



THE UNIVERSITY OF
TENNESSEE
KNOXVILLE

BUDGET ALLOCATION MODEL

Campus Open Forum

October 22, 2019



Draft: For Discussion Purposes Only

Project Objectives

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

We understand the **goals** of the budget redesign initiative are to:

- 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
- Provide effective incentives for both academic leaders and campus administrators
- Increased transparency and greater correlation between decision making responsibility and the investment of financial resources

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.

Steering Committee Membership	
David Manderscheid, Provost & Sr. Vice Chancellor (Co-Chair)	Chris Cimino, Sr. Vice Chancellor, Finance & Administration (Co-Chair)
Phillip Daves, Associate Professor, Haslam College of Business	Kim McCullock, Associate Vice Chancellor, Finance & Administration
Ernest Freeberg, Professor, Department Head, Department of History	Sally McMillan, Interim Director, School of Adv. and Public Relations
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, College of Engineering	Hongwei Xin, Dean, UT AgResearch
<i>Working Group Membership: Kim McCullock, James Price, Keith Thomas and Gary Gray</i>	

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

Guiding Principles

The Steering Committee developed the following set of guiding principles to inform decisions on the development of the budget model.

- Supports the flagship, land grant mission, vision and values of the diverse constituencies of the University in advancing its pursuit of on-going excellence in teaching, research, scholarship, creative activity, outreach and engagement.
- Facilitates investment in the operational and administrative units, essential to university and college priorities.
- Fosters innovation, collaboration and responsible fiscal stewardship through flexible incentive design.
- Allocates resources using a transparent, consistent and straightforward methodology.
- Provides accessible, predictable, accurate and timely information to promote trust across colleges, administrative and support units.

Developing guiding principles was a critical first step in UTK's budget redesign initiative that will inform decision points surrounding the development of a new incentive-based budget model.

Project Timeline

Month:	1	2	3	4	5	6	7	8
	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar
Phase 1: Project Initiation & Visioning	● ★		⋮					
Phase 2: Model Development		★	★ ● ★					
Phase 3: Consensus Building			⋮	★ ●	★			
Phase 4: Infrastructure Development			⋮				○	🚩

★ - Steering Committee (SC)
● - Deans Meetings
🚩 - Deans Retreat
○ - Tentative Open Forum Date

- Met with Stakeholders to identify current budget state key themes
- Facilitated three Steering Committee meetings focused on Model organization and preliminary decisions required to construct a Budget Allocation Baseline Model
- Met with Deans Council and several members of Faculty Senate Budget and Planning Committee
- Completed FY2019 Actuals Model and confirmed tie out of revenues and expenses in the model to Treasurer's Statement of Fund Balances report
- Commenced buildout of FY2019 Baseline Model

INDUSTRY TRENDS



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.

