



# BUDGET REDESIGN INITIATIVE

Academic Leadership Retreat  
August 27, 2019



*Draft: For Discussion Purposes Only*

# Discussion Topics

Huron is pleased to partner with UTK on this important budget redesign initiative and proposes the following goals for today's conversation:

## Meeting Agenda

1. Provide project overview and timeline
2. Present background on University budgeting
3. Outline next steps

# Steering Committee Membership

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

Steering Committee Membership	
<b>David Manderscheid, Provost &amp; Sr. Vice Chancellor (Co-Chair)</b>	<b>Chris Cimino, Sr. Vice Chancellor, Finance &amp; Administration (Co-Chair)</b>
Phillip Daves, Associate Professor, Haslam College of Business	Kim McCulloch, Associate Vice Chancellor, Finance & Administration
Gary Gray, Assistant Provost, Finance & Administration	Lindsay Melton, Asst. Dean, Finance, College of Nursing
RJ Hinde, Vice Provost for Academic Affairs	James Price, Executive Director, Budget & Finance
Terri Lee, Dean, College of Arts & Sciences	Ann Robinson-Craig, Budget Director, College of Arts & Sciences
Steve Mangum, Dean, Haslam College of Business	Keith Thomas, Director, Budget & Finance
David Matthews, Associate Dean & Professor, Interior Design	Dixie Thompson, Vice Provost & Dean, Graduate School
Ami McBride, Budget Director, The College of Engineering	Hongwei Xin, Dean, AgResearch
<i>Working Group Membership: Kim McCulloch, James Price, Keith Thomas and Gary Gray</i>	

**The Steering Committee will be supported by members of Huron<sup>1</sup> who will assist in assessing the current state of budgeting, developing a financial model, and engaging with campus stakeholders.**

# PROJECT OVERVIEW

# Understanding of Your Needs

**Huron understands that UTK hopes to develop a new budget model that will help align its financial resources with the strategic priorities.**

**As UTK proceeds with its budget model redesign initiative, the University is seeking:**

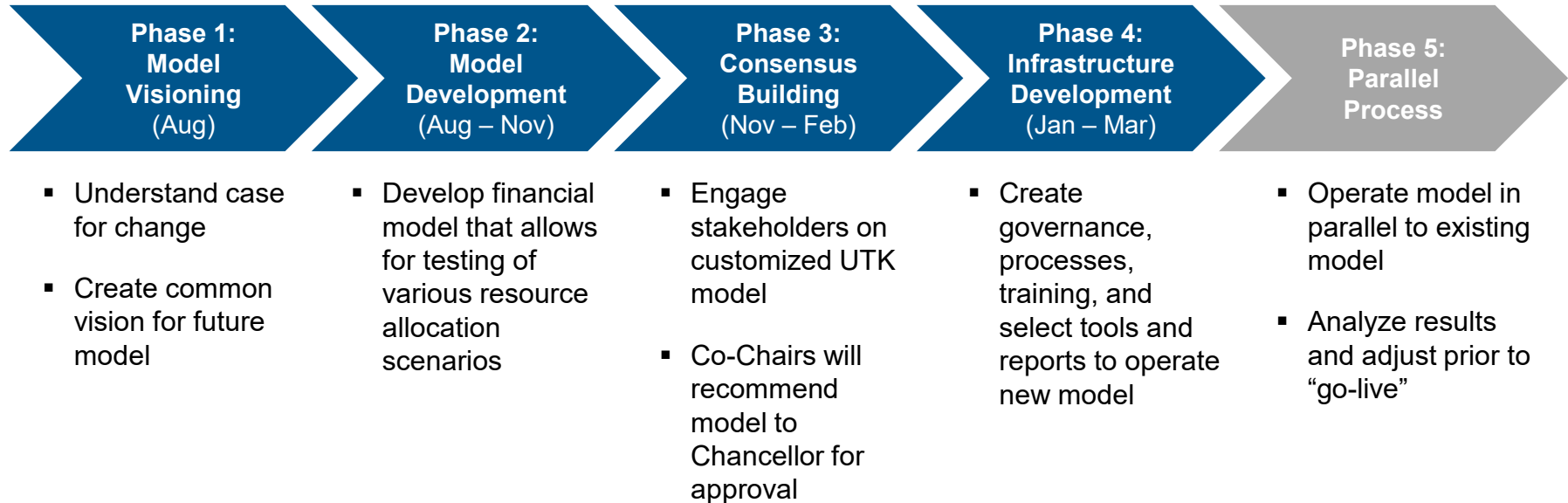
- To develop a budget model that promotes more effective use of resources and allocates funds in a manner that aligns with the University's core mission and strategic priorities
- To promote student success, stimulate strategic-growth, encourage innovation and entrepreneurship, and support institutional excellence
- Effective incentives for both academic leaders and campus administrators
- Increased transparency and greater correlation between decision making responsibility and the investment of financial resources

