

WORKING PAPER, V1

April 2012

Incentive-Based Budget Model **Provost Allocation**

The following information is intended to provide context for a discussion on the Provost Allocation within an incentive-based budget. This paper includes a general overview of the Provost Allocation, its sources and uses, how the allocation is initially calculated, and how it will be set on an incremental basis in future years.

PRINCIPLES

Before delving into the specifics of the Provost Allocation, it is important to reiterate the overarching principles of the UC Davis budget process. These principles should help inform the decisions to be made on specific aspects of the budget model.

1. Establish a sustainable funding model with incentives that advance the Vision of Excellence and the 2020 Initiative.
2. Advance and encourage campus strengths and priorities such as interdisciplinary scholarship and internationalization, as well as boost economic development.
3. Be transparent, linking authority with accountability.
4. Be as simple as possible to understand, administer and implement; rely on common and easily available data sources.
5. Encourage creativity and responsible risk-taking while providing for reasonable reserves and oversight.
6. Balance local autonomy with a strong sense of unity in vision and values.
7. Provide mechanisms for investments in fresh ideas at all levels.
8. Provide for reasonable transitions and bridging strategies.

The Provost Allocation is an important feature of the incentive-based budget model and as such, a key principle is to ensure that incremental decisions about the Provost Allocation complement the formula driven elements of the revenue allocation model.

TERMINOLOGY

The **Provost Allocation** is a combination of unrestricted state support and funding from assessments on tuition revenue and indirect cost recovery (ICR). The purpose of the Provost Allocation is to support the common good and promote excellence across campus.

For 2012-13, the Provost Allocation will also include graduate tuition revenue. The goal is to disaggregate graduate tuition revenue from the Provost Allocation for 2013-14. In future years, other sources of revenue may also be included in the Provost Allocation (e.g., summer session tuition, patent revenue, institutional overhead for auxiliary and similar activities).

The term **state appropriation** refers to the State General Fund appropriation, which is the unrestricted state support appropriated through the State Budget Act to the University of California and a portion of which is allocated to UC Davis by the Office of the President. The State General Fund appropriation includes funds for the Agricultural Experiment Station (AES).

The **General Fund**, known by its fund number (19900) includes the state appropriation and tuition revenue (resident and non-resident supplemental).

The **annual budget process** is the series of actions by which the campus reviews the alignment of its expenditures with its vision and priorities. The process provides units the opportunity to present budgets and demonstrate accountability.

The revenue sources allocated by the incentive-based model will be called **core funds** and include tuition (and equivalent funds), ICR, state appropriation and the Provost Allocation. The method for allocating these funds is entirely a decision by the campus, not subject to external restrictions. Other funds will be considered for inclusion in the view of core funds and the budget model over time.

Unless otherwise stated, the term **unit** is intended to refer to the primary campus organizational units that are led by a dean, vice provost, vice chancellor or university librarian. Universities that have implemented incentive-based budgets tend to allocate funds at the highest level. There is no expectation that funds be distributed to departments using the same methodology that drives allocations to the schools, colleges and divisions.

WHAT IS THE PROVOST ALLOCATION?

Most basically, the Provost Allocation is the distribution method for non-formula driven sources of funds. Much of the attention in the new model is focused on revenues (tuition and ICR) that will be assigned according to formulas based on how units contribute to generating those revenues. However, not all funds will be allocated in this manner. In certain cases, this is an aspect of the funds themselves. While one could devise a distribution formula for the state appropriation, it would be more artificial than the mechanisms available to distribute tuition

and ICR. In other cases, like the assessments on tuition and ICR, the institution has made a decision to balance central and unit funding, giving both a role in resource allocation.

The new budget model is not intended to make units independent but establish a balance between independence of units and institutional coordination and cooperation. To respect that balance, both the Provost and Chancellor and the units need a role in deciding funding levels. Furthermore, there will always be initiatives that the center is in the best position to identify and promote. Initially we will not have significant new, uncommitted funds, but over time we expect the Provost Allocation to provide funding for initiatives.