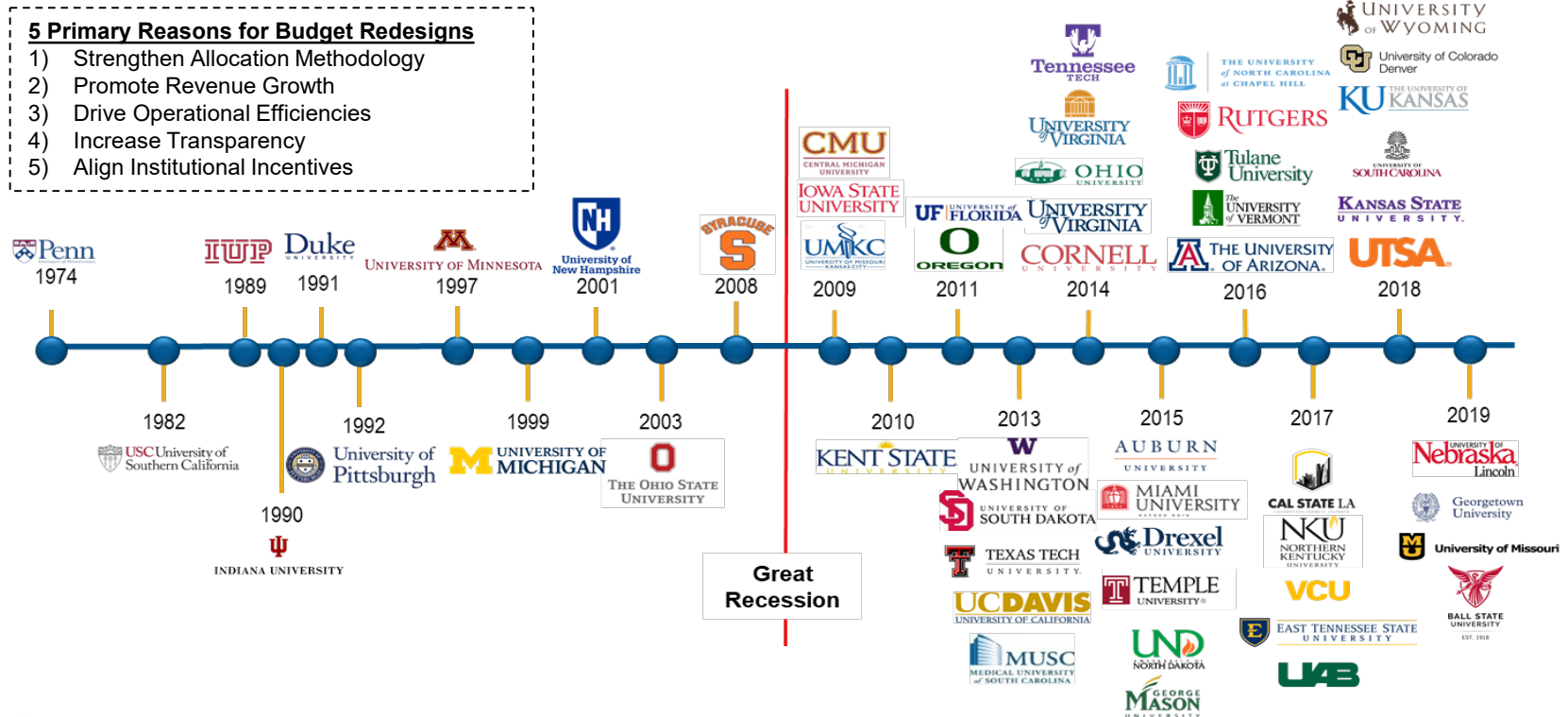
Common Budgeting Models		
<p style="text-align: center;">Incremental</p> <ul style="list-style-type: none"> ▪ Centrally driven ▪ Current budget acts as “base” ▪ Each year’s budget increments (decrements) adjust the base ▪ Focus is typically placed on expenses ▪ Common modifications: <ul style="list-style-type: none"> ▪ Revenue incentives may be incorporated for the allocation of resources above-and-beyond the base 	<p style="text-align: center;">Formula Funding / Performance Funding</p> <ul style="list-style-type: none"> ▪ <i>Formula</i>: Unit rates are input-based and commonly agreed upon with annual fluctuations driven by quantity of production (not rate changes) ▪ <i>Performance</i>: Unit-based model focused on rewarding mission delivery ▪ Unit rates are output based and commonly agreed upon variables ▪ Annual fluctuations are driven primarily by changing production and not from changes to rates 	<p style="text-align: center;">Incentive-Based</p> <ul style="list-style-type: none"> ▪ Focus on academic units ▪ Incorporates a devolution of revenue ownership to local units and allocates costs to revenue generating units ▪ Utilizes a centrally managed “subvention pool” to address strategic priorities ▪ Common modifications: <ul style="list-style-type: none"> ▪ Revenue allocation rules, number of cost pools and participation fee (tax rate)
<div style="border: 1px solid black; padding: 5px; margin-bottom: 5px;"> <p style="text-align: center;">Customized Incentive-Based Budgeting</p> <p>A higher degree of central leadership control over resources (<i>most common model since 2005</i>)</p> </div> <div style="border: 1px solid black; padding: 5px; margin-bottom: 5px;"> <p style="text-align: center;">Traditional Incentive-Based Budgeting</p> <p>Some central leadership control over resources (<i>common model from 1990 to 2005</i>)</p> </div> <div style="border: 1px solid black; padding: 5px;"> <p style="text-align: center;">Each Tub on its Own: Bottom (ETOB)</p> <p>Extremely de-centralized. Academic units operate as their own financial entities (<i>only 3 universities using</i>)</p> </div>		

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.

