

May 27, 2010

Phyllis M. Wise
Provost and Executive Vice President

RE: Activity Based Budgeting Report

Provost Wise:

In response to your charge letter dated October 21, 2009, the Steering Committee on Activity Based Budgeting (ABB) has met regularly over the past seven months to assess the viability and plan for how an ABB model might be implemented at the University of Washington. The attached report is the result of that effort. Further, while the Steering Committee makes several recommendations in support of moving forward with the phased in implementation of ABB, it recognizes that significant work remains before ABB can be fully implemented in FY 2012. In that context, this report should be also considered as an update on the progress to date.

As mentioned in our previous correspondence to you, we believe it is important to note one of the core values of the final ABB report: Activity Based Budgeting 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. Our report builds on this core, and we have developed a plan for moving the University to a new budget model that values transparency, accountability and flexibility in managing budgets without altering the strategic plans of the academy.

You directed the Steering Committee to engage in three tasks:

1. Appoint five sub-committees to consider issues related to: 1) academic impact, 2) research and indirect cost recovery, 3) administration and common good elements, 4) structure and delivery of a tax model, and 5) definitions and data points;
2. Synthesize the work of the sub-committees to develop an implementation plan that would enable a roll out of an ABB model to begin on July 1st, 2010; and
3. Provide a final recommendation to the Provost and President on the viability and prudence of implementing ABB at the University of Washington.

In response to your charge outlined in the three tasks above, the report begins with an overview of the underlying values that were agreed to by the Steering Committee, as well as recommendations on how the concepts of revenue, taxation, and expenses should be handled in an ABB model. While details of the model are included in the report, we would like to stress that the Steering Committee recommends the implementation of an ABB model be focused on

the budget relationship between the Provost and the Deans, the Vice Presidents, and Vice Provosts, as well as their respective units. The report also identifies several outstanding issues that will require further study and resolution prior to full implementation.

Finally, it should be noted that the draft report was shared widely throughout the University community and feedback was solicited among faculty, administration and students. Comments are included as an attachment to the report.

Highlights and next steps include the following:

1. The five sub-committees were convened and included broad representation from faculty, administration, and students from units throughout 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 has developed an implementation plan and schedule for ABB that includes a “soft launch” on July 1, 2010. The soft launch will 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 recommends that the University continue working towards the implementation of ABB, but that it should not be fully implemented until FY2012. Further, we recommend that the role of the Steering Committee continue through 2011 in order to further examine and refine the recommendations in this report. The Committee should continue to review and develop recommendations regarding the identified secondary issues and other issues yet to arise. We anticipate that we will 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 has recently 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 are developing an implementation work program for the remainder of the year for the full launch on July 1, 2011. The team will continue to receive guidance regarding policy from the Steering Committee.
5. We recommend that the sub-committees reconvene this fall to review the newly launched ABB model and address any issues that may have arisen.

The Steering Committee recognizes that significant work remains in order to understand how to incorporate auxiliary educational activities into the model, support graduate instructors, and calculate the actual tax rates, among other needed refinements. As a result, the Committee will continue to review and develop recommendations regarding the identified secondary issues. In this context, this is less of a final report, and more of an update on the progress to date.

Please contact us if you have any questions. Thank you.

Sincerely,

Doug Wadden
Executive Vice Provost for Academic Affairs

Paul Jenny
Vice Provost, Office of Planning & Budgeting

Cc: *Steering Committee on Activity Based Budgeting*

Ann Anderson, Associate Vice President and Controller, Office of Financial Management

Tom Baillie, Dean, School of Pharmacy

Bruce Balick, Professor, Department of Astronomy and Chair, Faculty Senate

Harry Bruce, Dean, The Information School

Ana Mari Cauce, Dean, College of Arts & Sciences

Paul Hopkins, Chair, Department of Chemistry

Jim Jiambalvo, Dean, Foster School of Business

Mary Fran Joseph, Chief Financial Officer, School of Medicine

Mary Lidstrom, Vice Provost for Research

Matt O'Donnell, Dean, College of Engineering

Gary Quarfoth, Associate Vice Provost, Office of Planning & Budgeting

Ed Taylor, Vice Provost and Dean, Undergraduate Academic Affairs

V'Ella Warren, Senior Vice President, Finance & Facilities



Activity Based Budgeting Steering Committee Report May 2010

Activity Based Budgeting Steering Committee Members:

Paul Jenny, Vice Provost, Office of Planning & Budgeting, *Co-chair*

Doug Wadden, Executive Vice Provost for Academic Affairs, *Co-chair*

Ann Anderson, Associate Vice President and Controller, Office of Financial Management

Tom Baillie, Dean, School of Pharmacy

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Executive Summary of Activity Based Budgeting Recommendations

Values

- 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.
- Activity based budgeting (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 (collectively referred to as VPs).
- There should be no requirement for applying ABB to the department level.

