into one of the other categories; some operations may act like a primary unit while others act like a support unit
- For simplicity and consistency, these are not typically recommended

Revenue and Expense Allocation

In general, incentive-based budget models share four common elements related to the flow of revenues and expenses across the institution.



Direct Revenues vs. General Revenues

Huron worked with the University's budget office to distinguish direct revenues from general revenues, which are typically allocated to primary units based on a defined methodology to promote balanced growth.

Direct Revenues	General Revenues
▪ Revenues that are directly attributable to goods or services provided by a primary unit ▪ Revenue is typically recognized by the primary unit within the University's financial systems	▪ Revenues are received by central administration on behalf of those primary units that generate the revenue ▪ Revenues are pooled together and allocated to primary units based on varying methodologies and selected metrics to promote growth
Examples include: ▪ Direct State Appropriations ▪ Program & Course Fees ▪ Other Student Fees ▪ Grants & Contracts ▪ Indirect Cost Recovery (IDC) Revenue ▪ Gifts ▪ Sales, Services, and Other	Allocable Examples include: ▪ Undergraduate Tuition ▪ Undergrad. Scholarships & Financial Aid (contra-revenue) ▪ Graduate Tuition ▪ Graduate Scholarships & Graduate Aid (contra-revenue) ▪ Online Undergraduate Tuition ▪ Online Graduate Tuition ▪ General State Appropriations

Support Unit Cost Allocations

Huron and the Steering Committee grouped central support units into cost pools and identified initial allocation metrics to allocate each pool's net expenditures to the academic units.

Cost Pool	Initial Allocation Metric
Academic Support	Student Headcount
Administrative Services	Total Direct Expenses
Executive Affairs	Total Direct Expenses
Facilities	Net Assignable Square Ft.
Information Technology	Total Institutional Headcount
Libraries	Student FTE
Research Administration	Grants and Contracts Revenue
Student & Enrollment Services	Student Headcount

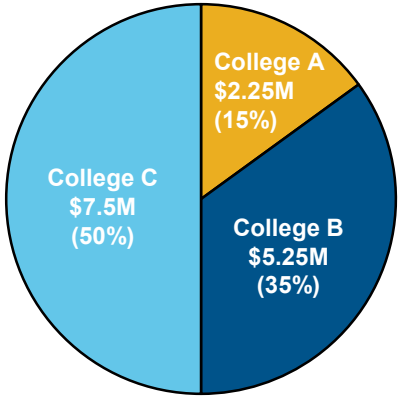
Support Unit Cost Allocation Calculation

Once a support unit cost pool amount is determined, activity-level metrics are used to allocate proportional expenses to Colleges. Below is an illustrative example for an IT cost pool using "Institutional Headcount" as the activity-level metric.

Illustrative IT Cost Pool Net Expenditures	
IT Cost Pool Net Expenditures	$15M

Illustrative Institutional Headcount Metric		
College	Headcount (HC)	HC %
College A	300	15%
College B	700	35%
College C	1,000	50%
College Total	**2,000**	**100%**

Illustrative IT Cost Pool Allocation



- In this particular example, the IT cost pool would allocate $7.5K per institutional headcount
- In future years, this amount will vary depending on the approved budget of the IT cost pool

The activity-level metrics are used to allocate the net expenditures of each cost pool. Additionally, fluctuations in the activity-level metrics do not lead to corresponding fluctuations in the size of the cost pools.

Central Funding Mechanism

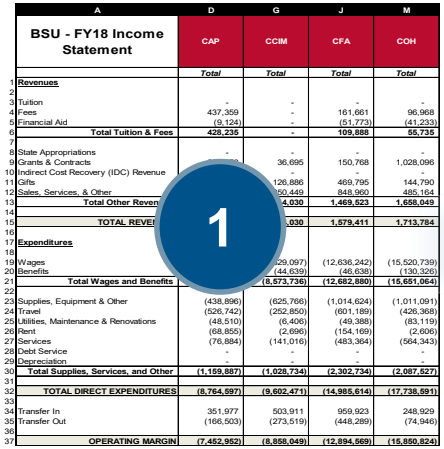
One of the most critical elements of an incentive-based budget model is the creation of a pool of resources to address unit-level subsidies, university priorities, revenue growth strategies, and other strategic initiatives.

