

## MEMORANDUM

**TO:** Joint Strategic Planning Committee  
President Robert L. Carothers, Chair

**FROM (by Alpha):**

Linda Barrett, Director  
Mark Higgins, Dean  
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**DATE:** April 1, 2008

**SUBJECT:** Performance Based Budgeting and Planning

Per your request, the Performance Based Budgeting and Planning Subcommittee has explored the current literature on innovative university budget models, and reports from state universities that have recently changed their budget model/ process and their relationship to university strategic planning. It is clear from our review and analysis that the integration of strategic planning and budget processes with academic program evaluation/ measures and student learning assessment is critical to the quality and success of an institution.

An effective budgeting system should be based on a focused strategic plan. Strategic planning will assist in defining the mission, goals, values, and priorities of the institution and will create a dynamic framework for the future of the university. Below we provide recommendations in four integrated areas. These include: 1) strategic planning: foundations and guidelines; 2) performance metrics; 3) decision making & budget procedures; and 4) a budget model. Although these recommendation focus on academic affairs they are applicable to all divisions within the university.

### **Strategic Academic Planning: Foundations and Guidelines**

*The strategic plan should lead the overall process and serve as the foundation for the philosophical and academic concepts that guide the process for budget planning and resource allocation for every department/unit, college or division. The table below lists our recommended changes in the University strategic planning process. Details and guidelines will need to be developed as the change to a strategically focused budgeting process progresses.*

- ❖ The President, Provost and Vice Presidents with advice from the Joint Strategic Planning Committee, colleges, departments, faculty, students and staff will develop a University strategic plan. The academic strategic plan will provide the central focus for the University strategic plan, and will consider learning and research innovations, core competencies, opportunities and challenges. The JSPC also should consider forming an advisory group with internal and external expertise and three-year staggered terms that will provide information on new developments, metrics and trends in strategic planning.
- ❖ This strategic plan will be reviewed on an annual basis. Planning assumptions and guidelines will be identified and the plan will flow from the University's mission, vision and shared values.
- ❖ The Provost working with the colleges and units will develop an academic strategic plan and review it each year.
- ❖ Each academic department will develop a strategic plan that needs to be consistent with the university mission and strategic plan for that college and the division of Academic Affairs. The department plans will be reviewed annually. The review will evaluate performance and changes in capabilities, opportunities and challenges. The Department will make any changes in the strategic plan that will help achieve the university's strategic objectives.
- ❖ Revised department strategic plans will include a narrative that explains the reasoning behind any revisions and changes in prioritization. They should be submitted to the Dean for review. The Dean will meet with the Chairs and give his/her approval or return the plan to the department.
- ❖ Once revised, the Dean will work with Provost and Vice President for Academic Affairs to achieve final approval. If changes are made at the Dean or Provost level, then these will be communicated with the Department before the plans are finalized.
- ❖ Transparency is of prime importance.
- ❖ The strategic plans for the non-academic units of the institution will be closely aligned with and in support of the academic mission.

### ***Performance Metrics***

*The development of a set of performance metrics is an essential part of the strategic planning and budget processes. These measures should be designed to assess the progress being made toward achieving strategic objectives. These should include both qualitative and quantitative performance measures. Our recommendations follow:*

- ❖ Performance metrics used in strategic planning, decision-making, and budgeting will be developed based on strategic priorities at the department/unit, college, division and university levels.
- ❖ Performance measures include both unique and common measures.
- ❖ Common performance measures are those that are used across academic units to evaluate performance on broad university strategic initiatives. Examples of common performance metrics include: credit hours per faculty member, net revenue per department, teaching and scholarly reputation (e.g. national awards), grant dollars per faculty member etc. They will be developed to measure progress on the department, college, division and university strategic priorities.
- ❖ Unique performance measures are specifically related to a department or college's strategic initiatives. The measures should be tied to specific initiatives in the strategic plan. For example, if a department's strategy calls for more grant funding, then they will need measures to assess the success of their efforts. These could include proposals submitted, proposals awarded, success in developing relationships at specific granting agencies, etc.
- ❖ Unique performance metrics also will be developed for interdisciplinary and partnership programs to encourage collaboration.
- ❖ Performance metrics should be designed and evaluated with respect to intended and unintended consequences.