The Provost Allocation is also a means to provide campuswide services, which are important considerations for any institution. These services tend to have the following characteristics:

1. Deliver benefit to all or most members of an organization.
2. Provide an economy of scale or meet needs that are generally cost prohibitive and ineffective if parts of the organization were to provide the service independently.
3. Require consistent functionality and service levels across the institution.
4. Are not easily supported by recharge rates because it is difficult or cost prohibitive to measure usage by and set a price for individual users.

Campuswide services at a university include the library, facilities infrastructure, and functions like accounting, payroll, or human resources. These services do not have an associated stream of revenue like tuition, so the Provost Allocation is used to make sure they are funded appropriately.

Finally, we considered several alternatives for names for these funds - early budget model documents referred to the Provost Supplement. The choice of name is important because of a name's potential to carry implicit value judgments. It is critical to understand that the Provost Allocation is a healthy and integral part of the new budget model. Receipt of funds from this source does not imply failure by the unit or an additional endorsement by the Provost. As much as possible, the members of the campus community need to see the Provost Allocation as value neutral.

WHAT ARE WE TRYING TO INCENTIVIZE?

As pointed out in a study of how the Michigan budget model is perceived by campus citizens, it is important to be clear about the intent of the incentives that are created. As stated in the report, “incentives should work only *within* the units’ strategy; they should neither constrain nor encourage behavior or initiatives that do not fit the units’ strategy and mission.”

The Provost Allocation should

- Reward strong performance.
- Support those who provide critical functions.
- Allow units to plan effectively.
- Encourage new initiatives consistent with the mission and strategy of UC Davis.
- Encourage the exploration of new ideas that will serve society.
- Encourage interdisciplinary activity and cooperation between units.

The Provost Allocation should not

- Undermine the key incentives in the new budget model.
- Produce a sense of dependence on the center to fund critical activities.
- Engender disruptive competition between units for central resources.

INITIAL CALCULATION

Initially, the Provost Allocation is the self-balancing part of the budget model. For 2012-13, the first step is to distribute significant undergraduate tuition revenue per the formula to each unit. Second, the tuition revenue is compared to the sum of the general fund base budget and benefits from the central pool. Finally, the difference is reconciled by the Provost Allocation. That is, funds will be distributed so that the transition to the new model replicates current budget levels as nearly as is appropriate given changes in State funding. Table 1 illustrates how the Provost Allocation fills the gap between undergraduate tuition revenue and what a unit currently receives from general funds and benefits from the central pool.

Table 1: Transition to the New Budget Model (dollars in millions)		
Fund Type	Current Budget Model	New Budget Model
Base Budgeted General Funds	\$30	
Benefits from the Central Pool	8	
Undergraduate Tuition Revenue		24
Provost Allocation		14
Total	\$38	\$38
ICR Funds¹	\$5	\$6

¹ICR Funds allocated to units will increase in 2012-13. This is not a result of the budget model per se, but it does reflect an overarching goal to distribute a greater proportion of these funds.

For units that do not generate undergraduate tuition revenue, general funds and benefit spending power will be replaced entirely with a Provost Allocation. Lastly, it should be noted that for 2012-13, graduate tuition revenue is part of the Provost Allocation, because the methodology for allocating graduate tuition has been deferred until 2013-14.

To see the current baseline budget and preliminary baseline budget under the new model for each unit, refer to Appendix I. The figures in Appendix I are preliminary and will be refined over the coming months.

INCREMENTAL APPROACH

After the initial transition to the new budget model, the Provost Allocation will be set on an incremental basis. Each unit's allocation will be calculated with reference to the prior year with adjustments that reflect institutional priorities, availability of resources, and relative level of need.

One concern expressed about the change to the new budget model is the idea that each year units would be expected to provide detailed justification for funding equivalent to the prior year. This implies a zero-based budgeting approach in which total budgets must be justified annually. This is not the approach we will take and is not the approach taken at other institutions with incentive-based budget models. One of our governing principles is that sudden shifts in funding are disruptive and to be avoided to the extent possible. Where major changes are needed, we expect in many cases to apply transition plans that phase in the change over time, as has been our longstanding practice.

