

DRAFT VERSION of University of Florida Budget Council Report on Responsibility Center Management

Introduction:

The University of Florida Faculty Senate Budget Council is “charged with making policy recommendations and facilitating faculty participation in shared governance” within the area of “budget and fiscal matters as they involve the academic mission of the University.” For the academic year 2010-11, the Budget Council has been tasked with reviewing the implementation of Responsibility Center Management (RCM) with particular attention to: (1) its implementation and impact on budgeting and planning and (2) initial monitoring as to whether the allocation of resources is consistent with Faculty Senate actions and UF’s long term and short term strategic plans.

Budget Council deliberations summarized in this report have been guided by review of documents outlining the background and implementation of Responsibility Center Management at UF (commencing this academic year), interviews with nine unit/Responsibility and Support Center deans and administrators, input gained from UF faculty through a joint meeting with the Senate Council on Research and Scholarship and Budget Council and web submissions to the UF Senate Blog, and discussions with the Provost, the Chief Financial Officer, and the Vice President for Business Affairs.

The report is organized to (I) provide brief historical background of RCM, (II) review RCM underlying principles, (III) outline opportunities RCM may afford to the University of Florida, (IV) a summary of RCM’s beneficial impacts, (V) the identification of adverse consequences during the first year of RCM implementation, (VI) specific problem areas and solutions suggested by the RCM committee, and concludes with Budget Council recommendations of further steps regarding RCM implementation at the University of Florida. As the report will show, it is the conclusion of the Budget Council that RCM is a useful budgeting tool that carries with it a high degree of transparency, and should provide an overall benefit to Administrators and Faculty working collaboratively to efficiently allocate resources within the University of Florida. Yet the RCM budgeting model carries with it unintended consequences and deleterious impacts which need to be addressed as the University community becomes more experienced operating within RCM budget principles.

I. Historical Notes:

The original concept of Resource Center management (a synonymous term for Responsibility Center Management, RCM) was developed in 1987 at the Indiana University (consisting of nine campuses, 15,000 faculty and staff and 89,000 students) and by Edward L. Whalen who was charged with three tasks: (1) to identify coherent budgetary units; (2) to develop a formalism that would distribute resources which would be fair and equitable; and finally (3) to persuade members of the academic and administrative community that the system was viable and thus engage them in its implementation. (Edward L. Whalen, *Responsibility Center Budgeting: An Approach to Decentralized management for Institutions of Higher Education*, Indian University Press (1991), reviewed in G, Williams, *Higher Education* **26** , 351 (1993)).

At the University of Florida, President Machen convened the Responsibility Center Management Committee on July 21, 2008 and charged it to review the merits of revenue based budget models and to develop a RCM budgetary model for the University of Florida. The RCM model was first implemented at UF in Fiscal Year 2011.

II. Responsibility Center Management (RCM) Principles:

RCM or Revenue Responsibility Budgeting provides a budgetary philosophy that attempts to couple fiscal decisions with their consequences by decentralizing the budgeting process to colleges and other academic units (**Responsibility Centers**). RCM guiding principles provide college/unit-level ownership for revenues (from General revenue and tuition allocations, gifts and endowments, research and service income, and indirect cost recoveries from externally funded activities) and links them to financial responsibility for the college/unit activities that support the university mission (teaching, research, facilities, and administration). Included within the college/unit financial responsibilities are taxes for (1) shared, central units or **Support Centers** (e.g., library, IT, general counsel, business affairs and human resources) and (2) funding for subventionary support (**'Strategic Pot'**) under the direction of the President/Provost.

Examples of subventionary expenditures include: (1) incentives to reward the development and implementation of innovative academic programs to support the university mission, (2) provide compensation adjustments to colleges/units of equal quality with disparities in cost and (3) provide start-up funding for innovative, new academic programs. Under RCM, it is essential that college/unit administrators consider both the direct expenditures, such as salaries and materials, and the indirect costs/expenditures, such as facility and administrative costs, in support of academic activities. The provision of clear rewards and sanctions are essential in the linking of financial responsibility to support of the academic mission. The allocation of resources and the continuing assessment of college/unit productivity must be open and involve faculty, staff, students and administration and be transparent.