Basic design

- Revenue-generating Units (schools and colleges) and Non-revenue generating Units (central academic and administrative units, to be referred to as University Units) must be distinguished from one another. While a unit is considered one or the other based on the preponderance of activity, these labels should not be used to limit the distribution of resources. If a non-academic unit has revenue generating activities, it should experience the same allocation approach as an activity-generating unit.

Revenue

- Revenue distribution for tuition will be defined by the unit of instruction and the unit of enrollment. For the purposes of allocating tuition revenue, the group recommends basing instruction on the number of student credit hours (SCH) generated, defined by the course

of record. The group recommends basing the enrollment portion of revenue distribution on the number of degrees awarded annually.

- The proposed division for undergraduate tuition revenue allocation is 80% SCH taught and 20% degrees awarded.
- Distribution of graduate tuition should also be based on an 80/20 split, but with the allocation ratios reversed--80% of the revenue would be defined by enrollment and 20% based on SCH taught.
- Majors and all sub-sets of majors (such as pre-majors, dual majors, non-declared majors and changed majors) should not be a factor in revenue distribution.
- Undergraduate tuition revenue would be a “blended rate” within each tuition category that reflects the overall institutional mix of resident and non-resident populations and not the specific enrollment of any unit or program.
- Summer quarter would be brought into the ABB model as a normalized fourth quarter and included in the revenue distribution process. Associated expenses would be subject to the tax on expenditures.
- 100% of generated Indirect Cost Recovery (ICR) should revert back to the unit that generates the research funds.
- Any revenues generated by central university units should be returned wholly to them, as is proposed for activity-generating units.
- Continue to use recharge rates for variable and/or discretionary usage of service from University Units.

Taxation

- Taxes should be levied against appropriate expenditures of activity-generating units with the use of tax revenues directed to the funding of all central activities, from libraries to human resources, from grant support to facilities maintenance, undergraduate and graduate administrative offices, admissions, academic advising, campus police, and more.
- Additionally, the tax revenue will be used for centrally defined and supported cross-subsidization of units, programs that cannot realistically operate on tuition revenue alone, new academic and administrative initiatives, temporary funding for any number of projects or proposals as part of startup or bridge funding, and as a contingency for unanticipated cost increases. The tax is also expected to cover faculty start-ups, retentions, and research matching funds. The Provost should consider the tax stream as a source of funding to mitigate units disproportionately burdened by the tax assessment.
- The discussion of the use of tax revenues should be in conjunction with annual budget reviews between the Provost and Deans, Vice Provosts, and Vice Presidents.

- Tax will be applied to all expended funds of activity-generating units save those that are recommended to be exempted from the tax such as private philanthropy, clinical income, etc. In general, taxable expenditures would focus on General Operating Funds (GOF); Designated Operating Funds (DOF), including Indirect Cost Recovery; and other unit-generated funds.
- Tax will be levied on expenditures based on a two-year lag. Units will be provided the amount of assessed tax prior to the start of the fiscal year to allow sufficient planning at the unit level.
- Taxes should apply to any non-activity units that have expended funds derived from their revenue generating activities.
- Auxiliary units such as UW Medical Center, Intercollegiate Athletic, and so forth are considered self-supporting units and are not included in the discussion of ABB. However, we expect these units to continue to pay appropriate administrative and institutional overhead assessments.
- The Bothell and Tacoma campuses currently retain all of their generated income and are also excluded from the ABB discussion. As with auxiliary units, we expect them to continue to pay appropriate administrative and institutional overhead assessments.

Expenses

- Benefits should be reallocated to units as an associated cost of salaries.
- Current debt loads held centrally should remain so and should be included in the base calculation for the tax rates.
- Future debt obligations may be the obligation of the Dean, paid out of their revenue, or a central obligation paid from tax revenues, depending on the unique needs represented by a need for additional campus debt.

Implementation Plans

- A soft launch is proposed for July 1, 2010 (FY2011), with allocation of incremental tuition revenue less a hold-back of 30%. The majority of budgeted incremental tuition in FY11 will be allocated to activity generating units based on the coefficients used to allocate tuition recommended in this report. Because we will not develop a formal taxation model until FY2012, we further recommend that 30% of the incremental tuition (consistent with current GOF and DOF fund distribution) be held centrally to fund activities that would otherwise be funded by a tax.
- Migration of current budgets to ABB-developed budgets should be revenue neutral (units should not experience a negative impact to their permanent or temporary budget as a result of changing to an ABB model).