The annual budget process will provide an opportunity for units to present budgets and demonstrate accountability, including accountability for their distribution and management of funds deployed across their departments. The outcome of the budget process will be incremental adjustments at the unit level, rather than a full re-set of the budget. In addition to adjustments to base budgets, units may receive one-time funds as part of the annual budget process.

IMPACT OF BUDGET SHORTFALLS IN CORE FUNDS

2012-13 marks the fifth consecutive year of core fund budget shortfalls. There are two primary sources of budget shortfalls on the institutional level: reductions in State appropriations and increases in fixed costs (e.g., negotiated salary increases, increases to employee benefits).

We will continue to take a coordinated response to shortfalls, taking an institutional perspective to determine the appropriate adjustments including budget cuts and the use of alternate funding sources to minimize the impact and ensure equitable treatment. The Provost Allocation will be a vehicle for the institutional response, since the final decision about a budget cut may often come in the form of a reduction in the Provost Allocation.

Some units will cover a higher portion of their budget from their share of tuition and ICR than others and the Provost Allocation will constitute a smaller part of their budget. In theory the resources available for the Provost Allocation could continue to contract, particularly due to State budget cuts. If this were to happen, UC Davis might reach a point at which some units no

longer receive any direct State support—in other words their Provost Allocation is zero. Then in the case of any further budget cuts, the campus will have to decide whether to cut budgets only of those units that receive Provost Allocation funds, exempting any unit that covers all of its expenses from revenue it generates. The alternative will be to issue a negative Provost Allocation—in essence an additional assessment on that unit. Part of the reason for doing so is that the campus depends on some units to generate excess funds in order to support critical, more expensive programs. This results in patterns of cross-subsidization that the campus needs to maintain and the Provost Allocation is a critical mechanism to effect such cross-subsidies (this point is discussed further below).

SOURCES OF FUNDS FOR THE PROVOST ALLOCATION

The Provost Allocation will be made from a pool of central funds derived from multiple sources. Dollars in this pool will be considered fungible, available for allocation across all of the needs and priorities supported by the Provost Allocation (see Appendix III for more details).

- **State appropriation.** Barring a further collapse in direct State support, this is likely to remain one of the largest sources of funds going into the Provost Allocation pool.
- **Provost share of tuition** currently set at 30% of undergraduate tuition net of return to aid. The share is yet to be determined for graduate, professional and summer tuition.
- **Provost share of ICR**, proposed as 60% of indirect cost funds net of categorical set-asides for Garamendi, specially negotiated F&A Rates and other similar items.
- **Institutional overhead assessments** on auxiliary and similar activities. Currently auxiliary activities pay a campus assessment to reflect administrative support they receive from other units on campus. Starting in 2012-13, these units will also be responsible for the share of the Office of the President funding tax related to their activities. In the future we plan to combine these assessments into a single institutional overhead rate that will be used to fund the OP tax and campus support for the unit.

USES OF THE PROVOST ALLOCATION

There will be a wide range of functions and programs which will continue to receive central funding through the Provost Allocation.

Academic units

At implementation, the Provost Allocation will be used to hold units constant to their current budget base, subject to the impact of any decrease in overall funding.

The new budget model is a revenue allocation model, not a cost allocation model. As such, the model itself does not provide a mechanism to evaluate the relative levels of spending authority

across units. The change in budget model does not change the need for any activity or reduce its costs. And, the revenue sources being allocated by the model – primarily tuition and state support – are not charged or collected differentially to reflect different cost structures. Therefore, the initial Provost Allocation will be set at a level to maintain units as close as possible to a baseline of their current budget.