## **Decision-Making/Budget Procedures**

*Planning meetings and program and performance reviews among faculty and chairs, Deans, Council of Deans, JSPC, Provost and President are central components of successful budget and planning processes. We make the following suggestions:*

### **Future Budget Requests (two and three years out)**

- ❖ Deans will meet annually with chairs to review strategic objectives, initiatives and performance metrics.
- ❖ The Deans should have a three-year budget plan that becomes the foundation for the budget request. This three-year budget plan must align with the Budget and Financial Planning cycles and the college's academic strategic plan.
- ❖ Deans submit requests for new resources and initiatives as well as areas from which resources can be redeployed (reduced) to the Provost . Requests for new resources/lines should be based on a well-documented investment analysis and clear relevance to University and division priorities. That is, departments/colleges must explain what the new resources/lines will add to the department, college, divisions and university, and show how past performance or anticipated opportunities merit the investment. The link between the request for new resources and the strategic plan needs to be explained. The source of funding for the new resources must also be described. For example, financial resources for specific initiatives may be tied either to anticipated tuition resources or anticipated external funding dollars when the anticipated impacts across the university's strategic plan and mission warrant such an investment.
- ❖ The President and Provost make a final determination of where they will make projected strategic investments and where they will reduce expenditures.
- ❖ After the President in consultation with Budget and Financial Planning has reviewed the total university budget and any available state guidelines, the revised budgets requests are approved by the President/Provost.
- ❖ The approved Academic Affairs budget request will be submitted to Budget and Financial Planning in a timely fashion.
- ❖ Various events can require changes in the approved academic affairs budget. Notification of the financial impact of these changes will be made to the Provost and the Council of Deans.

### **Budget Allocation (next fiscal year budget)**

- ❖ The Departments' should review their existing second year budget (of the three year plan) with their Dean for revisions due to unanticipated circumstances. The rationale for all changes should be documented relative to university mission, department and college strategic plans. This process includes approval of hiring plans specified in the revised two-year-out budget, which has become next-year's budget.

- ❖ Provost meets with the dean to determine and approves final budget, including final faculty hires, for the subsequent year.

### **Mid-Year Budget Review (current fiscal year budget)**

- ❖ Provost meets with Deans and Council of Deans in December to discuss any mid-year budget adjustments. Rationale for revisions will be documented for the university community.

## **Budget Model**

*A dynamic budget model assists in reinforcing the priorities and decisions summarized in the strategic plan. Transitioning from a modified incremental budget model to a activity/responsibility/ performance based model (see brief summary of budget models in Appendices A and B) will require a minimum of one year to implement and is beyond the scope of this committee. We make the following recommendations:*

- ❖ Senior leadership must provide strong support for development of a new budget model.
- ❖ The JSPC should appoint a new budget model implementation committee by May 2nd. The members should consist of at least 50% of the current subcommittee, who through this process have developed expertise in planning and budget models, along with representatives of faculty and staff from the remaining colleges and various administrative units. It is critical that the JSPC review Appendix B (see Iowa State) in determining the membership of the new budget model committee.
- ❖ The budget model will be constructed and developed consistent with the strategic plan.
- ❖ The University will create a budget model that incorporates the strengths of responsibility, activity and performance based budget models (see Appendices A and B) and that can be adapted to the unique strategic plans and financial circumstances at the University.
- ❖ The model will allow unit managers develop their own strategies to best capitalize on their core competencies and the opportunities available to them. The design of the budget model should consider, but not be limited to, contribution margin, value creation, and positive externalities of the unit.
- ❖ Resource allocation will be related to activities and performance, opportunities and challenges.
- ❖ The budget model should be designed to create positive incentives and mitigate negative incentives for long-term improvements relative to the performance measures that will be developed.