- The launch on July 1, 2011 (FY2012) will reflect two centralized tax rates (one on expenditures, one on direct research costs).
- An implementation team comprised of central budget and accounting staff and comparable school and college staff will be formed to develop implementation plans and processes to deliver on the recommended policies and actions developed by the Steering Committee. The role of the implementation team will be technical in nature. The Steering Committee will oversee the effort of the team and ensure that all recommendations are consistent with the policy direction developed by the Steering Committee.

Secondary Issues to Resolve

- The utilization and maintenance of campus space has not been fully addressed by the steering committee. Currently the ‘cost’ of maintaining space is assumed to be funded through the tax model, but we believe that overall space management is a major issue that will need to be addressed in a future phase of ABB.
- We will need to revisit the tax structure and migrate to a more robust cost attribution model with taxes based on a variety of factors, possibly including faculty/staff headcount and assignable square footage.
- Funding and support of TAs and RAs.
- Tuition setting authority at the school/college level.
- Differential tuition rates.
- Direct admission/enrollment of freshmen.
- Strong central curricular oversight is needed to monitor initial behavior of units and programs to avoid misuse of the credit-hour performance system.
- A conversation about how best to handle many of these University units that may exist within academic units should be held outside of the development of an ABB model. This is a conversation regarding strategic mission and not one that should be led by the budget model.
- Inclusion of gift and endowment funds in the taxed expenditure base of units.
- Taxation of research expenditures.

Continued Governance

- The Steering Committee and/or a similar oversight committee to be appointed by the Provost will be held responsible for annual reviews of ABB policy.
- Units receiving funds from the tax revenue collected by the Provost should provide accountability measures to ensure that the funds are being utilized consistently with the overall needs of the institution. All units, but especially those funded by tax revenue, should be required to demonstrate accountability and efficiencies with respect to their individual portfolios with performance indicators and benchmark activities.

Report Introduction

Over the last few years, The University of Washington (UW) has been assessing the potential value and feasibility of implementing an activity based budgeting (ABB) system. During this assessment period, the Vice Provost for Planning & Budgeting and others held discussions regarding ABB with the Board of Deans and Chancellors, the Senate Committee on Planning and Budgeting and at a variety of administrative forums. Provost Wise formalized the assessment period by creating a working group charged to examine the implications of ABB at the UW. The working group met during summer 2009 and submitted a report to the Provost that endorsed the development of an ABB model at the UW, which would be reviewed by the campus community and considered for implementation by Provost and President (Attachment 1). To achieve this, the Provost formed a steering committee that coordinated the efforts of five separate subcommittees. The subcommittees' policy recommendations are included in this report. It is the Steering Committee's recommendation that the UW Seattle campus adopt an ABB approach to resource allocation based on the policy direction contained in this report.

Activity Based Budgeting (ABB): A review

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 University of Washington already possesses several attributes of an ABB-like budget model in that our research activity determines the flow of research revenues back to the areas that generate these revenues. Additionally, faculty positions are held locally, not centrally, and are managed by each decanal unit with regard to vacancies, appointments, returns to operating budgets, and the temporary and permanent allocation of resources to departments and programs within schools, colleges and units. Likewise, the two branch campuses of the University (UW Tacoma and UW Bothell) currently receive their own activity based funding (tuition revenue), and pay a tax for centrally provided services.¹ Additionally, some units, including, among others, the UW Medical Center, Student Housing, Intercollegiate Athletics, and Parking are required to be self sufficient and manage their resources with no draw on the core education activities of the University. One could argue that they already are managed from an activity based perspective.

¹ We do not recommend that the Bothell and Tacoma campuses adopt an ABB model. As noted above, both campuses retain all of their locally generated resources. Regarding their budgetary process, they are considered independent of the Seattle campus, save an institutional assessment paid to the Seattle campus for core central services. (Note that this is only a budgetary focus and does not exclude the significant leadership that the President, Provost, Faculty Senate and other senior leaders play in the development of the strategic mission of UW Bothell and UW Tacoma.)

How might ABB work? The revenue allocated to units for their instructional activity might be distributed based on student credit hours, the numbers of majors, or the number of degrees awarded. A possible formula could award 80% of tuition based on undergraduate student credit hours and 20% on degrees awarded. At the graduate level, it might be the opposite, with 80% determined by enrollment and 20% based on credit hours taught.

An ABB budget model not only directs revenue back to where an activity, such as instruction or research, occurs, but also uses allocation or tax methods to provide funding for centrally based administrative services. One common method is to apply a tax on expenditures in the units that generate the institution's revenue, using known expenditure data from a prior period so that the tax can be "known" at the beginning of a fiscal year. The corresponding funds derived from this tax on activity can provide the funding for all centrally based administrative support services, from libraries to human resources, from grant support to facilities maintenance, undergraduate and graduate administrative offices, admissions, academic advising, campus police, and more. Additionally, the tax revenue can support centrally defined and supported cross-subsidization of units, programs that cannot realistically operate on tuition revenue alone, new academic and administrative initiatives, and temporary funding for any number of projects or proposals as part of startup or bridge funding.