**Huron understands that UTK has engaged with a consulting partner to:**

- Develop a clear understanding of the institution's model redesign goals
- Build out a pro forma budget model according to the redesigned parameters desired by the University
- Facilitate communication, constituency engagement and stakeholder education surrounding the new model and its relevant process, policy, and operational implications

# Project Plan Overview

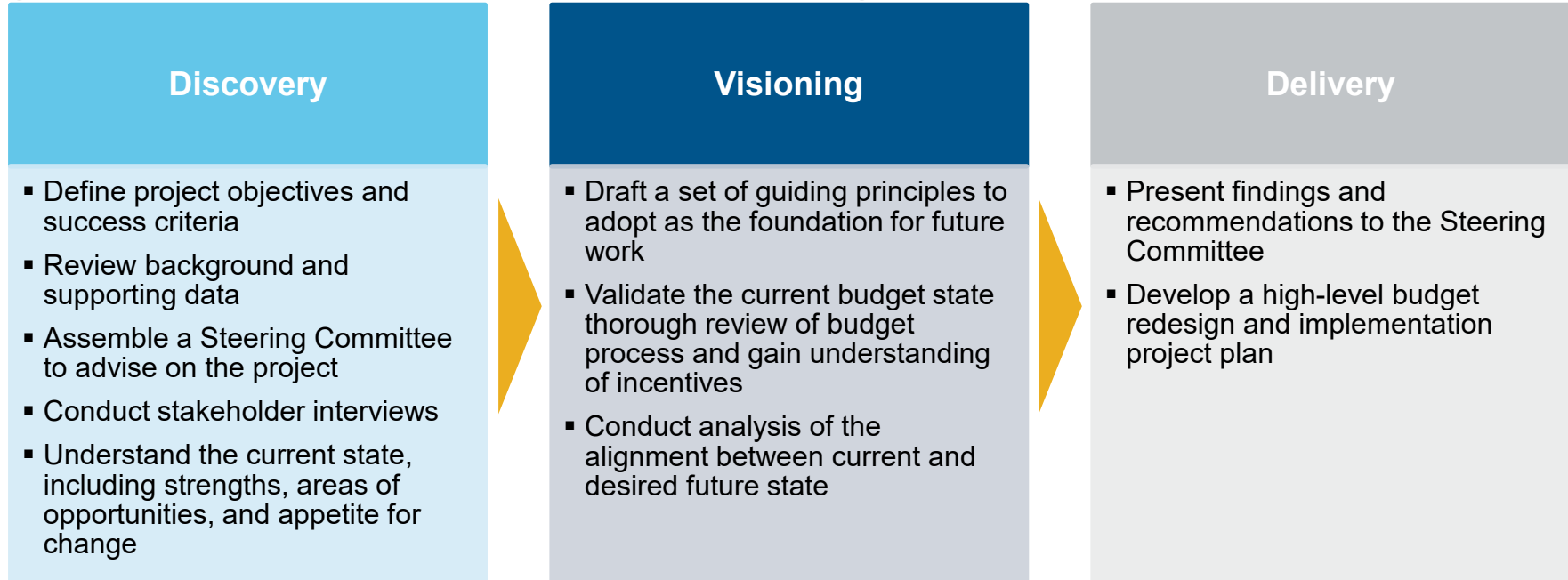
Huron conducts budget redesign efforts using a multi- phase approach that covers model design, testing, and implementation.



