March 30, 2018

Gerald J. Baldasty
Provost and Executive Vice President
Professor, Department of Communication

Dear Jerry:

In January 2018, you charged our Joint Task Force on Supplement Distribution to **design a forward-looking, realistic set of recommendations regarding supplement distribution that seeks to minimize financial duress to individual units and recognizes the significant circumstantial changes in tuition revenue distribution and program delivery**. In addition, you asked that the task force's analysis recognize that the supplement is a mechanism for managing state subsidies and cross-subsidies between Seattle units.

As part of that work, the task force was charged to develop a conceptual framework that differentiates the following flavors of state funding:

- **Permanent state subsidy** needed to supplement tuition revenues;
- **Seed money** provided for the establishment of programs before revenue generation is generated, and for which state subsidy is not required in perpetuity; and,
- **Funding for activities or programs** that may not be core to our mission and thus, subject to annual funding reviews.

In addition, the task force was asked to review several options generated by the Office of Planning & Budgeting (OPB) regarding changes to supplement distribution. These included:

- Modifying ABB "tax" rates;
- Taxing tuition revenue growth;
- Implementing a rolling supplement reset; and,
- Adjusting undergraduate per-credit/degree allocations.

Having completed several months of discussion, analysis, collaboration and consideration, we submit the attached report, which details the changes and interventions we propose.

Thank you for charging our committee with this important work. We hope that these proposals are helpful to you and the campus.

Sincerely,

Zoe Barsness, Professor, Chair of Faculty Senate Committee on Planning & Budgeting, **Co-chair**
Michael Bragg, Dean, College of Engineering, **Co-chair**
James Jiambalvo, Dean, Foster School of Business
Robert Stacey, Dean, College of Arts & Sciences
Azita Emami , Executive Dean, School of Nursing
Dan Grossman, Professor, Faculty Senate Committee on Planning & Budgeting member
Mary Hebert, Professor, Faculty Senate Committee on Planning & Budgeting member
JoAnn Taricani, Professor, Faculty Senate Committee on Planning & Budgeting member
Sarah Norris Hall, ex-officio, Office of Planning & Budgeting, Provost's representative
Erin Guthrie, Director, ex-officio, Office of Planning & Budgeting, staff to committee

Report of the Joint Task Force on Supplement Distribution

I. Introduction: Background, Supplement Definition, Task Force Charge, Principles for Supplement Distribution and Summary Recommendations

Background

In January 2017, the Provost charged an Activity Based Budgeting (ABB) Oversight Committee with four primary tasks: (1) review the original approach to defining and distributing the supplement; (2) document that original approach as well as the modifications which have affected supplement growth or contraction; (3) propose principles for annual review of supplement; and (4) establish principles for supplement redistribution.

Last Spring, the Oversight Committee recommended that supplement funding levels could be adjusted in response to various changes, some of which are described in this report. Importantly, the Oversight Committee (1) issued a problem statement regarding static supplement levels; (2) reviewed the originating ABB framework and principles for supplement distribution, confirming that the Provost could indeed modify supplement levels as necessary; and (3) conceived of several ideas to modify supplement distribution.

The supplement artifact is a complex one that warrants explanation and definition. Please review Appendix 1. Background and Current Distribution of Supplement for additional information.

When ABB was fully implemented, a 'hold harmless' agreement was struck with deans. For the transition year, no unit was to receive less permanent general (GOF) and designated (DOF) operating funds than it had the year previous. The difference between the GOF and DOF base from the prior year and the calculated tuition (after financial aid and tax) and indirect cost recovery (after tax) was distributed to units as "supplement."

Figure 1. Supplement Arithmetic

$$\boldsymbol{FY12\ Supplement = Permanent\ GOF + DOF\ Base - (FY11\ Tuition + FY11\ ICR)}$$

Each year since, investments in unit supplements have been spelled out in annual allocation tables. Investments that were categorized as 'supplement,' because they were not formula-driven tuition or indirect cost recovery, included funding from the state for tuition backfill, state funding for compensation, state funding for provisos, and provost reinvestment funds.