Effective Budget Allocation Benefits

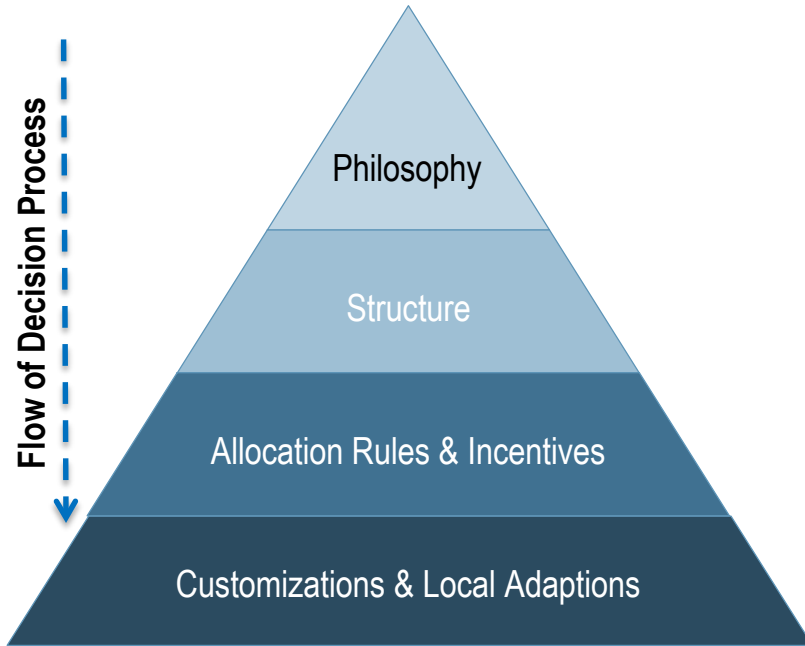
As a university explores potential changes to its budget allocation model, it is important to maintain its focus on the benefits of effective resource allocation.

- **Facilitates two-way discussions** between entities, a joint understanding of markets, and annual discussions about institutional priorities
- Translates strategic goals into **management and operating plans**
- Results in policies and procedures that **focus on incentive alignment, entrepreneurship, and the efficient use of resources**
- Improves the **effectiveness of incentives** with the potential to create win-win opportunities across an entire institution
- Identifies the **true nature of internal subsidies** (transfer payments)
- **Avoids “incremental” budgeting**, which fails to evaluate base budget allocations or adequately reflect changes in key drivers

PROJECT UPDATE AND MODEL DEVELOPMENT EFFORTS

Model Development

Huron will support the Steering Committee as they consider a broad set of critical model development decisions, with each element requiring increased levels of institutional insights and customizations.



Description
Reflects the desired financial management model, considering elements such as centralization, authority, accountability, and responsibility.
Reflects the elements of the model with respect to scope of funds, categorization of operating units, presentation of data.
Reflects how the model will portray the institution's internal economy and drive behavior.
Reflects model tweaks to address operational realities, institutional culture, and local unit needs.

Developing the Model

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).

Actuals Model

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

Baseline Model

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

(Next slide shows an illustrative Baseline Model framework)

Customized Model

- Highly customized incentives to drive mission-critical needs
- Fits with University culture and strengths
- Features strategic investment pool for University priorities

Illustrative Baseline Model

Fund Types / Restriction	Primary Units								Support Unit	University Total
	College 1	College 1	College 1	College 2	College 3	College X	Academic Units Total	Auxiliary Units Total	Support Units Total	
	Unrestricted	Restricted	Total	Total	Total	Total	Total	Total	Total	
1 Tuition	F	F	F	F	F	F			##	F
2 Fees	F				F	F			##	F
3 Less: Financial Aid	F				F	F			##	F
4 Total Tuition & Fees										
5 State Appropriations	F				F	F	F	F	##	F
6 Grants & Contracts	##				##	##	##	##	##	##
7 Indirect Cost Recovery (IDC) Revenue	F				F	F	F	F	##	F
8 Gifts	##	##	##	##	##	##	##	##	##	##
9 Sales, Services & Other	##	##	##	##	##	##	##	##	##	##
10 TOTAL REVENUES										
11 Wages	##	##	##	##	##	##	##	##	##	##
12 Benefits	##	##	##	##	##	##	##	##	##	##
13 Total Wages and Benefits										
14 Supplies, Equipment & Other	##				##	##	##	##	##	##
15 Travel	##				##	##	##	##	##	##
16 Utilities, Maintenance & Renovations	##				##	##	##	##	##	##
17 Rent	##				##	##	##	##	##	##
18 Services	##	##	##	##	##	##	##	##	##	##
19 Debt Service	##	##	##	##	##	##	##	##	##	##
20 Depreciation	##	##	##	##	##	##	##	##	##	##
21 TOTAL DIRECT EXPENDITURES										
22 Transfer In	##	##	##	##	##	##	##	##	##	##
23 Transfer Out	##	##	##	##	##	##	##	##	##	##
24 OPERATING MARGIN										
25 OPERATING MARGIN (%)										
26 Support Unit Allocations										
27 Academic Affairs & Student Affairs	F				F	F	F	F	##	F
28 Central Services & Administration	F				F	F	F	F	##	F
29 Executive Affairs	F				F	F	F	F	##	F
30 Facilities	F	F	F	F	F	F	F	F	##	F
31 Information Technology	F	F	F	F	F	F	F	F	##	F
32 Libraries	F	F	F	F	F	F	F	F	##	F
33 Research	F				F	F	F	F	##	F
34 TOTAL SUPPORT UNIT ALLOCATIONS										
35 UNIT MARGIN BEFORE CENTRAL FUNDING										
36 Participation Fee	F				F	F	F	F		F
37 Strategic Funding Distribution	M	M	M	M	M	M	M	M		M
38 UNIT MARGIN AFTER CENTRAL FUNDING										
39										