The campus budget contains a pattern of cross-subsidies between units. In the current system they are mostly hidden. They exist for good reasons that reflect the diversity of areas of inquiry and services which any university must master. Some of these things “pay for themselves” in a fairly direct manner, others do not or do so more subtly. The campus also has priorities, missions, identities, and special areas of contribution to society that in some cases need support. Until revenue streams grow or new revenue streams emerge, or priorities or mission change, cross-subsidization will continue to be necessary to keep UC Davis engaged in its current programs to the degree and at the level necessary. The principle of establishing an initial baseline based on current budgets makes sure that we retain current cross-subsidies as we start this new model.

Over the long term, the Provost Allocation will fund mission-based activities as well as maintain baseline funding and cross-subsidies. Allocations from the Provost may take the form of increments added to ongoing base budgets or one-time funds. This will be true for all aspects of the Provost Allocation.

Priorities: The campus may identify certain kinds of expenses which it will continue to fund from central sources, such as promotion increases, targeted hires, matches, or start-ups. A basic choice will be between whether to require units to fund these things since they now receive the funds, or continue to fund them centrally because they reflect institutional rather than school-level priorities and policy decisions.

Initiatives: One of the clear reasons for holding back a portion of the income that otherwise could flow to the units is that it allows the Provost and Chancellor to fund strategic institutional initiatives, and it is critical that mechanisms exist to provide the funds for that. It is also the case that if there is no or minimal growth in resources, funds for initiatives—new actions—can only come by cutting funds for other activities. This means that in the first year of the model there may not be significant additional funds for initiatives.

Augmentations or Shortfalls: The Provost Allocation may be adjusted in response to state funding increases, state funding cuts or fixed cost increases.

Basic Operations: The Provost will continue to provide funding for the ongoing budgets of academic units. Increases and decreases will depend on many factors, including priorities and the needs for investment. There is no principle that the Provost wants to decrease the level of

support to academic units, although it is in everyone's interest for units to strengthen their ability to provide support from tuition, ICR, and other sources.

Faculty salaries and faculty FTE require special consideration and will be addressed in more detail in a separate paper. We anticipate that a larger portion of faculty salary and benefits will be retained at the unit level. Also, regardless of any changes to current policy, faculty merit and promotion increases given as part of the normal academic review process will be funded annually as part of the Provost Allocation.

Over time the campus may want to develop mechanisms to help fund capital investments (renewal and renovation of facilities, major equipment and systems purchases, and new construction) from the streams of funding generated by the units. There are various models in higher education for structuring this sort of contribution to "plant," but we will not address that possibility until the new budget model has been well-established and we start to see an improvement in funding from all sources.

Campuswide services from administrative and academic support units

All campus units depend on a large number of service units that need to function well. These are primarily housed in the administrative and academic support units. In some ways the first call on the Provost Allocation will be to fund these services, because they do not have an independent source of funding.

At the organizational level defined for the budget model these include:

- Academic Support
 - General Library
 - Office of Graduate Studies
 - Information and Educational Technology
 - Office of Research
- Administrative Units
 - Administration and Resource Management
 - Office of the Chancellor
 - Office of the Provost
 - Student Affairs
 - Development and Alumni Relations
- Facilities Management

Appendix II shows the current funding profile for these units and the academic units.

For all of these units, budgeting in the new model will be similar to budgeting today in that they will operate from a budget developed with and approved by the Provost and Chancellor based on resources available and institutional needs. In addition to a base budget, they will fund some of their activities through recharge activities that will be governed and reviewed according to current policies and procedures.

There will, however, be differences:

1. As revenue streams grow, assessments will cause central resources to grow in tandem. The Provost will have to choose between many possible uses of incremental funds, but growth should provide an opportunity to fund strategic investments.
2. Pressures for accountability may increase. While the prolonged period of budget cuts has resulted in sustained scrutiny of administrative budgets, pressure may even increase under the new budget model as the overall allocation of resources becomes more transparent. It will be the responsibility of executive leadership to take a balanced approach that makes progress in accountability and performance systems but does not impose unrealistic burdens.