Again, please review Appendix 1 for a more detailed discussion of the supplement and, if further information is desired, please review OPB's ABB Frequently Asked Questions.[1]

ABB Joint Task Force Charge

As the Oversight Committee noted, the Provost has the authority to amend the supplements provided to units; however, the Provost recognized that any sudden changes may prompt financial challenges at

[1] ABB Frequently Asked Questions: http://opb.washington.edu/abb-frequently-asked-questions.

the unit level. Thus, he charged a joint task force of deans and faculty from the Senate Committee on Planning and Budgeting with considering the unit supplement construct.

The Provost asked that the Joint Task Force **design a forward-looking, realistic set of recommendations regarding supplement distribution that sought to minimize financial duress to individual units and recognized the significant circumstantial changes in tuition revenue distribution and program delivery**. In addition, he asked that the supplement be recognized as a mechanism for managing state subsidies and cross-subsidies between Seattle units.

<u>Principles for Supplement Distribution</u>

The task force reaffirms the ABB Oversight Committee's recommendation that changes to supplement funding should be made consistent with the following principles:

Principle: Deploy State Funds Strategically

The supplement provides an important means to implement institutional priorities and facilitate strategic investment or disinvestment. The Provost can and should modify the supplement to fund strategic initiatives and address mission critical needs. Unit supplements are therefore expected to change over time, in alignment with evolving institutional priorities and the future strategic needs of the greater UW community.

Principle: Deconstruct "Hold Harmless"

The concept of "hold harmless" should only be applied to the supplement when formulae change. Holding activity units harmless during transition periods when formulae change entails a compensatory shift in the supplement. However, holding units harmless from the effects of the formula essentially forever should be an exception and the result of leadership choice, rather than a default position.

Principle: Dampen Major Funding Swings

It is critical to the institution that units not experience dramatic and sudden budgetary decreases. Supplement modifications should therefore be accomplished in a way that enables units to plan their budgets accordingly, without major disruption. As ABB distributions shift automatically, in accordance with the initiation of new programs and the growth or decline of majors in existing programs, units require time to ramp their operations up or down. The supplement should provide a means to smooth out abrupt shifts in ABB funding and facilitate units' ability to meet their immediate and longer-term operational needs while responding responsibly to substantive changes in their resource base.

Principle: Consider Cost of Programs

A great public research university cross subsidizes its programs and all students, faculty and staff benefit from the breadth and depth of a diverse academic and research enterprise. It is also true that degrees and majors vary in costs and that budgets and the supplement should reflect those differences, respecting the cost of delivery of student credit hours (SCH) and degrees. Since ABB funding is distributed with no relationship to instructional costs, the supplement serves an important cross-subsidization purpose, providing support for programs whose instructional costs are inherently higher and historically providing less support for units whose costs are nearer ABB funding levels.

In addition to the principles established by the ABB Oversight Committee, our task force suggests an additional principle:

Additional Principle: Respect Funding Sources and Intent

State funding is often appropriated unevenly, and tends to be targeted to specific programs. However, the supplement reflects both Provost and state legislative funding decisions. Any supplement modification process should respect and be informed by the various sources and categories of funding that make up the unit's current supplement and any portion of supplement funding intended to compensate for the costs of ongoing unit activity (e.g., state provisos to supplement tuition revenues for higher cost programs and degrees, instructional costs associated with accreditation requirements) should be sustained.

Summary Recommendations

To facilitate the task force's effort to develop recommendations that support strategic use of the supplement while respecting units' differential operating costs, the task force developed a conceptual framework that differentiated the following flavors of state funding which have historically been combined in the 'supplement' category without distinction:

1. Permanent state subsidy needed to supplement tuition revenues for higher cost programs and degrees;
2. Seed money provided for the establishment of programs and strategic initiatives before revenue is generated, and for which state subsidy is not required in perpetuity; and,
3. Funding for activities or programs that may not be core to our mission and thus, subject to annual funding reviews.