Fund Types / Restriction

Unit Organization

Allocable and Direct Revenues

Direct Expenditures

Support/Central Unit Allocations

Central Funding Mechanism

Organization Overview

An incentive-based model classifies organizational units into three categories based on the key attributes described below. The Steering Committee considered how units should be categorized within the model.

Primary Units

- Ability to influence revenue generation:
 - Price
 - Quantity (not captive market)
- 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
- IT, HR, and Facilities may have service-level agreements with select primary units

Primary Units Organization

The Working Group and Steering Committee selected Primary Units and organized them into three categories: Academic, Other Academic and Auxiliary.

Primary Units		
Academic Units (10)	Other Academic Units (2)	Auxiliary Units (7)
<ul style="list-style-type: none"> ▪ College of Architecture and Design ▪ College of Arts and Sciences ▪ College of Communication and Information ▪ College of Education, Health and Human Sciences ▪ College of Nursing ▪ College of Law ▪ College of Social Work ▪ Haslam College of Business ▪ Herbert College of Agriculture ▪ Tickle College of Engineering 	<ul style="list-style-type: none"> ▪ Centers and Institutes: <ul style="list-style-type: none"> - Baker Center - Bredesen Center - Ctr Environmental Biotechnology - Inst Adv Comp Manu Innovation (IACMI) - Institute for Nuclear Security - Joint Institutes (JIAM, JINS, JIBS, JICS) ▪ Conferences and Non-Credit Programs 	<ul style="list-style-type: none"> ▪ Athletics ▪ Dining ▪ Housing ▪ Parking ▪ Service Center ▪ Thompson-Boling Arena ▪ VolShop

Support Unit Allocations

Cost pools were grouped based upon Working Group and Steering Committee discussions to be allocated in the budget model based upon a specific rule or metric.

Cost Pool	Support Units
Academic Support	Chancellor's Honors, Continuing Studies, Distance Learning, Educational Advancement, Graduate School, Military Science & Leadership, Provost & Sr. Vice Chancellor, Teaching & Learning Innovation, Access and Diversity Funds, Center for Global Engagement
Administrative Support	Associate VC Finance and Admin, Budget and Finance, Bursar's Office, Business Services, Chancellor, General Support, Institutional Memberships, Institutional Research, McClung Museum, UT Foundation Direct Support
Employee Services	Human Resources, Staff Benefits
Facilities	Assoc VC Facilities Services, Emergency Management Services, Environmental Health & Safety, Facilities Services,
Utilities	Utilities
IT	Associate VC and CIO, Data Processing Services
Libraries	Libraries
Public Safety	Assoc VC Public Safety/Chief, Campus Police
Research	Research & Sponsored Support, Research Development, Research Integrity, Sponsored Projects Accounting, The Science Alliance, VC Research and Engagement, Natl Inst Bio Math Syn (NIMBioS)
Undergraduate Scholarships & Fellowships	Scholarships & Fellowships
Student Services	Enrollment Management, Student Life