PROCESS FOR DISTRIBUTING THE PROVOST ALLOCATION

Fundamentally, the process for distributing the Provost Allocation will be simple. The Provost will work with Budget and Institutional Analysis to determine what funds are likely to be available in the Provost Allocation fund and then allocate those funds to achieve the best possible mix of results when one considers the wide range of things funded from this source.

One goal in the budget model is to increase the level of transparency behind allocation decisions. Formulas like those used to distribute undergraduate tuition and ICR simplify and clarify the allocation process. The Provost Allocation will reflect the Provost and Chancellor's best judgments, but it will be more challenging to explain the rationale for those decisions.

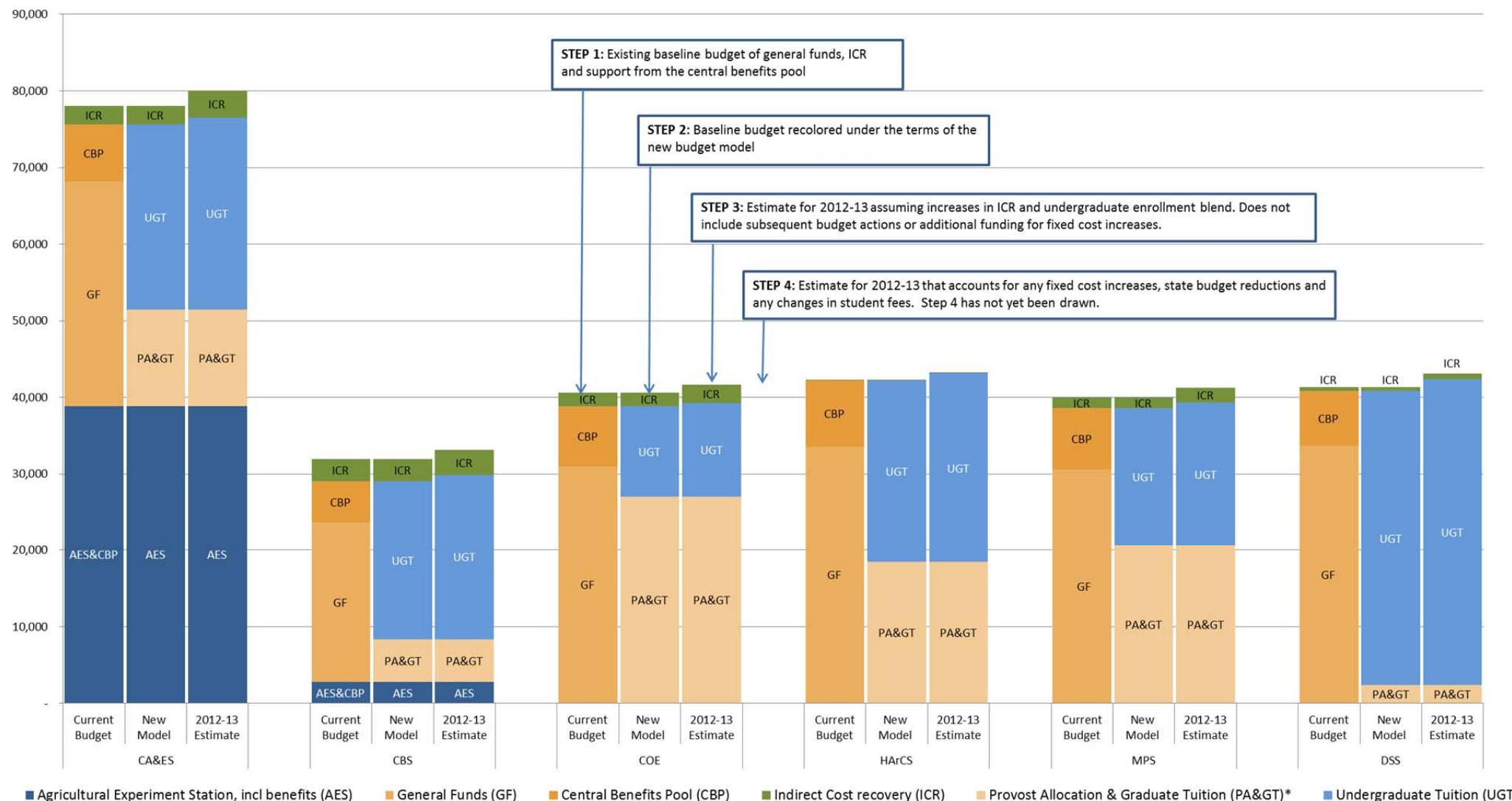
Some aspects of the budget process can help communicate the reasons behind decisions related to allocation of central funds.

