Budget Advisory Committee

# University Budget Models: An Overview

10-31-18

University of Northern Iowa

# Purpose of Budgeting

- Provides a forecast of planned revenues and expenses
- Framework for allocation of financial resources
- Guides management decisions
- Reflects organizational values

# Accounting vs Budgeting

<u>Accounting = Past</u>

- Recording what happened
- Reporting how we spend revenue
- Auditing the process of past actions

<u>Budgeting = Future</u>

- Gathering data to look forward
- Projecting/modeling the future
- Decisions/planning

# Basic Types of Budgeting Models

1. Incremental based budget
2. Zero-base budget
3. Initiative based budget
4. Activity based budget
5. Performance based/Formula based budget
6. Responsibility Centered Management

Varying degrees of Centralized or Decentralized decisions

# Incremental Budgets

Model where the current year's budget is used as the base for the next year's budget, which is only *incrementally* adjusted by a percentage (up or down) depending on total projected revenue.

Probably the most common form of budget and is <u>the basis for UNI</u>

Benefits:

- Starts with a base budget, which is not frequently revisited so…
- Easy to implement, and
- Provides budgetary stability, allows units to plan into the future

Weaknesses:

- Assumes that budgets are well-aligned to need
- Less responsive to new priorities
- Harder to link costs to the value created

# Zero-Base Budgets

Division and unit budgets are zeroed out and rebuilt each year. Units have to analyze and justify all budget needs each time. Since every component is evaluated each year, all expenditures (new or continuing) are on equal footing.

Benefits:

- Allocations based on projections of activities to determine need
- Effective way to monitor and control unnecessary costs
- Previous budget does not (directly) impact new budget (except for sunk costs)
- Can be more responsive to strategic initiatives or budget changes

Weaknesses:

- Time consuming and difficult to implement
- Can create internal competition
- Because most Higher Ed costs are fixed in salaries, can only be effectively implemented on a small portion of the budget

# Activity-Based Budgets

Funding is allocated to promote desired activities or outcomes that see the greatest return on investment. Funding is (in part) tied to specific activity such as community engagement, STEM initiatives, obtaining grant money, providing a particular service.

Basically linking broad priority categories and behavior with budget.

Benefits:

- Intended to drive and promote specific activities/behavior so can be tied closely to strategic objectives
- Can link revenue and strategic objectives
- Can help drive additional fundraising

Weaknesses:

- Requires Significant pre-planning and data analytics.
- Not related to fixed costs, so typically is only practical on portions of the budget.

# Initiative-Based Budgets

Similar to Activity Based Funding but focused on more specific outcomes. Funding is (in part) tied to specific activity such starting a new center, boosting enrollment in one area, improving facilities in one area for the purpose of recruitment, or implementing a campus-wide tool (e.g. CRM). Basically using budget to jumpstart a project.

Benefits:

- Funds are allocated for a specific project which can provide a kick start
- Usually one-time, or fixed-term funding, so not necessary a long-term commitment

Weaknesses

- Not associated with long-term or comprehensive budget planning.
- Only useful for high-priority, high-impact activities.

# Performance-Based or Formula based Budgets

Budgets for units are based on defined outcomes as measured by a pre-determined formula. Metrics for the formula likely would include (but not be limited to) majors, FTE enrollment, graduation rates, staff, physical space, the major CIP code, degree levels, etc.

Often, when this model is used, it is mandated by state legislation

Benefits:

- Funding is focused on outcomes as measured through metrics
- Easy to implement and easy to understand.
- Units can try to maximize their allocations

Weaknesses:

- For good or bad, the metrics drive behavior
- Probably favors certain fields over others
- Might drive competition more than collaboration

# Responsibility Centered Management (RCM)

Decentralized budget which delegates operational authority to the divisions, but also makes them responsible for their revenue and expenditures.

- Each unit receives its own revenue (tuition, appropriation, etc) based on enrollment
- Units can set their own priorities and pursue them to the extent they have the funds.
- If they can carry a surplus, might be allowed to roll forward. Also responsible for cutting expenses during budget shortfalls.
- Gaining popularity; about 20% of R1 universities use this model

Benefits:

- Provides a clear budgetary philosophy for the campus
- Creates incentive to be fiscally responsible since the benefits are realized at the unit level
- Encourages entrepreneurial and innovative initiatives

Weaknesses:

- Can encourage competition rather than collaboration
- Can place financial considerations above academic
- Probably favors certain fields over others
- Definitely favors programs with higher enrollment and/or lower delivery cost