Campus Open Forum Summary

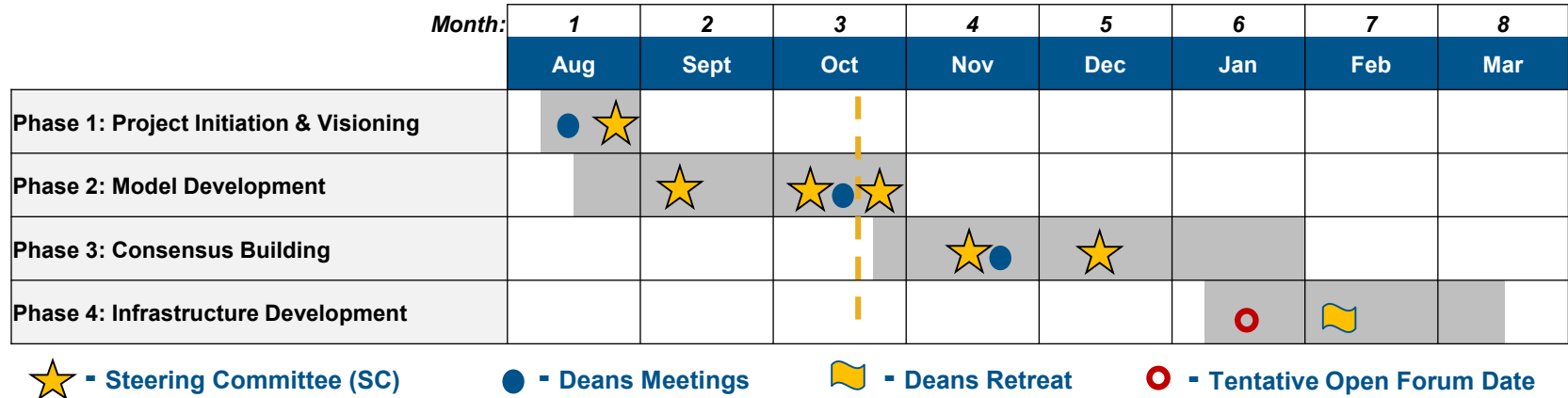
Today's presentation was designed to provide a project overview, share some industry trends, and to review current efforts.

- This is a thoughtful process that many institutions have successfully implemented, but which will be customized to fit with UTK's unique strengths, culture, and strategic priorities
- This new approach to budgeting is designed to help the University make better strategic use of its resources through more data-informed decisions
- Stakeholder input has been and will continue to be considered and we ask that you provide feedback by engaging with Steering Committee members and university leadership

QUESTIONS?

At this time, we've reserved 20-25 minutes for Q&A.
When asking a question, please share your name and department/unit.

Project Timeline and Next Steps



Huron and Working Group Next Steps:

- Continue to work with Steering Committee and Working Group to create initial model methodology
- Finalize Excel budget model framework build to integrate various scenarios
- Launch and monitor initiative inbox to share submitted feedback with Steering Committee and to address questions

THANK YOU!

Stay informed and visit:

[HTTPS://BUDGET.UTK.EDU/BUDGET-ALLOCATION-MODEL/](https://budget.utk.edu/budget-allocation-model/)

or e-mail: BUDGET-ALLOCATION-MODEL@UTK.EDU



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HURON

APPENDIX

Key Model Elements

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

Element	Description
Direct Revenues	<ul style="list-style-type: none"> Typically recognized as revenue by the primary unit for goods or services provided
Allocation of General Revenues	<ul style="list-style-type: none"> Models devolve ownership of revenues from Central Administration to the local units that generate them; particularly, tuition, state appropriations and indirect cost recovery (i.e. F&A)
Direct Expenses	<ul style="list-style-type: none"> Schools and colleges have traditionally been accountable for, and actively managed, direct expenses
Allocation of Indirect Expenses (Cost Pool Allocations)	<ul style="list-style-type: none"> Optimal decision-making requires that the full costs of activities be understood; not just the direct costs, but also the facilities utilized, and central services provided By understanding how indirect costs are allocated, management can estimate the full marginal costs of proposed initiatives Each primary unit (i.e. Academic Units, Auxiliaries, and Centers & Institutes) pays for its own direct expenses plus a share of the central support unit expenses
Use of Central Funding	<ul style="list-style-type: none"> The provision of direct resources for strategic initiatives benefits the whole institution Allocations from central sources (i.e. “subventions”) to primary units are used to support mission-critical units with under-funded operating costs In part, the use of a central fund addresses the economic problem of the commons