The task force also reviewed several options generated by the Office of Planning & Budgeting (OPB) regarding the means by which changes to supplement distribution might be effected. These included:

1. Modifying ABB "tax" rates;
2. Implementing a rolling supplement reset;
3. Taxing tuition revenue growth; and,
4. Adjusting undergraduate per-credit/degree allocations.

Each of these options was assessed in regards to their consistency with the principles outlined above.

Additional ideas were welcomed by the Provost, but ultimately, the task force recommends a multifaceted and holistic rather than formulaic approach to supplement review and modification. The task force therefore recommends:

1. Modify supplement funding levels to assure investment and disinvestment in unit operations that is aligned to meet mission critical needs and support existing and emergent strategic priorities;
2. Establish an interim cap on ABB growth related to undergraduate programs beyond a preset growth percentage to reduce significant swings in unit ABB funding that may negatively impact some units while preserving incentives for moderate unit growth in undergraduate programs;
3. Modify supplement funding levels after discussions with deans during annual reviews;
4. Expand the scope of ABB to include consideration of costs, support a process to establish a cost instrument and explicitly factor data derived from that instrument into supplement decisions.
5. Tax the total supplement of every unit 0-4% to generate funds at the center for strategic reinvestment.
6. Align strategic supplementation with strategic enrollment management

7. Advance a priority to implement differential tuition to cover the higher costs characteristic of STEM and other programs.

II. Deconstruct "Hold Harmless"

<u>Background</u>

When ABB was fully introduced on the Seattle campus, a "hold harmless" provision was implemented to assure a smooth transition to the new budget model, one in which units would not experience problematic shocks to their operations. Each Seattle school, college, or administrative unit thus received a "supplement" that was equivalent to the unit's "total base ABB budget," minus its total GOF and DOF budget—the former being predominantly the formulaically derived tuition and ICR allocation. This difference became known as the "supplement." Said another way, supplement funds were distributed to units as the difference between the GOF/DOF base and calculated tuition and ICR revenue.

The original calculation for the supplements ranged from a high of nearly $40 million (School of Medicine) to a low of *negative* $9.0 million. Arts & Sciences, for example, received a negative supplement as a consequence of the formulaic tuition and ICR funds in FY12 exceeding the sum of the GOF and DOF budgets for Arts & Sciences. Other than for Arts & Sciences, the supplements ranged from 12 percent (Foster School) to over 66 percent (Dentistry) of the units' total centrally provided budget.

In subsequent years, investments in unit supplements have included state funding for compensation and benefits, specific provost reinvestment funds, and provisos. The total of $125 million in supplements in the first year of ABB (FY12), which constituted about 25 percent of the total centrally provided allocation to the Seattle academic units, has grown to $219 million in FY17, about 33 percent of the total allocation.

To date, the supplement is comprised of the following;

- 57% is made up of a residual hold harmless base,
- 6% from reinvestment funds; 13% from tuition backfill,
- 9% from benefits and compensation,
- 3% from provisos, and
- The remaining 13% comes from in-year revisions.

It is important to note that the institutional context at the time the "hold harmless" construct was formulated was one that anticipated significant enrollment and tuition growth coupled with moderate inflation. If those expectations for enrollment growth and moderate inflation had been met, the initial "hold harmless" portion of the supplement would have been reduced gradually and naturally over time to become a negligible portion of each unit's overall budget. Current unit activities in regards to teaching and research would then have largely determined units' overall budget and assured better alignment of institutional resources to instructional activity without any active management of the supplement.

Since ABB's implementation, however, the Seattle campus has experienced a period of flat to low enrollment growth. Moreover, future enrollment is expected to continue to grow slowly. Within this flat to low enrollment growth environment, the undergraduate tuition pool has also significantly changed due to tuition rate changes, the enrollment growth that has occurred, and migration of teaching activity between schools and colleges. These three factors resulted in significant, new tuition funding being distributed to schools and colleges and, ultimately, shifting between schools and colleges.

