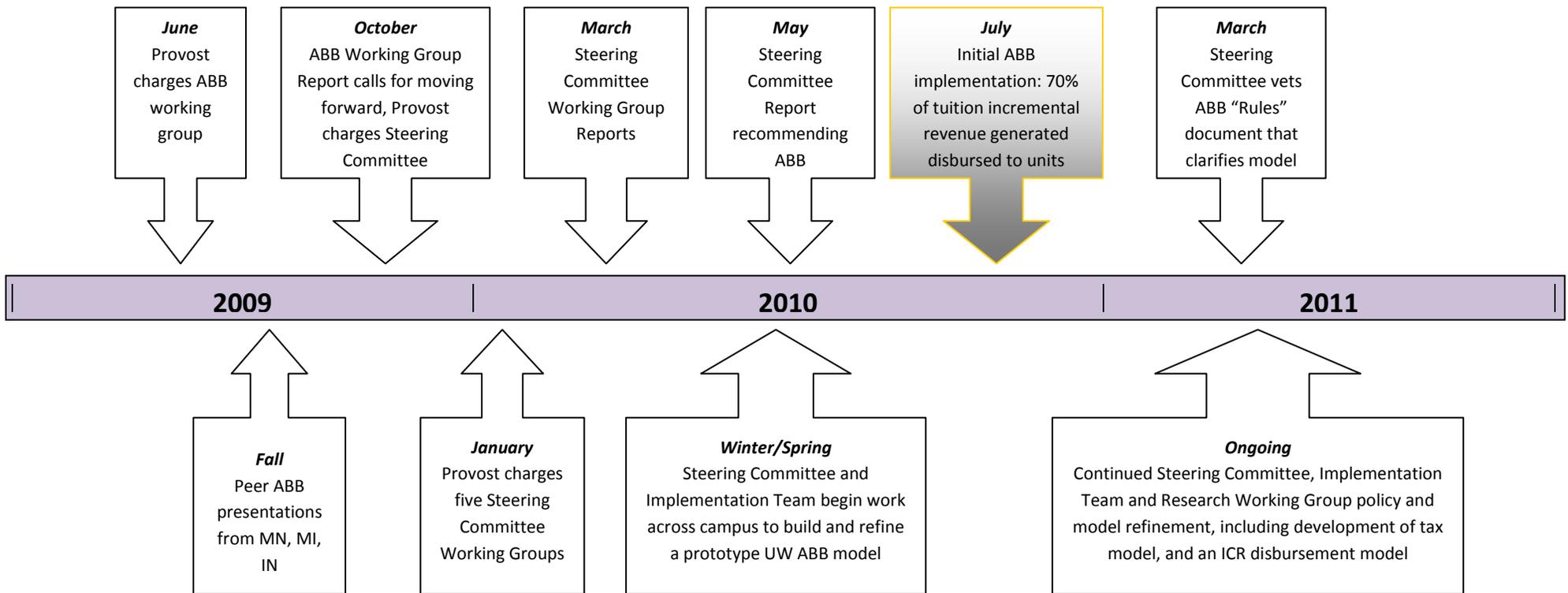


In October 2008, a [presentation](#) was made to the UW Board of Deans and Chancellors outlining preliminary thoughts on transforming UW resource allocation processes. The presentation focused on weaknesses of the incremental budgeting model employed by the UW, particularly given a rapidly changing funding environment, and emphasized the need to be more strategic in resource allocation, which in turn would be expected to increase transparency, accountability, fungibility and efficiency. In June 2009, the UW Provost appointed a Working Group to investigate the possibility of implementing an Activity Based Budgeting model at the UW, and the process continued from there, culminating in a ‘soft launch’ of an ABB model in July 2010, and continuing with policy and model refinement today. Below find a timeline and summary of these efforts.

Approaching Activity Based Budgeting (ABB) at the University of Washington: Timeline



Approaching ABB at the UW Phase 1: What is ABB and How Might it Benefit the UW

Incremental Budgeting vs Activity Based Budgeting

The University of Washington has long operated with an incremental budgeting model that bases budget proposals and allocations on the budget from the previous year. Over time, consensus has developed around the identification of several key weaknesses with this type of budget model:

- Does not align revenue generation with the activities associated with the revenue.
- The full cost of programs—whether instructional, research or service oriented—is unknown, limiting the ability to make informed decisions that fully take into account efficacy, value and cost of a given program.
- Is not sufficiently transparent to external stakeholders (including taxpayers, tuition payers and the legislature), which limits the ability to account for the use of current funds or make compelling cases for new investment.
- Does not have the flexibility required for effective reallocation of resources in response to workload shifts or changes in strategic priorities, which creates a disincentive for innovation that would require new funding.