# Building a Case for Change

## Phase 1: Project Initiation and Visioning (2 weeks)

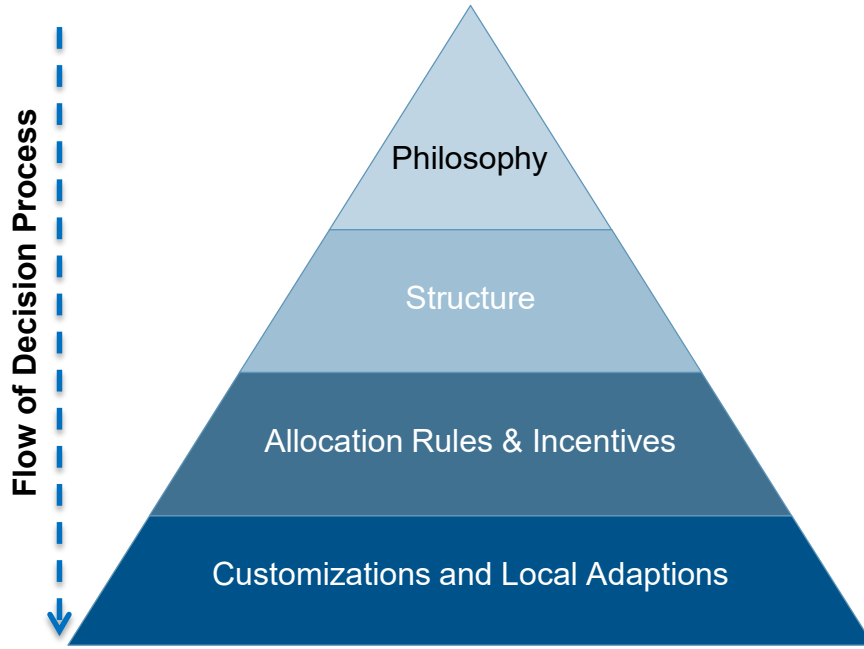
The objective of this phase is to develop an understanding of the current state and redesign goals in order to better facilitate the financial modeling discussions that will be part of Phase 2.



# Developing the Model

## Phase 2: Financial Modeling (10-12 weeks)

During this phase, Huron will take an iterative approach to develop a pro forma budget model using actuals financial data from UTK's most recent fiscal year (FY2019).



- **Philosophy** – reflects the university's desired financial management model, considering elements such as centralization, authority, accountability, and responsibility (*today's discussion*)
- **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



# Engaging University Stakeholders

## Phase 3: Consensus Building (8-10 weeks)

Huron will meet with a multitude of stakeholders across the campus community to generate support for a new agreed upon budget model.



# Supporting the Budget Infrastructure

## Phase 4: Infrastructure Development (10 weeks)

Support redesign of budget processes and support elements that facilitate annual budget development.