The reallocation of the undergraduate tuition pool coupled with a supplement still dominated by a residual hold harmless base that reflects the state of teaching and research activity in FY12 has resulted in a misalignment of resources. Our continued commitment to a fiscal strategy intended to be temporary and designed to facilitate units' ability to transition their operations to a new budget and fiscal environment, has constrained our ability to deploy central funds more strategically, in better alignment with current instructional activity, institutional priorities and strategic initiatives.

Recommendation #1: Supplements Can and Should be Adjusted

The committee reaffirms the statement by the 2017 ABB Oversight Committee that, "the Provost, working with the consultative budget committees and executive leadership, has the authority to change the supplement (e.g. permanent GOF and DOF budgets) of the schools, colleges and administrative units." The Provost, moreover, should modify supplement funding levels to assure investment and disinvestment in unit operations that is aligned to meet mission critical needs and support existing and emergent strategic priorities

III. Dampen Major Swings

Background

It is critical to the institution that units not experience dramatic and sudden budgetary decreases. The Provost should phase in any budget cut that would produce undue duress in recognition of the fact that schools and colleges hold tenured lines that cannot be violated. At the same time, rapid increases in the formulaic allocation (for example due to the rapid growth of resident undergraduate tuition during the period 2009 to 2012) when not linked to a corresponding increase in unit costs of operation, would constitute a reason to reexamine supplement levels.

Given that undergraduate tuition revenue represents the largest portion of revenue (72 percent of tuition revenue in FY18), competition between units for that revenue can pose a challenge for the stability of the institution. From FY13 to FY17, undergraduate tuition revenue increased 10 percent; but, the units generating the activity responsible for this increase shifted dramatically. Arts & Sciences received roughly the same undergraduate revenue in FY17 as in FY13. In contrast, the School of Public Health increased undergraduate revenue generated by 187 percent; the Information School increased by 127 percent, and the College of Education increased by 75 percent during this same timeframe.

In a relatively flat tuition and enrollment environment, these types of drastic swings exacerbate the already apparent budget constraints of particular units; and, for all units, these swings make it difficult to project and plan for the future.

Review Previous Options

The Office of Planning and Budgeting identified three options for dampening such revenue swings as outlined in their September 29, 2017 Planning and Budgeting Brief. The task force was asked to review these models and the committee's evaluation of these three models is provided below, as well as the description of a fourth alternative model proposed by the committee.

1. ***Rolling Supplement Reset Model*:** This model proposes a reset of the supplement every 3 – 5 years to adjust for the shift in undergraduate enrollments. One feature could be a 25% tax on ABB growth that would provide the funds available to implement the reset. The committee liked the idea of a regular, but not yearly reset of the supplement. No specific timeframe was set, but the committee felt a yearly reset would too time-intensive to execute and a 5 year reset too slow to allow needed corrections. The committee expressed concerns about taxing the growth in ABB as any such tax would reduce the intended ABB incentives for growth. The model also implies that the ABB tax would be implemented in such a way as to remove funds from the ABB portion of some unit budgets and move these funds to the supplement which was not supported by the committee.

2. ***Taxing Large Increases in the Generation of Undergraduate SCH/Degrees*:** Following this approach, unit supplements would be adjusted by taxing increases in undergraduate enrollments. The committee felt this would have the effect of increasing the size of the central portion of ABB as tuition funds increased. As with the Rolling Supplement Reset model, the committee was concerned about removing the built-in ABB incentives for growth. The committee also felt that this approach did not effectively address the core issue of planning and handling growth in a more strategic fashion.

3. ***Undergraduate Per Credit Distribution (Paul Hopkins Approach)*:** This model proposes to distribute a set number of dollars for each SCH and each degree awarded. This is in contrast to the present model in which the pool of ABB dollars available for allocation is a function of net tuition as determined centrally. The committee liked the predictability of the model that this would provide units by alleviating some of the planning challenges that the volatility in net-tuition-based ABB distributions presents the units. This approach, however, would shift risk and reward associated with volatility instead to the center. After discussion we felt this was a major change in ABB and should be delayed for consideration by a future ABB-focused committee.