Given these weaknesses and the current uncertainty about changing resources, the Provost appointed nine academic and administrative leaders to an initial [ABB Working Group](#) charged with exploring the possibility of implementing an Activity Based Budgeting (ABB) model at the UW. In its most basic definition, ABB is a method of budgeting in which the revenues generated from instructional and research activities are allocated directly to the unit responsible for the activity. ABB ‘empowers’ greater local planning and accountability and creates incentives for units to more efficiently manage resources and expenditures. Further, direct control of resources generated from activities creates incentives to set priorities and develop new activities consistent with the overall mission and strategic goals of the institution.

This budget model has been successfully implemented at several major public research universities including Michigan, Minnesota, and Indiana. While there are local variations in each of the respective budget models, it is generally accepted that an ABB approach is more transparent and stable than a traditional incremental budget model. Note that activity based budgeting is not the strategic plan of the University nor does it determine the University’s mission. Rather, activity based budgeting is a process whereby institutional leadership can implement policies that serve the best interests of the University. In this context, ABB should not be confused with other short-, mid-, or long-term strategic planning efforts in which the University or individual Schools or Colleges are engaged.

Peer Institutions with ABB Models Share Experience with UW

As part of its investigation into ABB, the UW Working Group consulted heavily with peer institutions that had adopted ABB models. In recent years, several universities transitioned to an ABB, also referred to as a responsibility center budget (RCB), model. Below is a *partial* list of leading public and private institutions that have implemented ABB or RCB.

Public: Alaska-Fairbanks (partial/hybrid), Illinois, Indiana, Iowa State, Kent State, Michigan, Minnesota, Missouri-Kansas City, New Hampshire, Ohio State.

Private: Chicago (partial/hybrid), Columbia, Cornell (partial/hybrid), Harvard, Johns Hopkins, Northwestern (partial/hybrid), Pennsylvania, University of Southern California, Vanderbilt, Washington University.

In addition to reviewing ABB/RCB process and model documents from these schools, the UW invited representatives from several peer institutions to come to the UW to discuss their adoption and implementation of ABB:

- [University of Michigan](#) (Phil Hanlon, Faculty member and Vice Provost for Academic and Budgetary Affairs, September 2009).

- [Indiana University](#) (Neil Theobald, Faculty member and Vice President and CFO, October 2009).
- [University of Minnesota](#) (Julie Tonneson, Budget Director, November 2009).

Extensive consultation with other institutions that had adopted an ABB model was integral to the Working Group's effort to assess the potential benefit ABB might bring, as well as providing an opportunity to learn from the trial and error that had occurred at other institutions. Discussions with these peers helped to cement the Working Groups' ultimate recommendation that the UW move forward in considering ABB.

Working Group Report Officially Recommends That UW Continue Exploring a Move to ABB

In October, 2009, the Working Group completed an [initial report](#) that recommended that ABB implementation at the UW be explored further via a Provost appointed Steering Committee that would also include five subcommittees focused on: Academic Impact, Research and Indirect Cost Recovery, Administration, Tax Model, and Data and Definitions. The group also recommended that:

- ABB be explored only for UW Seattle because UW Bothell and UW Tacoma already have a model by which they receive their tuition.
- ABB be considered only for academic units, academic support units, and administrative support units, not auxiliary and self supporting units such as UW Medical Center, Intercollegiate Athletics, Housing, and other units that manage their budgets as standalone, self-sustaining entities.
- ABB should seek to distribute tuition revenue and research indirect cost recovery revenue to the units that generate the revenue, and that an annual tax should be charged to schools and colleges to fund central costs and key university initiatives.
- Any change to the budget model of the UW should be revenue-neutral for all affected units at the time of initial implementation.