- UC Davis is instituting budget meetings this year between the Chancellor and the Vice Chancellors and between the Provost and Deans.
- As funds for initiatives become available, the Provost may want to set those funds aside as the budget is developed and use a separate request and allocation process for these funds during the Fall. This would allow time for full resolution of the State budget, providing the final information on funding available.

While the new budget model does not fundamentally change the way administrative functions are funded, the new model will bring with it significant changes in attitudes about budgeting. One possible impact may be increased scrutiny of spending in those areas. Certain areas, like Facilities or Information Technology, provide many services on a fee for service basis to internal users. Under the new budget model, a natural reaction may be to question why some services are paid for on a per use basis while others are supported by central funds. Specific concerns can be addressed within the existing framework for reviewing recharge activities.

APPENDIX I – Baseline budgets by unit

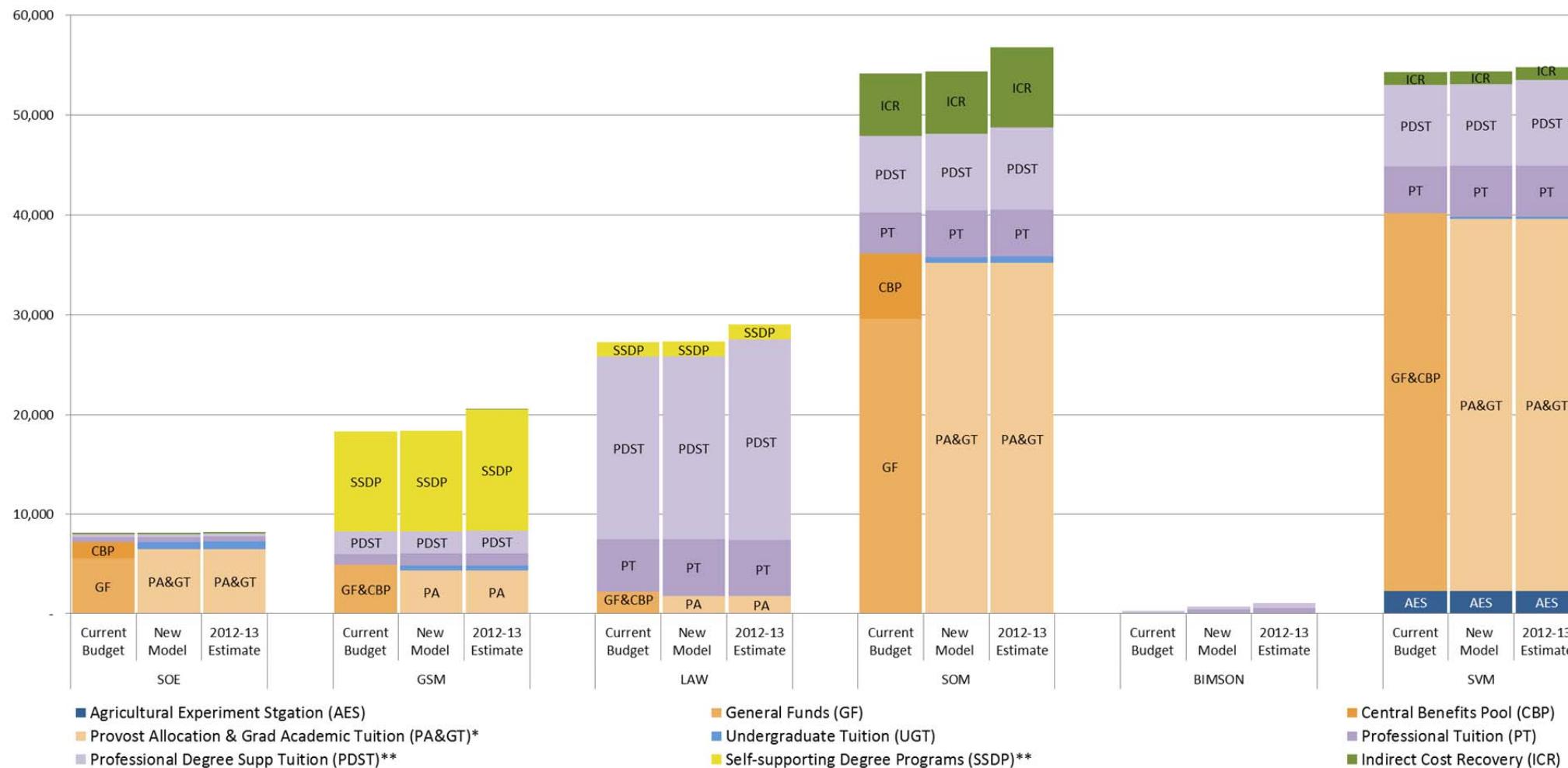
Establishing Baseline Revenue Budgets for Centrally Allocated Funds and Estimating 2012-13, Version 1