It should be noted that, in the typical ABB model, the centrally managed budgetary process usually stops at the unit level (school, college or campus) and is not centrally directed down to the departmental or programmatic level. The focus of the ABB work to date has been on the operating budget, and we have not considered nor recommended applying ABB to the capital budget. We recommend that any consideration of the capital budget follow the implementation of ABB in the operating budget.

ABB type budget models have been a prominent feature for many years at several leading peer institutions such as the University of Michigan, the University of Minnesota, and Indiana University, where the mechanics of the budget process have undergone periodic changes and refinements as the systems that support them have evolved.

At some institutions the tax is a simple flat rate based on expenditures, while at others all the specific local costs associated with many, if not every phase of university operations, are attributed to the source of the expense. Building heat and lighting, or maintenance and support services, are individually assigned to users who can monitor use and control consumption. There can be different tax rates for general expenditures, direct costs on research and self-sustaining or auxiliary activities.

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. Changes occur gradually over time, reflecting shifts in enrollment, expenses, program development, or reductions and strategic initiatives. Most institutions have not "reset budgets to apply the funding formula to a new adjusted base, but rather acknowledged the existing costs and resources of each unit.

So why would the University of Washington consider changing to an ABB budget model at this particular, and perhaps difficult, time? To paraphrase the published goals of the Michigan budget managers, it is precisely because the model encourages units to establish priorities and develop new activities with a clear understanding of the costs and benefits associated with those plans. An ABB budget model can create incentives to make the most efficient use of resources. It can attribute costs and allocate revenues via simple and transparent rules. It can provide the Provost with sufficient discretionary funds to support cross-unit collaborations and invest in new strategic initiatives, while assuring that central administrative support units have sufficient resources to carry out the mission of the university. In short, and compared to our current incremental budget model, it brings a new level of planning insight and provides a greater measure of predictability to all phases of the management of the university.

Are there potential drawbacks to such a budget model? Again, the short answer is yes. If not properly implemented and managed, critics cite the potential for mission creep and duplication of effort, either instructionally or administratively, along with the possibility of “silos” that thwart cross-unit or cross-disciplinary research or enrollments.

This is a highly abbreviated description of a typical activity based budgeting model, and we recognize that many detailed elements remain to be described, such as the handling of waivers and teaching assistantships, gift funds, endowment payouts, and auxiliary activities. Also, other factors can further expand the impact of any new budget model, where some institutions have greater flexibility over tuition setting authority, differential and significantly higher tuition and the ability to manage direct admissions of freshmen to their prospective majors. These are not, however, universal characteristics and do not in and of themselves negate the advantages of migrating to an ABB budget model.

It is important to refer to previous reports such as those contained in the Provost’s Joint Policy Advisory Committee on Tuition, Access, Financial Aid, Enrollment, Retention, and Service Operations as well as the recommendations of the five current ABB subcommittees referenced in this report, in arriving at a fuller understanding of the issues and options before us.

In summary, the recommended focus of ABB should be solely on the central academic mission of the university as defined as the core education budget, restricted operating budget, and auxiliary educational activities. Within the central academic mission there are two types of groups: Activity Generating Units (schools and colleges), and Non-Activity Generating Units (central academic and administrative units). While a unit is considered one or the other based on the preponderance of activity, these labels should not be used to limit the distribution of resources. If a non-academic unit has revenue generating activities, it should experience the same allocation approach as an activity-generating unit.

Recommendations

When examining the implementation of ABB within the central academic mission of the Seattle campus, the steering committee established some primary recommended approaches. To begin, we recommend that the discussion of moving to ABB be focused on the budget relationship between the Provost and the Deans, the Vice Presidents and Vice Provosts (collectively referred to as VPs). These leaders manage their budgets, in each of their schools, colleges and central administrative units, based on their respective responsibilities, and it is expected that there will be variances in how these leaders allocate their budgets. There should be no direct requirement of allocating ABB down to the department level. That said, we recognize that there will be some expectation within units to have the Dean or VP provide some context when explaining the relationship between internal unit budget decisions and ABB.

Of primary importance is the recommendation that the migration of current budgets to ABB-developed budgets needs to be revenue neutral. This has often been characterized as being “held harmless.” However, we recognize that, irrespective of ABB, all units are facing reductions due to the state’s budget challenges, and no one is being “held harmless.” Rather, our argument of revenue neutrality is a simple philosophy, that at the initial implementation of an ABB model, a unit should not experience a negative impact to their permanent or temporary budget as a result of changing to an ABB model.