Recommendation #2: Impose an Interim Cap on ABB Growth

While the committee feels a better long term strategy is to manage growth through strategic planning and enrollment management, the committee developed an alternative model that can be employed in the interim to reduce funding swings between units due to rapid changes in undergraduate SCH. The model could also be implemented based on an undergraduate SCH cap, a model variation that is also described below.

***Interim Cap ABB Growth model*:** Instead of taxing growth, this model proposes to cap growth, or actually to cap ABB funding for growth beyond a preset growth percentage. The intent here is undergraduate ABB growth and ABB and SCH as used here refers to the undergraduate portion of these metrics. Thus, if a unit's ABB distribution increased more than the cap value—for example growth in the unit's ABB distribution was 12% and the cap was 10%--then the 2% of ABB growth above the cap would be returned to the center, or effectively removed temporarily from the unit's supplement. The following year that prior year excess (e.g., 2%) would be returned to the unit if its growth does not exceed the cap (e.g., 2% for the past year and an additional 8% in the current year). The cap on ABB growth could be waived by the Provost, by prior agreement, in cases where the growth was planned as a strategic investment by the university.

It is important to note that the 10% cap is offered only as an example. The committee recommends that the exact cap percentage be set based on an analysis of past and expected ABB growth and its impact.

***Interim Cap (SCH) ABB Growth model*:** This model would take the same approach as the previous model except it focuses on capping the growth in SCH funds distributed through ABB. Any excess SCH funds generated by the unit would be returned to the center or retained by removing an amount of funds from the unit supplement equivalent to the excess SCH funds. Another option, rather than returning these funds to or retaining them at the center, would be to deduct any excess SCHs from the unit's ABB calculation which would in effect distribute all associated SCH funds to the other units in proportion to their number of SCHs.

The intent of both of these models is to provide an interim solution for dampening rapid growth in ABB funds that disadvantage other units. The cap model would discourage significant unplanned growth by units that has in the past negatively impacted other units. A cap approach, moreover, has the merit of preserving incentives for moderate growth while reducing significant swings in unit ABB funding.

IV. Deploy State Funds Strategically

The long term fiscal health and success of the university is a function of the focus, scope and timeliness of the strategic investments it makes. The Provost, as chief academic and budget officer of the university, has the responsibility to identify institution level strategic priorities and the authority to assure that adequate resources are deployed to realize associated strategic goals and objectives. The supplement is an important mechanism the Provost can leverage to direct resources to support existing and emergent strategic priorities.

Adjusting the Unit Supplement

From time to time, supplement adjustments must be made to redeploy funds for enterprise-level expenses. For example, a devastating major event, such as an earthquake, or a significant change in federal policy, may warrant permanent budget reductions to supplements. In addition, a change in university mission, values, or areas of emphasis would require an adjustment. Universities must periodically pursue new initiatives to meet societal needs, to pursue excellence, or confront and move beyond a major disaster or policy change. Sometimes a permanent investment is required, which would necessarily come through revisions to units' supplements.

Apart from sudden events or changes that would require swift supplement reductions, the principles outlined in this report (see section I Principles for Supplement Distribution section) prompt regular review and assessment of unit supplements. In addition, the committee noted that leadership in schools and colleges would want to plan for changes to supplement levels.

Recommendation # 3: Employ a Holistic Unit Review to Adjust Supplements

This committee recommends that budget meetings with schools and colleges expand in scope to include a college or school-wide program review of GOF and DOF permanent budget use, including current fiscal year and 3-5 years of projections, for both revenues and expenditures. Schools and colleges would be able to brief the Provost on the following elements: use of core operating budget funds; general needs and issues; impact of changes in funding (via supplement adjustment); and programmatic priorities. This review would include faculty staffing and hiring plans, enrollment plans, a review of the academic and fiscal vitality reports, an assessment of strengths and weaknesses as well as a review of the unit supplement's component parts and its use. The commitment to detailed planning and review will support strategic decision making and resource allocation that is required to best utilize the limited resources available to the UW to meet its competing and important strategic goals in future decades.