III. Potential RCM Opportunities:

The major opportunities afforded by RCM provide for predictable unit level budgeting and planning. The RCM approach provides a decentralized budget model that seeks to couple authority with responsibility. Most specifically, RCM is grounded in the understanding that colleges and other revenue-generating **Responsibility Centers** are granted revenue from General Revenue and Education Enhancement (Lottery) Funds, tuition, indirect cost associated with extramural funding, and revenues in exchange for the financial responsibility for supporting their academic mission. Thus, the following three RCM opportunities merit special mention:

- (1) Predictable budgeting can assist in UF-wide and unit-level strategic planning: RCM provides a foundation for revenue center budgeting in which activities are linked to revenue streams. Units can develop strategic plans that will support their mission and link current, proposed and planned activities to General Revenue and tuition money as well as entrepreneurial funding sources. In the absence of capricious State funding environments as we are currently experiencing, projections in general revenue and tuition should provide stable revenue estimates.
- (2) RCM offers unique financial incentives: Units can engage their internal stakeholders (faculty, staff and students) and external stakeholders (alumni, donors, 'consumers of unit services' as appropriate (continuing education, consulting, program funding sources from the public and private sectors)) in discussions regarding strategies for program development and strategies to secure funding from both the UF 'Strategic Pot' and non-UF or State revenue sources to support those programs and activities.
- (3) RCM fosters an environment of transparency and openness in budgeting and programmatic decision-making. RCM should encourage unit heads (deans) to engage faculty, students and staff in unit level strategic planning and programmatic decision-making.

IV. Beneficial Impacts of RCM to date

Transparency

The Budget Council concludes that the UF central administration has developed a very detailed accounting of the costs required to operate the central administration units. The costs reflected in the RCM model provide a high degree of transparency, and the accounting data have been posted electronically so that they are available to all. The identification of the operating costs of the central administration units is a major step forward for UF, and it provides a rational basis on which to judge whether a unit is providing the expected caliber of service relative to its cost. The significant benefits of the cost data are that they provide an accountability measure for the unit administrators, and that they provide a tool for administrators to make better informed resource allocation decisions.

Since December, 2010 the Budget Office Staff has been working to upgrade the budgeting computational platform with a commercial system, Hyperion. The Hyperion budget planning system is widely used in higher education, and is expected to facilitate rapid modeling of transient budget scenarios. It will utilize the same RCM data currently employed in the spreadsheet system it will replace.

The Budget Council has concern that various colleges do not manage budgets with the same level of sophistication and detail as the central administration, and therefore, budgeting at the college level tends to lack transparency. In order for RCM to realize its potential as a tool to enable efficient allocation of resources, the same degree of transparency in the operating costs available with the central administration units also needs to be available with the college units. The Budget Council recognizes that various college administrations are stretched very thin with existing resources. As such, the CFO has offered that the UF Budget Office Staff is willing to assist college units to develop a cost accounting model. The Budget Council believes the implementation of transparent cost accounting should be a priority for college units, and should be monitored by the Provost.

New Sources of Revenue

The Budget Council is aware that UF is an underfunded institution, and since 2008 the Budget Council has been encouraging the central administration to be creative in developing new revenue streams. The RCM budgeting model is designed to incentivize entrepreneurial activities within the college units to develop new revenue streams. A major opportunity for new revenue streams is the delivery of distance education. In recent years, distance education has quadrupled at UF. The Budget Council recommends that college units track the net revenue generated via entrepreneurial activities and periodically assess the success or failures of such programs.