Central Funding Mechanism Overview	
Rationale	▪ The sum of the parts is not optimal for the whole therefore the university needs the ability and flexibility to act as one entity with respect to key initiatives
Funding Source	▪ Central funds are centrally retained and/or generated revenues purposed for mission and strategic investment
Fund Principles	▪ The Strategic Initiative Pool can be a useful **management tool to help fund long-term initiatives** by advancing capital, provide critical subsidies to kick-start initiatives ▪ Funding size should **enable leadership to "steer,"** which will ultimately benefit the university mission as a whole ▪ Funds provided to any unit should **never be viewed as an annual entitlement** only as a way to kick-start initiatives ▪ The model uses a participation fee to generate the central fund, applying a participation rate to selected revenues. Having a **diverse revenue portfolio rather than a single source allows for stability** ▪ Participation fees **need to ensure "neutral starting points" at implementation**; thus the rate needs to be high enough to ensure surpluses are available to fill all Revenue Unit deficits

Model Development

Huron is currently gathering feedback from Deans and their Budget Directors on the allocation methodologies and incentives embedded within the "baseline" model to develop a "customized" model that works for BSU.

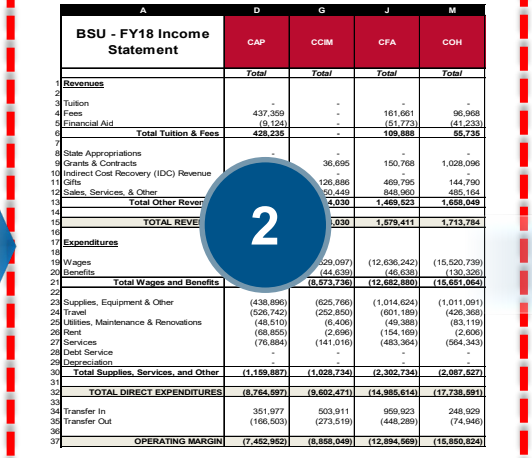
Actuals Model



BSU - FY18 Income Statement	CAP	CCIM	CFA	COH
	Total	Total	Total	Total
Revenues				
Tuition	-	-	-	-
Fees	437,359	-	161,661	96,968
Financial Aid	(9,124)	-	(51,773)	(41,233)
Total Tuition & Fees	**428,235**	**-**	**109,888**	**55,735**
State Appropriations	-	-	-	-
Grants & Contracts		36,695	150,768	1,028,096
Indirect Cost Recovery (IDC) Revenue		-	-	-
Gifts		126,886	469,795	144,790
Sales, Services, & Other		50,449	848,960	485,164
Total Other Reven		**4,030**	**1,469,523**	**1,658,049**
TOTAL REVE		**,030**	**1,579,411**	**1,713,784**
Expenditures				
Wages		29,097)	(12,636,242)	(15,520,739)
Benefits		(44,639)	(46,638)	(130,326)
Total Wages and Benefits		**(8,673,736)**	**(12,682,880)**	**(15,651,064)**
Supplies, Equipment & Other	(438,896)	(625,766)	(1,014,624)	(1,011,091)
Travel	(526,742)	(252,850)	(601,189)	(426,368)
Utilities, Maintenance & Renovations	(48,510)	(6,406)	(49,388)	(83,119)
Rent	(68,855)	(2,696)	(154,169)	(2,606)
Services	(76,884)	(141,016)	(483,364)	(564,343)
Debt Service	-	-	-	-
Depreciation	-	-	-	-
Total Supplies, Services, and Other	**(1,159,887)**	**(1,028,734)**	**(2,302,734)**	**(2,087,527)**
TOTAL DIRECT EXPENDITURES	**(8,764,597)**	**(9,602,471)**	**(14,985,614)**	**(17,738,591)**
Transfer In	351,977	503,911	959,923	248,929
Transfer Out	(166,503)	(273,519)	(448,289)	(74,946)
OPERATING MARGIN	**(7,452,952)**	**(8,858,049)**	**(12,894,569)**	**(15,850,824)**