While the Provost has the authority and responsibility to adjust the supplement to assure institutional resources are deployed in alignment with the institution's strategic priorities, it is critical that any adjustments be accomplished in a way that facilitates units' ability to conduct their own activities responsibly and successfully. The budget process should provide predictability for Deans. Adjustments in the supplement should therefore dampen existing year-to-year swings in current ABB budgets such that units are equipped to ramp operations up and down responsibly in the face of changes in demand for their course offerings and programs. A significant portion of the supplement should also account for differing program costs (e.g., accreditation requirements, curriculum design and staffing requirements).

Cost of Programs

A great public research university cross subsidizes its programs and all students, faculty and staff benefit from the breadth and depth of a diverse academic and research enterprise. It is also true that degrees and majors vary in costs and that budgets and the supplement should reflect those differences. The fragile system of cross subsidization may be compromised as student demand shifts from program to program, without regard to underlying costs.

Instructional programs typically include higher- and lower- cost activities. A large lecture class might be a lower-cost activity; a small upper division course, or laboratory course, might be a higher-cost activity. The formulaic ABB allocation could in principle under- or over-compensate a change in scale of such a program, justifying a change in supplement. In evaluating funding (or changes in supplemental funding), the Provost should ideally evaluate cost effectiveness in teaching and research delivery.

Recommendation # 4: Consider the Cost of Programs

When ABB went into effect, the original supplement was set for units by the "hold harmless" process. The supplement funding that was calculated may have been misconstrued to represent differential cost of programs, but in fact, the supplement arithmetic was simply a hold harmless calculation. The ABB construct has not been modified to include the notion of differential cost.

Members of the committee believe that a primary factor in setting the supplement for an academic unit each year should be the cost of delivering SCHs and degrees. To do this, the campus must have a process to calculate, understand and manage program costs. Expanding the scope of ABB to contemplate cost is obviously complex and involves consideration of accreditation requirements, peer competition, research and service loads, institutional priorities, etc. However, by establishing these costs and principles, supplement distribution *could* be based on these values, and better strategic priorities could be set. Thus, members of the committee support a process to establish a cost instrument and explicitly factor data derived from that instrument into supplement decisions.

If the Provost agreed to this recommendation, the Office of Planning & Budgeting would require 6-8 months of focused work with academic administrators and an additional FTE (or agreement to stop certain tasks) in order to complete this work.

Generating Funds for Strategic Investment

In our current funding environment, state support has been flat or diminishing and tuition growth is capped for the foreseeable future at approximately 2% per year. Absent growth in tuition or state support, we must strategically grow other revenue, reduce costs, disinvest from some endeavors or accomplish some combination of these in order to facilitate our ability to strategically reinvest while also addressing ongoing financial needs.

The tax rates and the supplement are two major levers in ABB that can be leveraged to generate funds for the center. Several of our previous recommendations will serve to generate funds at the center by employing these levers in different ways. By capping ABB growth following Recommendation #2, for example, ABB funding in excess of the cap percentage would be available—at least temporarily—for redeployment by the center in support of seed ventures or to meet other temporary needs. Recommendation #3 provides for supplement changes through the unit review process through which funds could be retained by the center for strategic reinvestment.

The Provost also requested that the task force evaluate the merits of modifying ABB "tax" rates when there are substantial shifts of undergraduate tuition revenue between units. The task force determined that our proposed cap on ABB funds related to undergraduate program growth was a more desirable approach than modifying the overall ABB tax rate. Similar to our assessment of the Undergraduate Per Credit Distribution (Paul Hopkins Approach) model, we felt this modifying the overall ABB tax rate would be a major change in ABB. We recommend its consideration again during the next comprehensive review of the ABB budget model.

Finally, the task force discussed at length the potential for a tax on the total supplement of every unit each year as an additional way to generate funds for strategic investment across the university.