*The allocation process for graduate tuition will be part of Phase II of the new budget model and will be separated from the provost allocation in 2013-14.

APPENDIX I – Baseline budgets by unit, continued

Establishing Baseline Revenue Budgets for Centrally Allocated Funds and Estimating 2012-13, Version 1



*The allocation process for graduate tuition will be part of Phase II of the new budget model and will be separated from the provost allocation in 2013-14.

** Not centrally allocated funds

APPENDIX II: Funding Context for Administrative and Academic Support Units

Unit	2011-12 General Fund	2011-12 Benefits	Total	2010-11 Expenditures	
	Base Budget (199XX) ¹	Estimate (199XX) ¹		All Funds (No Recharge)	Recharges
<u>Academic Support Units</u>					
General Library	\$15,443,437	\$2,800,000	\$18,243,437	\$18,303,010	\$845,806
Office of Graduate Studies	5,831,892	600,000	6,431,892	3,547,594	0
Office of Graduate Studies - Financial Aid	2,245,000	0	2,245,000	18,781,150	0
Information and Educational Technology	10,032,629	2,700,000	12,732,629	19,051,085	16,132,678
Office of Research - Administration	4,971,318	1,900,000	6,871,318	10,997,625	26,721
Office of Research - Other	5,000,000	1,400,000	6,400,000	81,325,594	17,758,321
<u>Administrative Units</u>					
ARM Administrative Services	11,609,573	4,600,000	16,209,573	23,172,820	39,512,000
ARM Facilities and Land Management	26,251,313	7,800,000	34,051,313	56,904,469	51,993,673
ARM Safety Services	7,838,626	1,800,000	9,638,626	18,259,621	8,656,581
ARM Purchased Utilities	30,976,589	1,400,000	32,376,589	32,635,533	7,593,116
Offices of the Chancellor and Provost	10,291,633	2,300,000	12,591,633	30,229,695	2,743,036
Student Affairs - Main	6,090,470	2,100,000	8,190,470	51,987,535	160,723
Student Affairs - Athletics	0	0	0	91,962,696	11,004,118
Student Affairs - Auxiliaries	48,113	13,000	61,113	26,784,018	1,067,168
Student Affairs - Financial Aid	1,069,026	0	1,069,026	156,154,263	0
Development and Alumni Relations	2,992,730	1,100,000	4,092,730	39,375,946	186,282
Total	\$140,692,349	\$30,513,000	\$171,205,349	\$679,472,653	\$157,680,222

¹The figures do not represent the funding that a unit will receive as part of the transition to the new budget model. They are for comparison purposes only.