In addition to this primary recommendation is the notion of simplicity and clarity. We recommend a transparent approach to the UW budget model that is clear and easy to understand, a model that follows the basic tenet that revenues generated by the activities of a unit are directly returned to that unit. This already exists for several revenue/fund types supporting the central academic mission of the campus. Direct research revenues flow to the unit housing the research; gift and endowment income flow to the unit charged with fulfilling the philanthropic intent of the donor. As such, the primary, but not exclusive, focus of our recommendations has been on the central funds of the campus as defined as GOF and DOF (both local funds and RCR).

As mentioned in the introduction, the steering committee recommended to the Provost the creation of the following subcommittees to examine and make specific recommendations on ABB implementation for the following areas included in the central academic mission of the Seattle campus: (1) Academic Impact, (2) Research and Indirect Cost Recovery, (3) Central Academic and Administrative Units, and (4) Delivery of a Tax Model. A fifth subcommittee was established to review Definitions and Data Points necessary to implement the policies established by the four policy focused groups. (Attachments 2-6). These recommendations, 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.

Academic Impact

There are several facets of the ABB budget model that the Academic Impact subcommittee discussed and that have been debated by the ABB steering committee. They include graduate and undergraduate tuition, enrollment, revenue, graduate tuition waivers, summer quarter, and fee-based programs.

The subcommittee concluded that revenue distribution for undergraduate programs should be defined by the unit of enrollment (defined by the number of degrees awarded annually) and the unit of instruction. For the purposes of allocating undergraduate tuition revenue, the group recommends basing instruction on the number of student credit hours (SCH) generated, initially defined by the course of record. The proposed ratio for tuition revenue allocation is 80% SCH taught and 20% degrees awarded. The subcommittee also felt that the budget model implemented should be one in which resources remain available to the Provost in order to subsidize specific areas, either due to the quality of the program or its need. Regarding graduate tuition revenue, the subcommittee recommends an 80/20 split, where 80% of the revenue is defined by the school of enrollment and 20% is based on SCH taught. (Note that this is the reverse of the ratio used to allocate undergraduate tuition.)

The subcommittee also recommends that majors and all sub-sets of majors (such as pre-majors, dual majors, non-declared majors and changed majors) not be factors in revenue distribution. This decision is based on the principle of simplicity, of clear indicators of activity, and on the least possible “gaming” of the budget model relative to student registration and course or program participation.

Undergraduate tuition revenue would be a “blended rate” that reflects the overall institutional mix of resident and non-resident populations and not the specific enrollment of any unit or program.

The subcommittee discussed the unique nature of both summer quarter and fee-based programs. It recommends that summer quarter be brought into the ABB model as a normalized fourth quarter and included in the revenue distribution process and its associated expenses subject to the tax on expenditures. Fee-based programs located in UW Educational Outreach would continue as currently structured, with a tax applied to the net revenue after central and departmental direct expenses are accounted for. State funding for programs that move to fee-based status may be held centrally, rather than locally.

Because many academic units remain heavily invested in teaching and research assistants, the subcommittee spent time discussing tuition waivers. In general, the group feels that the cost of waivers should be attributed to the home department but should not be taxed. That is, they would “zero out.” More data and analysis is needed, but the subcommittee considers this a manageable issue with limited immediate impact during a first phase, revenue-neutral rollout.

Research and Indirect Cost Recovery

Following the recommendation of the steering committee (that units responsible for the activity generating revenues receive the full allocation of those revenues), the working group recommends that 100% of generated ICR should revert back to the unit that generates the research expenditures. Regarding collaborative research activities that involve more than one unit, the subcommittee recommends that the primary unit should follow the ABB approach and allocate ICR to the sub-units collaborating with the primary unit coordinating the research effort, with exclusions allowed for small expenditures. A threshold of \$25,000 was recommended. While the steering committee

endorses this intent, we continue to support the recommendation that we should not establish a formal requirement that dictates the allocation of funds below that of the Deans and VPs.

To support central units and provide funding to the Provost for new and continuing initiatives, the subcommittee endorses the notion of a taxation system. Specifically, the group recommends that there be a single tax on central funds (GOF/DOF) and an additional smaller tax on direct research expenditures. More specifically, the subcommittee noted that in the current RCR model, approximately 31% of ICR is allocated to units with 69% retained centrally. In the first year of full implementation, one should expect the tax impact on unit-generated ICR to be less than this current derived level, but the combined tax on ICR plus direct costs should be similar to the current rate.