Local Budgeting Decisions

Within the UF community it is generally believed that college units best understand the vast and complex needs of faculty, staff, and students, and when properly incentivized, the most informed budgeting decisions are made locally. The RCM model gives college administrators complete authority to allocate its budgets as deemed appropriate. As already mentioned, such budgeting decisions should be made with accurate knowledge of direct and indirect costs in support of the college academic mission. The Budget Council believes that faculty morale and enthusiasm is enabled when given an opportunity to participate in setting college budgeting priorities. College faculty should expect budgeting transparency and an opportunity to provide feedback in setting priorities for budgeting decisions.

Opportunity for Predictable Budgets

In order for college units to engage in long range planning and be comfortable to take risk and engage in entrepreneurial activities, it is necessary that budget outcomes are predictable. In principle, RCM budgeting provides an opportunity for predictable budget outcomes. However, to date RCM budget predictability has not been realized. The Budget Council has found that the budget predictions based on the RCM model have deviated significantly over the past two years. There are two underlying causes for the variations. One cause is that RCM was rolled out in an environment where State resource allocations are on the decline. UF budget shortfalls have been distributed to college units. This has created significant challenges for the college units which have had to respond to short notice budget cuts. Another cause for the variations in predicted RCM budgets is that the weighting factors used to compute resource distributions have undergone significant tuning.

It is expected in the long run the State of Florida economy will improve and changes to RCM weighting factors will be significantly less frequent, which should stabilize RCM budget outcomes. However, should significant gyrations in RCM budget allocations continue, it could pose significant risk to the viability of RCM budgeting at UF.

V. Deleterious Impacts and Unintended Consequences of RCM to date

Fluctuating RCM Budget Outcomes

Fluctuations in the RCM budget outcomes has required college administrators to make last minute budget adjustments and has hindered long range planning. Reactionary decisions to unexpected budget outcomes do not typically result in efficient resource allocations. It is important that the RCM model stabilize as problems are worked out moving forward.

Interdisciplinary Academic Programs are at Risk

When two or more colleges jointly offer an interdisciplinary academic program, the current UF RCM model only allocates the student credit hours (SCHs) earned to a single college unit. For the colleges that do not earn SCHs from joint programs, the incentive is to drop joint programs. In addition, interdisciplinary programs do not typically generate large numbers of SCHs, and since RCM is a SCH based allocation model, additional incentive exists to drop such programs. Such incentives put interdisciplinary programs at significant risk.

Same Course in Different Colleges Valued Differently

The RCM model uses different weighting factors for each college unit to assign value to SCHs. Therefore, the same course taught in different colleges is valued differently under the RCM model.

Disincentives for Un-sponsored Research

Since research is not incentivized in the RCM model, the only incentive for research is the IDC return earned on sponsored research. Therefore, there are no incentives for un-sponsored research, and thus it is expected that un-sponsored research will not be encouraged.

Quality Scholarship is not Addressed in the RCM Model

The RCM model has no measures for quality scholarship to reward academic programs that perform at an elite level. The financial incentive is for courses to grow enrollment without consideration to the quality of the scholarship offered by the course instructor. The only

mechanism to address quality of scholarship using RCM is the Strategic Fund. Each year the Strategic Fund will receive an allocation from the RCM model, and the strategic fund may be used to reward academic programs that perform at an elite level.

While the Budget Council supports the use of the Strategic Fund to reward quality scholarship, it cautions that the University of Florida has not demonstrated that it has developed a reliable means to measure the quality of its academic programs. Typically, UF administrators rely on quantitative metrics to measure quality, as evidenced by tenure and promotion proceedings and merit pay. While some quantitative metrics are useful indicators, the sole use of quantitative metrics cannot provide a reliable measure of quality scholarship.

Public Service Not Recognized in RCM Model

College units that engage in significant public service activities typically carry a higher overhead cost as a result. Such public services are not recognized or encouraged by the RCM model.

Charges for Facilities and Space do not reflect Quality of Space

In the RCM model, all space occupied by college units is charged at the same rate, regardless of the quality of the space.