General fund base budget is as of December 2011.

APPENDIX II: Funding Context for Academic Units

Unit	2011-12 General Fund	2011-12 Benefits	Total	2010-11 Expenditures	
	Base Budget (199XX) ¹	Estimate (199XX) ¹		All Funds (No Recharge)	Recharges
<u>Colleges and Divisions</u>					
College of Agricultural & Environmental Sciences	\$29,358,064	\$7,500,000	\$36,858,064	\$58,078,604	\$1,170,118
College of Biological Sciences	20,876,662	5,200,000	26,076,662	90,313,946	3,877,452
College of Engineering	31,014,162	7,700,000	38,714,162	112,347,832	1,070,898
Division of Humanities, Arts & Culture	33,543,693	8,600,000	42,143,693	51,749,813	20,719
Division of Math & Physical Sciences	30,618,836	7,200,000	37,818,836	77,580,963	1,136,022
Division of Social Sciences	33,303,485	7,900,000	41,203,485	57,421,615	165,601
<u>Professional Schools</u>					
Graduate School of Management ²	5,980,121	0	5,980,121	19,069,897	(247)
School of Education	5,513,891	1,600,000	7,113,891	14,905,134	9,511
School of Law ²	7,458,188	0	7,458,188	23,779,821	(2,350)
School of Medicine	33,712,559	7,000,000	40,712,559	460,033,554	83,492,001
Betty Irene Moore School of Nursing ³	184,804	0	184,804	N/A	N/A
School of Veterinary Medicine ²	42,827,375	0	42,827,375	134,739,664	38,357,733
<u>Agricultural Experiment Station</u>					
College of Agricultural & Environmental Sciences	29,629,176	9,200,000	38,829,176	149,322,177	1,733,645
College of Biological Sciences	2,210,635	600,000	2,810,635	2,512,983	0
School of Veterinary Medicine ²	1,934,635	0	1,934,635	45,920,506	2,651,487
UC Davis Extension	0	0	0	28,177,089	6,779,085
Total	\$308,166,286	\$62,500,000	\$370,666,286	\$1,325,953,599	\$140,461,676

¹ The figures do not represent the funding that a unit will receive as part of the transition to the new budget model. They are for comparison purposes only.

General fund base budget is as of December 2011.

² Benefits from the central pool were decentralized in 2011-12 and are included in the unit's base budget.

³ Expenditures for 2010-11 are included in the total for the School of Medicine

APPENDIX III: Direct Funding to Campus Units and Funding Allocated by the Provost

The Provost Allocation is funded, primarily, from a combination of unrestricted state support, the Provost's share of undergraduate tuition and indirect cost recovery. Barring a further collapse in direct State support, this is likely to remain one of the largest sources of funds going into the Provost Allocation pool. The Provost share of tuition is currently set at 30% of undergraduate tuition net of financial aid. The rate is yet to be determined for graduate, professional and summer tuition. The Provost share of ICR is proposed as 60% of indirect cost funds net of categorical set-asides (e.g., allowable Garamendi expenses, specialized facilities and administrative cost rates).

Fund Flows to Units¹ and Provost Estimates for 2012-13 (dollars in millions)			
Fund Source	Flows directly to units	Allocated by Provost	Total
Tuition, net of return to aid			
Undergraduate tuition ²	\$145	\$62	\$207
Graduate tuition ²	0	34	34
Professional Tuition ²	18	0	18
Tuition subtotal	\$163	\$96	\$259
State appropriation ³	42	277	319
Professional degree supplemental tuition & Self-supporting degree program fees	54	0	54
Indirect cost recovery	65	58	123
Total	\$324	\$431	\$755

¹The term unit refers to primary campus organizational units led by a dean, vice provost, vice chancellor or university librarian.

²Includes nonresident supplemental tuition and excludes \$102 million that is used for undergraduate financial aid and graduate student support.

³State appropriations for the Agricultural Experiment Station are allocated directly to units.