As noted, the tax supported by the working group is expected to be used to fund central units as well as fund new and continuing initiatives. Specifically, we recommend that the initiatives supported through the tax model should include faculty start-ups, retentions, and research matching funds. Additionally, the group recognizes that some units may be disproportionately burdened by the tax assessment and that a simple and transparent allocation of ICR resources may not recognize the inherent quality of effort of the research activity. For both of these circumstances, the group again endorsed the notion that the Provost should consider the tax stream as a source of funding to mitigate these issues as they develop. Finally, the subcommittee was asked to consider the funding of current debt obligations pledged against Facilities ICR. The group recommends that the current debt loads held centrally should remain so and be included in the base calculation for the tax rates. Future debt obligations may be the obligation of the Dean, paid out of their revenue, or a central obligation paid from tax revenues, depending on the unique needs represented by a need for additional campus debt.

Central Academic and Administrative Units

In reviewing the basic definition of a central unit, the subcommittee recommended that the term University units is a more appropriate name and definition, as it correctly implies that the roles of these units are in support of all schools and colleges within the university. The group notes that the definition of these units may include museums and other university-wide activities that are currently wholly contained within a school or college. (For example, the Burke Museum may be considered a university unit but is currently housed within the College of Arts & Sciences.) While this may be an appropriate discussion, the steering committee recommends that this topic (i.e., where units, such as the Burke, should be organizationally housed) be discussed outside of the development of an ABB model. This is a conversation regarding strategic mission and not one that should be led by the budget model.

In reviewing central University units, the group noted that there are a few activities funded at the center that are not part of any unit (university unit, or school or college). For example, all fringe benefits of centrally funded positions are funded centrally. The subcommittee recommends that benefits should be reallocated to units as an associated cost of salaries. They support the recommendation of the Research subcommittee that current central debt obligations should remain central and be funded through the application of a tax against activities.

While the majority of the collective activity of central university units does not directly generate revenue, we recognize that there are minor revenue streams associated with these units. The subcommittee recommends that, in following the basic approach of ABB, the revenues generated by central University units should be returned wholly to them, as is proposed for activity-generating units. Examples of revenues flowing to these units would include ICR on grants within these units, central fees (such as application and transcript fees), and tuition (e.g., Robinson Center for Young Scholars).

Finally, the subcommittee was asked to provide comments and recommendations regarding central University Units that receive a portion of their funding from recharge operations and a portion from central funding. If we move to a tax model, these units would effectively be funded from the central tax as well as from recharge activities. While they recognize the potential confusion associated with the perception of a double tax, the group recommends allowing the continuation of recharge rates for variable and/or discretionary usage of service. For example, it is consistent that the UW Technology budget is supported by central tax revenue for core infrastructure needs and supported by recharge revenue based on the variable population of IT users in each individual school, college, or academic unit.

Delivery of a Tax Model

Tax revenues should be levied against expenditures of activity-generating units with the use of tax revenues directed to the funding of central academic and administrative units, new academic and administrative programs and initiatives, existing academic programs that may need additional supplemental funding, and as a contingency for unanticipated cost increases, such as utility increases.

The allocation of the tax revenues should follow an annual budget/allocation process directed by the Provost in consultation with the Deans, Vice Provosts, Vice Presidents, and the Faculty Senate. The discussion of the use of tax revenues should be in conjunction with annual budget reviews between the Provost and Deans, Vice Provosts, and Vice Presidents.

In general we believe that in the initial roll-out phase of ABB, a single tax should be levied on all expended funds of activity-generating units (schools and colleges), including General Operating Funds (GOF); Designated Operating Funds (DOF), including Indirect Cost Recovery; and other unit-generated funds. Further, this single tax should apply to any non-activity units that have expended funds derived from their revenue generating activities. For example, if Student Life were to retain undergraduate application fees, then the tax should be applied against expenditures associated with the fee revenue. Longer term, it may be appropriate to migrate to a more robust cost attribution model than the recommended single tax model. This is noted in more detail in the secondary issues section of this report.

While there are several concerns regarding the taxation of expenditures on gift and endowment income, it is consistent with the stated principles of simplicity and transparency that expended gift and endowment income should be taxed in a similar manner as other generated funds, since expenditures of these funds are also using central services. However, there are several concerns surrounding applying the tax to these expended funds. Since many of these funds have explicit

donor restrictions as to their use, the source to pay for the tax on many of these individual funds would fall onto more fungible sources, such as GOF and DOF, and as a result may have the unintended consequences of limiting a unit's aspirations to expand their philanthropic base. This is of most concern when examining the impact of taxes on student scholarship and fellowship funds. It may be valid to consider these funds as pass through funding to the student who then expends the funds as tuition dollars that are already included in the tax base. We need to ensure that we do not create an instance of double taxation. Furthermore, there is already a "tax" on endowment income for investment expenses and to help support the UW's advancement efforts. If we decide to include these funds in the taxed expenditure base of a unit, it will be necessary to revisit the current practices associated with the levies against these funds.