- No use of allocation rules
- Reflects general ledger activity
- Reorg of transactions to align with unit and account definition

Baseline Model



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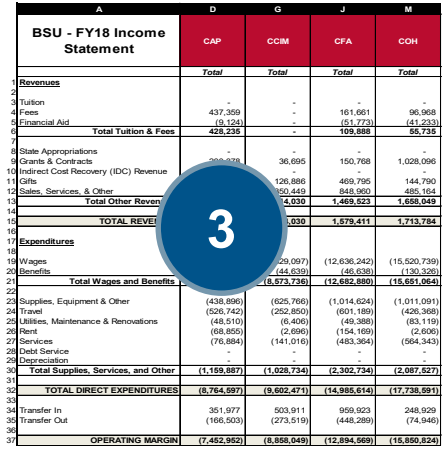
- All data-driven allocation rules
- Reflects internal economy
- Baseline for sensitivity analysis

Customized Model



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- Highly customized incentives to drive mission-critical needs
- Features strategic investment pool for University priorities

Moving Forward

1. Continue discussing key decisions for the model with the Steering Committee

2. Facilitate meetings with academic unit department chairs to share working model methodology (March 11 - 14)

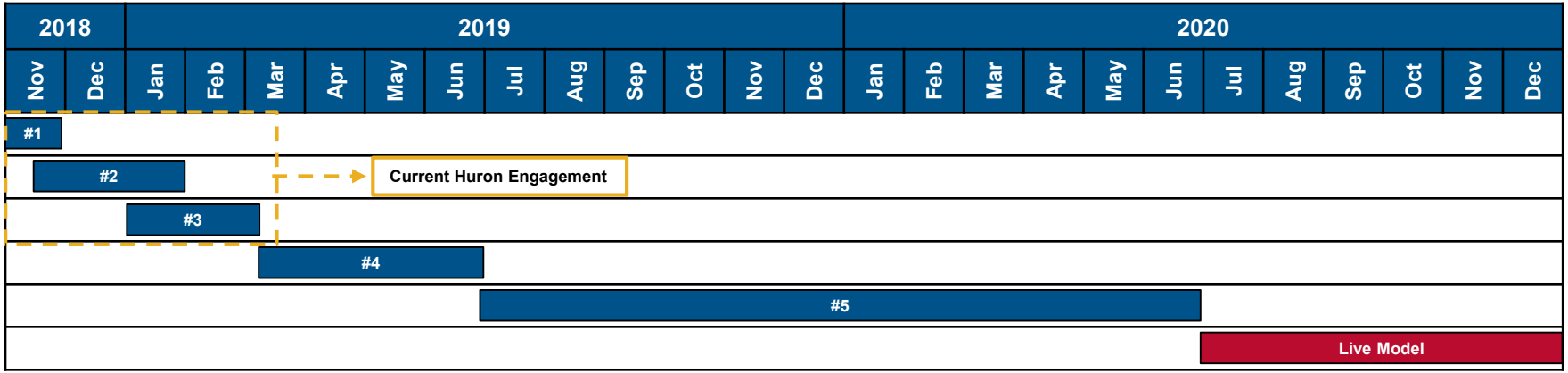
3. Incorporate feedback from Deans and Budget Directors on the “baseline” model to develop a “customized” model for BSU

4. Conduct a retreat with the Steering Committee and Academic Deans to develop an agreed-upon model for use in a parallel process (March 19)

5. Consider infrastructure, policies, and reporting capabilities that are needed to successfully implement a new budget model

Overall Implementation Timeline

The timeline below outlines an 18-24-month transition period for BSU to implement a new budget model. Huron is currently engaged to assist with the first three phases of this process.



Phase	Overview
1. Due Diligence and Visioning	Develop a clear understanding and vision through an assessment of current resource allocation practices
2. Financial Modeling	Build-out a “pro-forma” model to provide a platform for testing different model alternatives
3. Consensus Building	Address change management through methodical, data-driven stakeholder engagement
4. Infrastructure Development	Develop supporting tools, processes, and governance to carry out budget development
5. Parallel Year	Test a new model to understand outcomes if the new model were implemented

QUESTIONS?

Submit your questions and comments to newbudget@bsu.edu