Extra Workload on College Administrative Staff

Over the past several years college units have absorbed significant budget cuts, and many units have reduced the administrative staff to a minimum. However, the management of RCM data has created a significant additional workload for the staff.

RCM is a Zero-Sum Enterprise

When the student enrollment is fixed, then the gain of SCHs in one college is the loss from another college. At the University of Florida, on-campus undergraduate enrollment is capped. There is concern that collegiality among colleges could become compromised, especially if a college unit budget shrinks to the point where layoffs are required to balance the budget. The clear incentive is to grow graduate enrollment and distance education.

VI. Specific RCM Problem Areas and Solutions Provided by RCM Committee

The following eight topics were identified as potential present problem areas by the RCM committee and the following solutions are currently envisioned, as per communications from the Chief Financial Officer provided during Budget Council meetings. It is important to note that these problem areas are time-sensitive and suggested solutions are still subject to change.

(1) Tax on Endowment Earnings and Gifts

UF will not tax expenditures from endowment earnings and gifts. It is believed that levying a tax on these revenue streams will have a negative impact on the fundraising success. Others revenue streams will have an increased tax to compensate for the difference.

(2) Pass Through Expenses

Pass through expenses are expenditures of \$50,000 or more that are covered with fewer than three checks for a single event (i.e. paying a hotel for accommodations associated with conference). Pass through expenses will not be taxed.

(3) Direct Support Organizations

Direct support organizations will be taxed.

(4) Research

Sponsored research expenditures will continue to be taxed at the research assessment rate which is currently 8.5%.

(5) Look Back Period

The look back period is how far we look back at SCHs and historic expenditures to revenue and support costs. A longer look back period reduces volatility in budgets, but a look back period that is too long results in an unresponsive system. It has been agreed that the look back period will remain at 18 months.

(6) Predictability of Revenues

In order to provide colleges with revenue to encourage development of new programs, 25 percent of funds received from tuition increases will be distributed back to colleges using the RCM model. Such a distribution is subject to stability in State of Florida appropriations to UF.

(7) Interdisciplinary Academic Programs

The resolution to the disincentive for offering interdisciplinary programs is on the RCM Committee agenda for FY12.

(8) Facilities Utilization

Charges for utilization of University of Florida space will remain the same. There is an effort by the central administration to create a brokerage system to incentivize college units to trade space on a long or short term basis. Another program is being developed to take large partitions of space and mothball it until needed at a future date.

Budget Council Recommendations:

Based on the finding of this report, the University of Florida Faculty Senate Budget Council concludes that RCM is a useful budgeting tool that carries with it a high degree of transparency, and should provide an overall benefit to Administrators and Faculty working collaboratively to efficiently allocate resources within the University of Florida. Yet the RCM budgeting model carries with it unintended consequences and adverse impacts that need to be monitored and minimized. Furthermore, the implementation of RCM at the University of Florida took place during a time of severe economic down-swing, which highlighted the importance of considering general economic contexts on RCM budgeting.

The Budget Council therefore makes these recommendations towards continued oversight of RCM in the context of Shared Governance:

- The Budget Council recommends that an annual RCM report be presented to the faculty senate by the Provost, and that the Provost provide annual updates on RCM budgeting and its impact on the support of the academic missions, including the investment of 'Strategic Pot' funds to facilitate interdisciplinary programs and the support of innovative and high quality programs.
- The Budget Council recommends that the RCM Committee continue to address remaining issues concerning the support of interdisciplinary teaching and research programs, including but not limited to resolving the funding of student credit hour allocations involving two or more colleges, and issues related to programs with low student credit hours (SCHs) that are considered critical to unit mission but at risk because of the RCM SCH-based allocation formula.
- The Budget Council strongly recommends that the predictability of the distribution of RCM funds be resolved so that colleges/units know their budget allocations prior to

distribution. This includes the need for predictable weighting factors and anticipated revenue.

- The Budget Council recommends that the RCM budgeting process be transparent at both the university and college/unit level.

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