In addition to the single tax discussed above, we recommend that a separate, and presumably smaller, tax be assessed against direct research expenditures. Recognizing that research support costs are often greater than the actual indirect cost associated with research activity, this tax can provide a predictable source of funds for direct research supporting units, such as Health Sciences Administration, the Office of Research, and Grant and Contract Accounting.

If any expenditure base is determined to be exempt from the tax model, it is important that this effective subsidy be clearly articulated. For example, if gift or endowment income is ultimately exempt from this approach, the foregone tax on these expenditures should be noted as a subsidy to the portion of the UW mission funded by philanthropic dollars.

Finally, it is important that units are provided advanced information regarding the amount of assessed tax prior to the start of the fiscal year to allow sufficient planning at the unit level.

Auxiliary units and the Bothell and Tacoma campuses should continue to pay appropriate administrative and institutional overhead assessments. The process surrounding the setting of the individual tax rates (e.g., the base on which the tax is assessed, the period being taxed) should be closely aligned to the ABB tax model to the extent possible.

Definitions and Data Points

We expect that there will be continuing development and refinement of a common data set used in building unit budgets under an ABB budget model. Much of this continuing work will be done through the implementation team as it recommends approaches based on the policy recommendations of the steering committee contained in this report. Above all, it is necessary that all decisions are based on data that can be easily accessed and reproduced at both the central and unit levels. As a start, the definition group recommends the following approach to defining the coefficients used in allocating tuition.

To calculate student credit hours the working group recommends that the basic framework the UW uses to report student credit hours to both the State of Washington and to the U.S. Department of Education should be used for activity based budgeting calculations.

The official census day for enrollment calculations is the second Friday of each academic term (usually referred to as "10th day enrollment" – despite the fact that academic quarters do not

necessarily start on a Monday, and that the second Friday of an academic term may not be the 10th day of instruction).

Only courses that are categorized in the Student Information System as being on a state sponsored tuition schedule will be included in calculations.

All credits and course registrations for a given course are summed and credited to the college/school that sponsors or supervises the curriculum with which the course is associated.

As is done for various other internal UW reports, if a course/curriculum is jointly owned by more than one college/school, both units will be credited with all of the student credit hours. As a result, the sum of the student credit hours that are used for activity based budgeting calculations will be greater than the number of student credit hours taken by students and reported to the State of Washington and the U.S. Department of Education.

In addition to student credit hours, the date group reviewed the calculation of degrees awarded. There is a standard process under which a student applies for a degree and if that student meets the degree requirements, a “degree record” is created in the Student Information System. Calculating the number of degrees is complicated because students can have either multiple degrees or one degree with two or more majors.

A student receiving one degree with one major – counts as one degree.

A student receiving two degrees – both degrees should be counted; depending on what the degrees/majors are, this could be either two degrees credited to the same college/school or one degree credited to one college/school and another degree credited to a different college/school.

A student receiving one degree with two majors – counts as two degrees (each major is counted as one degree).

There are data fields within the Student Information System that associate both undergraduate and graduate degrees to specific departments and colleges. The working group felt that it would be wise to have appropriate staff in colleges/schools review the current specification for how degrees are associated with colleges/schools, and to propose any suggested changes to the Activity Based Budgeting Steering Committee.

Accountability Measures

The steering committee and several of the subcommittees noted that as ABB rolls out it will be critical to ensure that units receiving funds from the tax revenue collected by the Provost provide accountability measures to ensure that the funds are being utilized consistent with the overall needs of the institution. It would be difficult, costly, and time consuming to attempt to develop a common set of accountability metrics across all the varied activities supported through the tax structure (both those in activity and non activity units). We recommend as part of the annual budget review process that each unit provide individual accountability measures for their respective areas of activities. We recommend that as part of their charge, the implementation team

develop a consistent approach to develop of these measures. Over time, these individual reports may provide a common approach we can implement across the campus.

Implementation of ABB

Implementation of ABB will require fairly deep understanding of central budget and accounting systems and processes. The working group recommends that the co chairs of the ABB steering committee (the Executive Vice Provost and the Vice Provost for Planning and Budgeting) form an implementation team comprised of central budget and accounting staff and comparable school and college staff to develop implementation plans and processes to deliver on the recommended policies and actions developed by the steering committee. The role of the implementation team will be technical in nature; the steering committee will oversee the effort of this team and ensure that all recommendations are consistent with the policy direction it developed.

As noted earlier in this report, changing the budget model of the campus is a detailed and complicated process. There are likely several detailed nuances and applications yet to be discovered as we develop an implementation plan based on these recommendations. With this in mind, we recommend a target ABB implementation date of July 1, 2011. We believe that a full transition to ABB at the start of FY 2012 should give the campus sufficient time to review and comment on the actual detailed implementation approach developed over the next several months by the continuing work of the ABB steering committee. (Note that this transition to ABB should be considered a Phase I implementation and that we expect subsequent iterations to develop as we move further into this budgeting approach.)