- ❖ Representatives from the university, including members of the next budgeting committee (faculty and staff who are less familiar with these processes), should attend the NACUBO workshop on Integrated Planning and Budgeting, May 18-20, at the Hyatt Harborside, Boston. These people should then prepare a briefing to entire budget-model committee.
- ❖ The committee should visit the websites listed in Appendix B to review other university budget models. It will be worthwhile to contact members of the Iowa State University budget committee to learn more about their experiences with development, implementation, and use of their budget model. The budget model committee should search for other schools not listed in Appendix B to examine their best practices.

## Conclusion

The integration of strategic planning and budgeting requires a coordinated effort and participation by all major constituencies of the university. We have identified some of the key actions and roles that the President, Provost, Vice Presidents, Deans, faculty and chairs would have in this planning framework. In addition, an effective organizational architecture requires a balance between the assignment of decisions, performance measurement, accountability and an incentive system.

In this document, we have proposed the following central recommendations. Senior leadership must provide strong support for integration of the strategic planning process with a new budget model. A new budget model implementation committee should be appointed by May 2<sup>nd</sup>. This committee shall create a budget model that incorporates the strengths of responsibility, activity and performance based budget models, and that can be adapted to the unique strategic plans and financial circumstances at the University. An advisory group with internal and external expertise and staggered three-year terms should be formed and will provide information on new developments, metrics and trends in strategic planning. Lastly, we continue to develop a tentative template for deadlines that will serve to integrate planning with the current budget cycles and that can evolve as we work on these processes.

If you require any further information, we would be glad to meet with you to provide more detailed information.

## **Appendix A**

### **Types of Budget Models**

This appendix provides a brief description of various budget models mostly excerpted from “Follow the Money: The Changing World of Budgeting in Higher Education,” in *Higher Education: Handbook of Theory and Research Volume XIX*, edited by John C. Smart, University of Memphis.

#### *TRADITIONAL MODELS*

##### *Incremental Budgeting*

Incremental budgeting is the oldest and most common approach used in higher education. It uses the same budget from one year to the next, allowing only minor changes in revenue levels and resource distribution. These increases or decreases in budget are represented by a percentage or a dollar amount. This approach is simpler, easier to understand and apply, and more flexible than other approaches. Some weaknesses are that it is based more on inputs than on outputs or outcomes, and is slow to adapt to changing conditions.

##### *Formula Budgeting*

Formula budgeting is a procedure for estimating future budgetary requirements by using relationships between program demands and costs. It is a method that calculates the amount of funding a program requires by applying selected measures of unit costs to selected output measure. Primarily, it has been used at the state level as a method for public institutions to prepare their appropriation requests. Some strengths are that it provides an equitable distribution of funds among institutions, and budget requests are more uniform and easier to prepare, making it easier for institutions to communicate with state legislatures. The weaknesses with formula budgeting are that formulas are typically enrollment-driven, which may cause problems when enrollment drops, formulas do not deal with issues of quality very well, and new programs and other innovations are discouraged because the formulas are based on historical relationships.

##### *Program Budgeting*

Program budgeting was one of the first attempts to develop a more output-oriented approach to budgeting. It has been defined as a method in which budgets are created for specific programs or activities, rather than departments, and each program’s budget is apportioned among the several departments that contribute to the program’s activities.

##### *Zero-Base Budgeting*

Whereas incremental budgeting assumes that this year’s budget provides the base from which next year’s budget is developed, zero-base budgeting assumes there is no prior year base. Therefore, each activity and program must be re-justified each year. This process produces decision packages for each activity, which contain a description, performance measures, costs, and benefits. Some strong points of this method are that it focuses on

outcomes and results and the preparation of decision packages provides an excellent understanding of units, programs, and activities. The weaknesses of this method are that the preparation of these decision packages for every activity is highly time consuming and generates a great deal of paperwork, and that it assumes that no budget history runs counter to continuing commitments, such as faculty tenure, which is a characterization of higher education.