### Stakeholder Training

Identify opportunities to conduct stakeholder training related to the new model

### Process and Timeline

Support the development of a revised budget development process that incorporates new activities and timeline constraints

### Unit Reports and Templates

Work with budget managers and budget process facilitators to develop custom report templates and scenario planning models

### Governance

Support the development of a governance plan that defines roles and responsibilities of stakeholders in the new budget process



# BUDGETING OVERVIEW

# 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

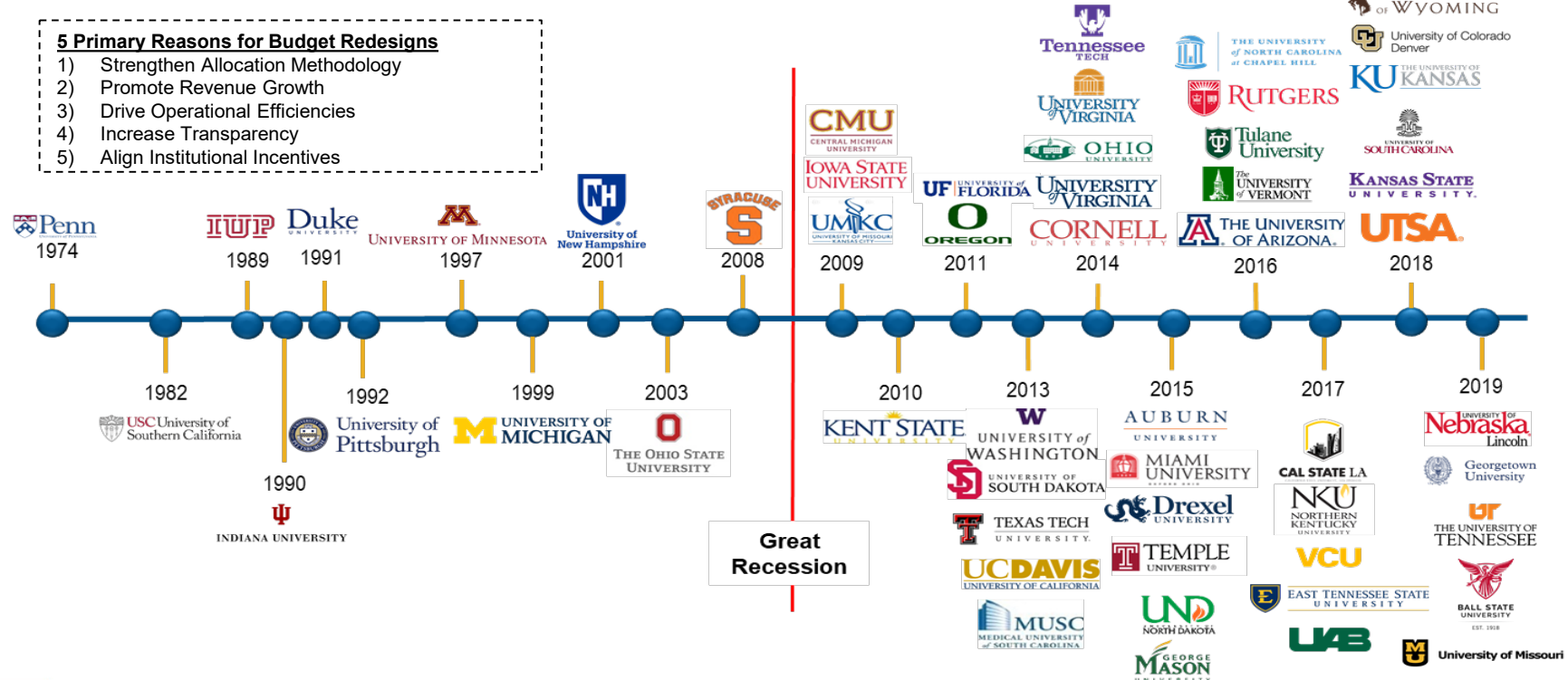
- **Plan** for developing resources
- **Prioritization** of resource allocations for strategic initiatives
- **Explanation** of the internal economy
- Mechanism to create institutional **incentives**
- Tool to empower departments to engage in **entrepreneurial** activities
- **Predictor** of annual financial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

# Recent Budget Model Redesigns

Since the Great Recession, and with the continued strain on revenue sources, universities are undertaking comprehensive budget redesign initiatives with increasing frequency.