While we do not recommend introducing a full implementation of ABB until FY2012, we do recommend the introduction of a “soft launch” of ABB at the start of the upcoming FY2011 with a focus on the expected incremental tuition generated on the Seattle campus. We recommend that the majority of budgeted incremental tuition in FY11 be allocated to activity generating units based on the coefficients used to allocate tuition as recommended in the academic impact section. Because we will not develop a formal taxation model until FY2012, we further recommend that 30% of the incremental tuition (consistent with current GOF and DOF fund distribution) be held centrally to fund activities that would otherwise be funded by a tax.

Secondary Issues

We recognize that changing the University’s budget model is a difficult process, and we need to ensure that the decisions reached centrally, or at the unit level, are not negatively impacted by the steep learning curve that is associated with a change of this magnitude. As such, we realize that in a Phase 1 roll-out, a simple tax structure based on expenditures is a fairly easy model to adapt and predict in planning and modeling exercises. However, as the University adapts to the new model, it may be prudent to revisit the tax structure and migrate to a more robust cost attribution model with taxes based on a variety of factors, possibly including faculty/staff headcount, and assignable square footage. This would more clearly demonstrate that the central costs incurred by a unit can be more transparently associated with the unique unit activity generating the costs.

In addition to this potentially more robust cost model, there should be a process in which all units, but especially those funded by tax revenue, are required to demonstrate accountability and efficiencies with respect to their individual portfolios with performance indicators and benchmark activities.

Major Policy Considerations

The transition to an ABB budget model provides an opportunity to examine several important contributing or controlling factors.

First is tuition setting authority and, within that context, the ability to establish discipline specific, unit specific, or campus specific differential tuition. The ability for some units to establish higher tuition levels reflects several conditions such as student demand, reputation, cost of delivery, and market or employment competition. The outcome of such a policy change could, if desired, minimize the degree to which cross-subsidization is required for disciplines with significantly higher costs, especially if restricted by necessary lower enrollments. Whether in STEM disciplines or lab or studio based programs, the instructional and support costs vary widely, and the ability to determine appropriate tuition and financial aid levels would contribute to a more balanced system of funding.

A related issue is direct admission of freshmen to their intended major. Currently, there are direct admission pilot programs in Business and Engineering (with several hundred students taking advantage of them) that address a number of important concerns. Recruitment of highly qualified students is made easier when students and their families compare offers from competing institutions. Also, students can better understand their status when the likelihood of qualifying for a major is a condition of admission, rather than something uncertain, partially outside their control, or at a later point in their academic career.

The ABB model would allow resources to flow to recruitment, advisory, and instructional efforts delivered by units or programs wishing to engage with students at an earlier stage of their education.

It has the added benefit of directing enrollment to specific majors and fields of study as part of the admissions process, addressing aspects of the state's strategic master plan, in a more controlled and predictable way.

If such an enrollment option were widely available at the UW, it would require careful oversight to maintain access for undeclared majors, changed majors, and transfer students, who currently make up 30% of our student population.

Additionally, there are a number of oversight and incentive issues that should be included as opportunities and concerns when examining ABB moving forward.

First, the UW's current decentralized funding environment is further emphasized in an ABB model, which will raise the question of how best to align the concerns of shared governance oversight with the greater responsibility of Deans, Chancellors, Vice Presidents and Vice Provosts

to manage their units. The history of committees such as SCPB is based on a Provost-centric model of decision-making and authority over positions and funding options. This does not reflect current behavior, let alone a future, more entrepreneurial university.

Secondly, the question of faculty salary policy needs to be reviewed relative to centrally or state defined allocations of merit funds and the possible local application of additional merit or salary adjustments.

Third, many observers feel that ABB can lead to “gaming” of the system relative to credit hour and instructional values and that strong central curricular oversight is needed to monitor initial behavior of units and programs. An analysis of how best to accomplish this for both undergraduate and graduate programs is needed, given that councils like the Faculty Council on Academic Standards are responsible for undergraduate reviews only and may need added participation and support.

Next Steps

Over the next several months, the steering committee will continue to examine and refine the recommendations in this report based on the work of the implementation team. We recognize that significant work remains in order to understand how to incorporate auxiliary educational activities into the model, support graduate instructors, and calculate the actual tax rates, among other needed refinements. Furthermore, the committee will continue to review and develop recommendations regarding the identified secondary issues and other issues yet to arise. We anticipate that our report due in mid to late May will not be a final report and will rather be an update of the progression to date. With the recommendation that ABB not be fully implemented until FY2012, we recommend that the role of the steering committee continue through next year. We anticipate that we will provide subsequent updates with a final detailed action and implementation report not ready until the middle part of the upcoming fiscal year.