The Working Group also developed a list of principles that would help guide the process of assessing, determining, designing and implementing an ABB model at the UW:

A new budget model ideally would:

1. Support, not determine, university missions and goals—including quality aspirations.
2. Incent positive behaviors, innovation and operational efficiencies that facilitate improvement in any of the standard performance metrics.
3. Be transparent.
4. Be as simple as possible to understand, administer and implement.
5. Enable the administration to effectively lead the institution and reallocate resources when necessary.
6. Use common data, definitions and information that are clear and standardized campus wide.
7. Allocate revenues to the centers that incur costs, and thus must have some way of explicitly accommodating the differential costs of instruction by school/college.
8. Include all central revenues (GOF/DOF, indirect costs from research grants, central scholarship/fellowship funds, etc.), not some subset of these funds.
9. Clearly identify cross subsidization.
10. Support “common good” services, programs and operations across the entire institution.
11. Facilitate planning (based on comprehensive systemic assessment), require acknowledgement of near-term and long-term mission objectives. It should contain accountability for performance relative to funding decisions (enrollment, retention, outcomes, etc.).
12. Be fundamentally forward looking in incentives, coupled with periodic rebalancing of investments.
13. Encourage how to redirect investments even under financially distressed circumstances.

14. Recognize the importance of maintaining current funding levels or phasing-in funding reductions for colleges and schools in the short-term as the ABB model is implemented to minimize the impact on existing programs, including incumbent students, faculty and overall program quality.

As a result of the Working Group report, the Provost appointed a larger Steering Committee on Activity Based Budgeting with decanal, faculty senate, and senior administration representation.

Steering Committee and Subcommittees Recommend ABB Implementation and Lay Groundwork for UW Model

In October 2009, the Provost charged the [Steering Committee on ABB](#) to:

- Create five subcommittees to examine specific aspects of ABB implementation at the UW.
 - Academic Impact
 - Research and Indirect Cost Recovery
 - Administration and common good elements
 - Structure and delivery of a tax model
 - Definitions and data points
- Develop an implementation plan and schedule that would enable a move to an ABB model as of July 1, 2010.
- Provide a final recommendation to the Provost and President on the viability and prudence of implementing ABB at the UW.

The Steering Committee met regularly over seven months and published a [final report](#) in May 2010. The report highlighted five conclusions and next steps:

1. The five sub-committees comprised a broad group of over 75 faculty members, administrators, and students from units across the University. The [recommendations of the sub-committees](#), in conjunction with the primary recommendations of the Steering Committee, represent the policy approach on how an ABB model should be implemented on the Seattle campus.
2. The Steering Committee developed an implementation plan and schedule for ABB that included a “soft launch” on July 1, 2010. The soft launch would focus on applying ABB to the allocation of incremental tuition revenue, less a hold-back of 30% (consistent with current GOF and DOF fund distribution) to be held centrally to fund activities that would otherwise be funded by a tax.
3. The Steering Committee recommended that the University continue working towards the implementation of ABB, but that it should not be fully implemented until FY2012. (In Fall 2010, given the economic crisis, it was decided that the “soft launch” would continue through FY2012 and full launch implemented for FY2013.) Further, they recommended that the role of the Steering Committee continue through FY2011 in order to further examine and refine the recommendations in the report. The Committee should continue to review and develop recommendations regarding the identified secondary issues and other issues yet to arise. They anticipated that they would provide subsequent updates with a final detailed action and implementation report in the middle part of fiscal year 2011.
4. In order to facilitate the soft launch, the Office of Planning and Budgeting formed an Implementation Team comprised of a small cross-section of administrators and staff who are validating data, refining definitions, and testing methodologies. Additionally, they were to develop an implementation work program for the remainder of the year for full launch on July 1, 2011. The team would continue to receive guidance regarding policy from the Steering Committee.

5. They recommended that the sub-committees reconvene in the fall to review the newly launched ABB model and address any issues that may have arisen.

The Steering Committee also identified a set of values that should guide an ABB model at the UW:

- Activity based budgeting (ABB) is a general term that describes a highly varied type of institutional budget model that more directly aligns the allocation of revenues and the attribution of expenditures for academic and administrative units. The President, Provost, Vice Presidents, Vice Provosts, Deans, and Chancellors manage the fiscal and academic mission of the university based on strategic plans that reflect the organizational, research, and scholarly ambitions of their areas.
- ABB is not the strategic plan of the university, nor does it determine its mission. Rather, it is the process whereby institutional leadership can implement policies that serve the best interests of the university.
- The maintenance of quality is crucial in all pursuits of the university. However, the definition of quality cannot be constructed as part of a budget model and needs to be considered within the strategic plans of the university and individual units. We must ensure that, as with any budget model, the recommended approach does not have a negative impact on the quality of our collective mission.
- We recommend a transparent approach to the UW budget model that is clear and easy to understand and follows the basic tenet that revenues generated by the activities of a unit are directly returned to that unit.
- An important concept related to the rolling out any new model such as ABB is that the initial budget of each unit is revenue neutral. That is, the budget model initially assigns funds based on historic or legacy funding levels and only new, incremental revenue increases are assigned based on activity.
- ABB should be focused on the budget relationship between the Provost and the Deans, the Vice Presidents and Vice Provosts.
- There should be no requirement for applying ABB to the department level.

The Steering Committee recommended that it continue working with the newly formed Implementation Team of technical experts from across the university to build a detailed ABB budget model consistent with the Steering Committee recommendations, as well as plan for a partial launch of ABB on July 1, 2010 and a full launch on July 1, 2011 (note that as discussed in the preceding page, the full launch date has been moved to July 1, 2012).

Approaching ABB at the UW Phase 2: Implementation Planning, Soft Launch, and Policy Refinement

Steering Committee and Implementation Team Build Prototype UW ABB Model and Achieve “Soft Launch”

The Steering Committee and Implementation Team worked with others across campus to prepare for a partial or ‘soft launch’ of ABB at the UW that would allocate incremental tuition revenue to schools and units at UW Seattle. They determined that there would be six steps required to calculate how tuition revenue would be distributed to units:

1. Classification of prior year students into groups using the new tuition categories,
2. Projection of revenue/incremental revenue,
3. Calculation for each tuition group of the percentage of SCH generated by each college,
4. Calculation for each tuition group of the percentage of enrolled majors from each college,
5. Calculation for each tuition group of the percentage of degree majors from each college, and
6. On the basis of steps 1 – 5, calculation of the amount of revenue to be distributed to each college.

Incremental tuition revenue for 2010-11 (excluding summer quarter) would be distributed directly to units and colleges (minus a 30% ‘holdback’ to fund the central administration and other university priorities), based on the following parameters:

Allocate on the basis of:	Undergrad	Grad/Prof
SCH	80%	20%
Degree Majors	20%	0%
Major Enrollments	0%	80%

The model itself, including detailed documentation, explanatory documents, a Frequently Asked Questions (FAQ) document, and overview presentations were all posted to a [UW ABB website](#).

For 2011-12, incremental tuition will be similarly distributed directly to units (less a 30 percent holdback), with the following parameters:

Allocate on the basis of:	Undergrad	Grad/Prof
SCH	60%	20%
Degree Majors	40%	0%
Major Enrollments	0%	80%

Approaching ABB at the UW Phase 3: Refinement, ICR, Taxation, and a Full Launch

UW ABB Rules Summary

The following are the principles and rules that have been developed for the full launch of the UW ABB model, which will become effective July 1, 2012. These rules will be vetted by the full Steering Committee in March 2011.

Overall principles

- School, college, and central administrative unit budgets will remain the same when ABB is rolled out, net of institutional budget cuts—ABB is not a tool to redistribute funding between units.
- The tax rates have been set so that the split of operating fees and ICR between units and the center will be similar to the current distribution of those sources of funds.
- The timing for calculating revenues and taxes has been determined by several objectives:
 - Provide enough time for units to plan
 - Base decisions on actual results that are as up to date as possible
 - Remain consistent with the Regents budget
- Where ABB budgets depend in essence on projections, adjustments to future budgets will occur at the point in the year when results are available.

Specific rules

1. Operating Fees
 - a. Amount to be distributed—Regents proposed budget, net of return to aid and waivers, divided by tuition category.
 - b. Basis for distribution—UG based 40% on degrees awarded in previous year, 60% on SCH taught during the previous academic year. Graduate based 80% on enrollment in the program during the previous academic year and 20% on SCH. After the year is finished, the difference between budgeted and actual

tuition will be calculated and the unit's budget for next fiscal year will be adjusted up or down to reflect the difference.

2. ICR

- a. aICR—100% returned to the unit that generates it.
- b. fICR—most held centrally. A portion will be returned to units (currently this amount is set at 10% with a long-term goal of reaching 100%).