# REALITY: Hybrid or Overlapping Budget Models

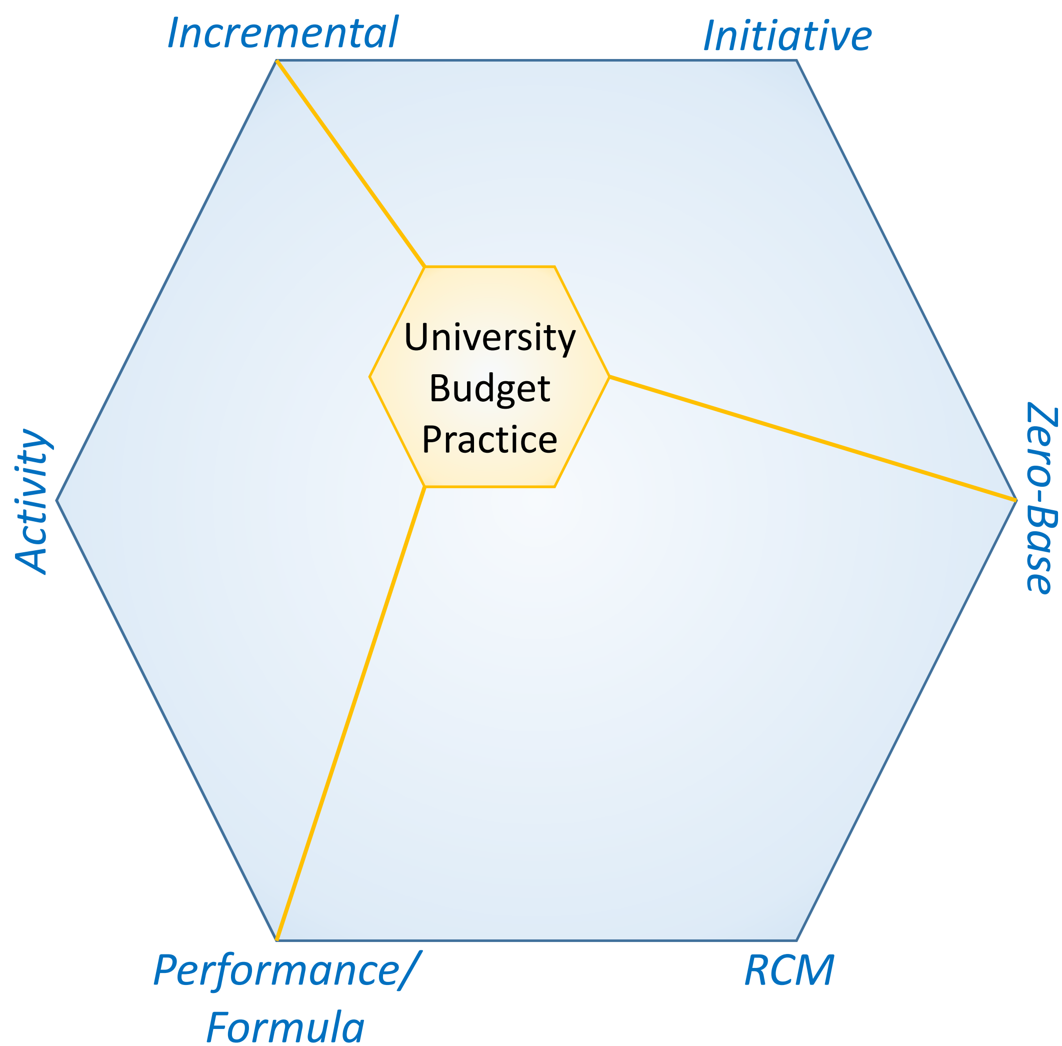
More common to use components of different models rather than a "pure" approach

<u>For example:</u>

1. An **Incremental** model might reserve some one-time funds for special **Initiatives** funding

2. A **Performance** or **Formula** based model might be used to set a **Zero-Base** or initial **Incremental** budget

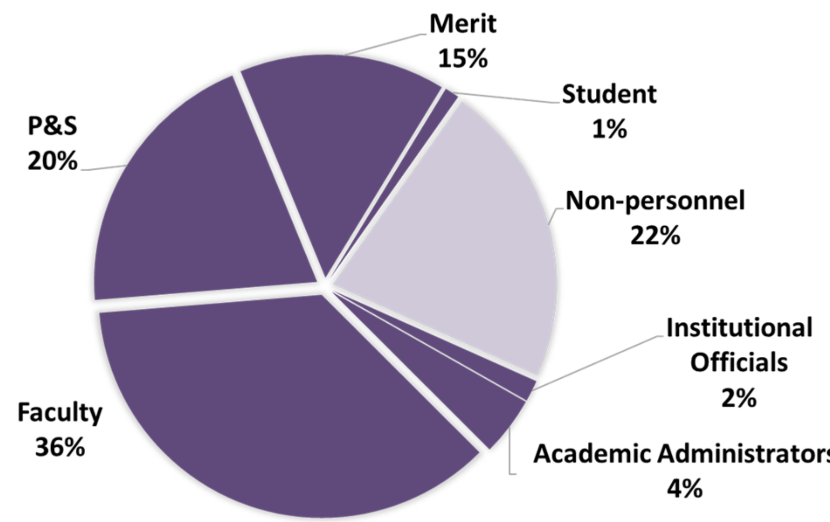
Periodically an **Incremental** budget might be **Zeroed** out and reset based on **Performance** measures.



# Factors that Influence Budget Models

- Institution type: Public, Private
- Mission: Research, Comprehensive, Liberal Arts
- Strategic Goals
- Governance Structures and Mandates: Boards, Legislature

# UNI Budget




Mostly Incremental

- Some Initiative or Activity based funds
  - New programs
  - Short-term projects
  - Center startups
- Limited flexibility; 78% expenses in salary
  - Salary "incrementally" increase annually
  - Re-allocation mostly limited to turnover
- Most of the remaining 22% are still partially fixed.
- *What does this mean when budget grows; shrinks?*