## RECENT DEVELOPMENTS

### *Performance Budgeting*

This is an approach States use to allocate budgets to state universities. In performance budgeting funds are allocated to public campuses based on selected measures of performance. If a state school achieves a certain performance level it is allocated designated amount. Very few states use this approach and in states where it has been experimented with such as South Carolina it is used to allocate a very small amount of the total higher education budget. The key question is can components of this budget system be incorporated into a university budget?

### *Responsibility Center Budgeting*

Responsibility Center Budgeting is similar to Performance Budgeting except it is used for budgeting at the institutional level rather than state. The basic idea is that all costs and income generated by each college, faculty, or department are attributed to that unit, appear in its budget, and are under its control. Incentives are created and barriers removed to allow each academic unit to increase income and reduce costs according to its own academic plans and priorities. All cost of administrative and service units are allocated to academic units. Restrictions on line-by-line budgets are relaxed or eliminated. There are advantages and disadvantages. The major strength is that it provides incentives for entrepreneurship and rewards performance. It highlights areas that are not earning enough revenues to cover their costs. The weaknesses are that it is often short-term oriented and requires significant information technology resources. It is safe to say that each institution that has adopted RCB has modified it to reflect its own instructional character. Appendix B has illustration of RCB models at a number of universities.

### *Activity Based Budgeting*

With an Activity Based Budgeting model various activities are identified. They can be instructional activities, research activities, service activities, and support activities. It is very similar to program budgeting where the program is the activity. The costs and outputs of the activities are budgeted and activity rates computed. These rates can be compared to the rates at benchmark institutions. The emphasis is on reducing the cost per unit of output while meeting a set level of quality. For example, the cost per credit of nursing instruction could be budgeted and compared to other benchmark programs. If there is a gap, then the unit would work to reduce that cost and their budget would be adjusted accordingly. This method works best when used as part of a formal quality management program.

## Appendix B

### Responsibility Center Budgeting Examples from State University Web Sites

The web pages below have relevant information from a sample of State Universities that employ responsibility/performance based budgeting.

1. Indiana University was one of the first State Universities to find a need to change their budget system to better align planning and budgeting and actually implement a responsibility center based budget system. That was almost 20 years ago. The web page below describes their pioneering work and is a good case to begin with.

<http://www.indiana.edu/~obap/report17.pdf>

2. This committee looked closely at the Iowa State model. This could well be a very good model to use as a starting point for a URI model. The web site has a wealth of information about their experience.

<http://www.public.iastate.edu/~budgetmodel/RMM/0107rpt.shtml>

3. The committee also looked at the University of Michigan budget model. Michigan was another early adopter and innovator in responsibility center budgeting. The web page below describes their budget model. They label their model an activity based model and the Michigan model, however it is very similar to the responsibility center models described in the pages above.

[http://www.provost.umich.edu/budgeting/ub\\_model.html](http://www.provost.umich.edu/budgeting/ub_model.html)

4. This document gives a clear and concise description of the Ohio State budget model and how over the past 4 years they've coordinated planning and budgeting using the model.

<http://oaa.osu.edu/documents/Budgetprinciples2003-2008.pdf>

5. UNH has been using a responsibility budget model for the past 7 years. They did a comprehensive 5 year review that is worthwhile reading. The conditions UNH faced when they implemented the model were similar to those we faced then and now. We can speed up the learning curve if we use the experience of others.

<http://www.unh.edu/rcm/steeringreport.htm>

6. Even small universities like Montana State have instituted strong linkages between budgeting and strategic planning. This web page gives a good example of a planning and budgeting timetable of activities and participants. It is also a very good example of bottoms up budgeting

<http://www.montana.edu/upba/pdf/budgetprocess05.pdf>