## 5 Primary Reasons for Budget Redesigns

- 1) Strengthen Allocation Methodology
- 2) Promote Revenue Growth
- 3) Drive Operational Efficiencies
- 4) Increase Transparency
- 5) Align Institutional Incentives



Note: This illustration depicts institutions who have undertaken a budget model redesign and does not reflect Huron-only budget redesign clients.

# 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			
<b>Incremental Budgeting</b> <ul style="list-style-type: none"> <li>Centrally driven</li> <li>Current budget acts as “base”</li> <li>Each year’s budget increments (decrements) adjust the base</li> <li>Focus is typically placed on expenses</li> <li>Common modifications:               <ul style="list-style-type: none"> <li>Revenue incentives may be incorporated for the allocation of resources above-and-beyond the base</li> </ul> </li> </ul>	<b>Formula Funding</b> <ul style="list-style-type: none"> <li>Unit-based model focused on providing equitable funding</li> <li>Unit rates are input-based and commonly agreed upon</li> <li>Annual fluctuations driven primarily by the quantity of production and not from changes to rates</li> <li>Common modifications include weighting schemes to control for local cost structures</li> </ul>	<b>Performance Funding</b> <ul style="list-style-type: none"> <li>Unit-based model focused on rewarding mission delivery</li> <li>Unit rates are output based and commonly agreed upon</li> <li>Annual fluctuations are driven primarily by changing production and not from changes to rates</li> <li>Common modifications:               <ul style="list-style-type: none"> <li>Weighting schemes to control for local unit mission</li> </ul> </li> </ul>	<b>Incentive-Based Models</b> <ul style="list-style-type: none"> <li>Focus on academic units</li> <li>Incorporates a devolution of revenue ownership to local units and allocates costs to revenue generating units</li> <li>Utilizes a centrally managed “subvention pool” to address strategic priorities</li> <li>Common modifications:               <ul style="list-style-type: none"> <li>Revenue allocation rules, number of cost pools and participation fee (tax rate)</li> </ul> </li> </ul>
<b>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.</b>			

# 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)
<ul style="list-style-type: none"> <li>A higher degree of central leadership control over resources</li> <li>Local units keep most of their revenue but give up more than in the traditional incentive-based budgeting model through a higher subvention “rate” paid</li> <li>Through increased subvention revenue, central administration has greater ability to subsidize colleges, fund strategic initiatives, and support mission-related programs</li> <li>This iteration has been the most commonly implemented since 2005</li> </ul>	<ul style="list-style-type: none"> <li>Some central leadership control over resources</li> <li>Local units keep majority of the revenue they generate, but give up some to a central pool through a subvention “rate” paid</li> <li>Rates generated can be used by the central administration to subsidize colleges, fund strategic initiatives, and support mission-related programs</li> <li>These models were most frequently implemented from 1990 to 2004</li> </ul>	<ul style="list-style-type: none"> <li>Extremely de-centralized model; limited central leadership control over resources</li> <li>Academic units essentially operate as their own financial entities</li> <li>Very little strategic control held by central leadership (President, Provost, COO, etc.)</li> <li>Under-performing units must cut costs or generate more revenue to cover any losses incurred</li> <li>Only three U.S. institutions use this extreme iteration, one of which is shifting away</li> </ul>
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.		

# Budgeting Alternatives: Pros & Cons

The use of hybrid models reflects the reality that each model comes with its own set of benefits and considerations.