3. Other revenues

- a. Summer quarter will eventually be returned to the units that teach based on SCH taught.
- b. Over time, other revenues that can be attributed to particular units but that are centrally retained will also be distributed out to the generating units

4. Costs

- a. Most costs will continue to reside in units where they are currently budgeted.
- b. The cost of faculty promotion salary increases will be covered by the units, subject to institutional policies.
- c. Merit salary increases will be determined centrally, based on the availability of new revenues or state allocated funds provided for that purpose.
- d. To maximize the degree to which ABB aligns responsibility for costs with their related activities, additional costs currently covered by the center will be transferred to units where there is a clear case that they are best managed locally and that they reflect the impact of activity at the unit level.

5. Centrally allocated funds

- a. Provost will allocate her funds from all sources (particularly State appropriation and ABB taxes) to units following several principles:
 - i. Maintain or incrementally adjust current patterns of cross subsidization
 - ii. Support institutional objectives
 - iii. Honor specific State appropriation instructions such as provisos
 - iv. Current agreements to apply ICRs to specific costs will be incorporated into the total allocation from the Provost

6. Taxes

- a. Operating Fees
 - i. Will be taxed at a rate of 30% of the budgeted operating fee revenue.
- b. ICR (Indirect Cost Recovery)
 - i. aICR (the administrative portion of the Facilities and Administration cost reimbursement formula) will be taxed at a rate of 30%. The amount of the tax will be calculated based on actual aICR earned during the most recently completed fiscal year.
 - ii. The portion of fICR (the facilities portion of the F&A cost reimbursement rate) returned to units will not be taxed for the first 5 years of ABB—the portion of fICR retained by the center will be considered equivalent to a tax.
- c. Direct research
 - i. Realized Direct Research funding (based on MTDC—Modified Total Direct Cost) will be taxed at a rate set so that the combination of the portion of fICR retained by the center, the tax on aICR, and the tax on Direct Research funding will be equal to the percent of ICR retained by the center under the current RCR (Research Cost Recovery, UW's current internal system of allocating ICR funds from research) program. Currently this translates into a tax rate 4.37% on Direct Research.

The amount of the tax will be calculated based on actual realized research funding (MTDC) earned during the most recently completed fiscal year. Note that realized Direct Research funding is defined as being equal to MTDC expenditures on the grant for a given year.

- d. Summer quarter and self-supporting programs
 - i. Self-supporting programs (both those administered by UWEO (University of Washington Educational Outreach) and those that are operated out of the units themselves) and Summer Quarter income will be taxed at a rate of 30%.
 - ii. The amount of the tax will be calculated based on actual revenue earned from these programs during the most recently completed fiscal year, which will be the fiscal year two years prior to the budgeted academic year (e.g., revenue from FY 12 will form the tax base for FY 14).
 - iii. UWEO will bill the center for its costs associated with administering each program, which will be paid out of the tax funding the center receives from these programs.
- e. Gifts and endowment payout
 - i. A tax rate on gifts and endowments will be set based on four primary considerations. First, support for Advancement will not be disrupted (there are several current practices that direct some funding from gifts and endowment payouts to support University advancement efforts). Second, since activity funded by Gifts and Endowments generate support requirements in other units, these funds will be included in the tax system in some way. Third, the taxes will not create incentives to classify income within a particular fund. Fourth, the taxes will be structured and explained in such a way as to minimize donor concerns.

Next Steps

The Steering Committee, Implementation Team and others across the university continue to work on refining UW ABB policies and rules, as well as working toward a full launch, including building out and testing a taxation model. Specifically, decisions still to be made throughout the spring and summer include, but are not limited to the following list:

- Whether to decentralize TA/RA waivers and/or restructure graduate tuition tiers.
- Detailed procedures to allocate summer quarter tuition and costs to the schools.
- Accounting for Educational Outreach charges for fee-based programs, and clarifying appropriate use of this mechanism for offering programs.
- How to appropriately consider tax basis on fee based programs offered directly by the school or college.
- Whether to apply taxes to all revenue types.
- Policies and processes to incorporate enrollment projections and new programs into ABB revenue budgets.
- How to deal with gift and other funds planned for capital expenditures, scholarships, and loans.
- How to deal with facilities in the long term, including full return of fICR to schools/colleges.

Additionally, the Steering Committee will continue to hold meetings with groups across campus to solicit feedback as well as communicate ABB policies and progress.