Common Budgeting Models				
	Incremental Budgeting	Formula Funding	Performance Funding	Incentive-Based Models
Benefits	<ul style="list-style-type: none"> <li>Consistent treatment of budgets over time</li> <li>Simple to understand and facilitate</li> <li>Provides equity across units</li> <li>Maximizes central flexibility</li> </ul>	<ul style="list-style-type: none"> <li>Provides an objective method for making budget decisions</li> <li>Uses readily available data</li> <li>Easy to understand</li> <li>Success is easy to measure</li> </ul>	<ul style="list-style-type: none"> <li>Focus placed on achievement of university mission</li> <li>Productivity data is used</li> <li>Encourages planning</li> <li>Rewards high-performing units</li> </ul>	<ul style="list-style-type: none"> <li>Promotes entrepreneurship / revenue growth</li> <li>Encourages efficient operation of administrative service units</li> <li>Aligns revenues and costs</li> <li>Facilitates conversations about priorities</li> </ul>
Considerations	<ul style="list-style-type: none"> <li>Requires stability of funding and consistent priorities</li> <li>Needs periodic “re-basing” to ensure base does not become an entitlement</li> <li>Encourages spending to maintain budget</li> </ul>	<ul style="list-style-type: none"> <li>Incentive to increase size, not increase quality</li> <li>Difficult to differentiate among local unit business models (e.g. student type, research)</li> <li>Accounting for local unit factors increases model complexity</li> </ul>	<ul style="list-style-type: none"> <li>Difficult to account for differences in quality of inputs and/or may sacrifice quality of outputs</li> <li>Poor performance may lead to a “downward spiral”</li> <li>Units may experience time lag between decision and results</li> </ul>	<ul style="list-style-type: none"> <li>Requires strong central and local unit leadership</li> <li>Criticized for replacing academic with financial focus</li> <li>Without adequate transparency, academic collaboration hampered</li> <li>May require additional infrastructure to support financial management</li> </ul>
<b>Institutional culture, organizational complexity, mission, and systems capabilities are all factors that should be considered when determining a university’s optimal budget model.</b>				



# 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
<b>Devolution of Revenue</b>	<ul style="list-style-type: none"> <li>Models devolve ownership of revenues from central administration to centers which generate them</li> <li>In particular: Tuition and fee revenues, direct research revenue, indirect (F&amp;A) research revenues, and endowment and gift revenues</li> <li>The majority of models also devolve state appropriations based-on agreed upon methodologies</li> </ul>
<b>Allocation of Costs</b>	<ul style="list-style-type: none"> <li>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</li> <li>An understanding of how indirect costs are allocated enables planners to estimate full marginal costs of proposed initiatives</li> <li>Each center pays for its total costs with the revenues it owns plus a share of centrally owned revenues</li> </ul>
<b>Use of Subvention Pools</b>	<ul style="list-style-type: none"> <li>The provision of direct resources for strategic initiatives benefits the whole of the institution</li> <li>Allocations from central sources to responsibility centers called “subventions” are used to offset mission-critical units with high operating costs</li> <li>In part, this addresses the economic problem of the commons</li> </ul>
<b>Financial Accountability</b>	<ul style="list-style-type: none"> <li>In exchange for devolving revenue ownership, the system requires bottom-line responsibility and rewards strong fiscal performance:               <ul style="list-style-type: none"> <li>Centers retain positive operating margins and repay negative ones</li> </ul> </li> <li>Financial accountability is a means, not an end in universities, and annual budget plans must still be reviewed and approved by university leaders</li> </ul>

# 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.

Chancellor's Cabinet	Provost & CFO	Deans	Administrative Units	Department Chairs & Faculty
Remove luxury of "all things to all people" by forcing difficult decisions	Force clarity regarding priorities and strategic initiatives	Know full cost of activities (academic programs, research, etc.) and prioritize them through cross-subsidies between revenue generating activities and mission-driven activities	Connect service levels and resource levels	See how activities drive funding for their respective units

The background is a solid dark blue with a series of light blue, curved, motion-blurred lines that sweep across the frame from the bottom left towards the top right, creating a sense of speed and movement.

**QUESTIONS?**

# APPENDIX

# Huron Team Members



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**MORE INFORMATION WILL BE FORTHCOMING ABOUT A BUDGET REDESIGN  
WEBSITE THAT IS BEING DEVELOPED BY UTK**