Recommendation # 5: Tax the total supplement of every unit

As an alternative or additional way to generate reinvestment funds, the task force recommends the use of a supplement tax from 0 – 4% with these tax funds going to the center for distribution by the Provost. The committee recommends that if a tax is implemented it be applied to both academic and administrative units alike. Units could make their case during their annual review for their need to recapture these funds, and potentially capture additional funds, based on their local needs as well as the strategic needs of the campus. Any consequent decrease in unit supplement associated with such a tax would not take effect for one year to give units time to adjust their budgets.

The committee discussed whether or not a uniform tax rate for the supplement was appropriate, considering that units will be differentially affected by that tax. For example, when the size of the supplement reflects the need to manage a high cost program because of accreditation standards or field of study, the tax will hit those units harder. The task force determined, however, that the annual budget review provided the opportunity and most appropriate context for each unit to make a compelling case for its claim on central resources earmarked for strategic reinvestment. A uniform taxation of every unit's total supplement also has the virtue of very publicly signaling and normatively reinforcing the notion that supplements are not pro forma or gifted in perpetuity but must be defended and can be adjusted on a strategic or differential cost of instruction basis. And, while the term "tax" will always be uncomfortable, many on the committee felt that the imposition of a fee, cost, or tax at the same percentage on all units would be more fair than asking the Provost to select where to make cuts (or request a return on the unit's supplement allocation). The committee acknowledges, however that a taxation process on supplement also has disadvantages that need to be managed if such a plan is implemented. The primary disadvantage is the workload and stress generated by each unit defending its supplement each year, even the units that will ultimately see no change or an increase in their supplement. This process could also generate frustration and competitiveness between units eroding the excellent relationships and collaborations that currently exist.

It is important to note that the task force also discussed the merits of a tax on units' whole budget, but ultimately dismissed this approach. A majority of the committee felt that units' research and instructional revenue, having already been subject to the ICR and ABB taxes respectively, should not be taxed yet again. In addition, to provide context and transparency to campus priorities, the committee suggests that in a year when the tax option is used, it would be advantageous for the Provost to clearly communicate to the campus community the strategic priorities that will be facilitated with the resulting funds returned by the units to the center.

Recommendation 6: Align Strategic Supplementation with Strategic Enrollment Management

Management of the supplement should also be informed by and aligned with strategic management of the ABB distribution. The initiation of new degree programs and growth or decline of majors in existing programs can drive large changes in ABB distribution; a sound budget strategy and planning process therefore demands that supplement and enrollment management across units be aligned.

Recommendation 7: Differential Tuition

The task force also discussed revenues required to deliver instructional programs over and above state funding and tuition revenues (at current enrollment levels). Currently, many programs rely on tuition funding from other tuition categories and Provost Reinvestment Funds (tax on tuition and ICR).

Our campuses are constrained by insufficient revenues and escalating program costs, some of which are simply out of our control. Compensation increases, benefit load rates, utilities, grounds maintenance, operations costs and other Seattle-driven expenses have risen faster than state and tuition revenue growth. Further complicating this issue is the fact that students are expressing interest in, and moving to STEM fields, where costs are higher than typical Liberal Arts majors.

As a result, the task force agreed that our institution should advance a priority to implement differential tuition to cover the differential costs characteristic of STEM programs. The task force feels that by understanding program costs, the campus would be well positioned to justify this need to the state of Washington Legislature and to our student body generally. Please see Appendix 2. Differential Tuition Brief.

Appendix 1: Background and Current Distribution of ABB Supplement - ABB Oversight Committee, Spring 2017

In October 2009, the Working Group on Activity Based Budgeting (ABB) responded to Provost Phyllis Wise's charge that they consider, "…issues that need to be addressed in reframing our budget model to one that more transparently aligns revenue generation with the activities associated with the revenue." The working group report stated:

> "To both respect historic commitments and assure maintenance of essential services, it is crucial that any new budget model be at least revenue neutral to all units. This is not to say that the budgets of units … will not change prospectively. Rather, again at the onset, the new budget for a unit must be equivalent to the current General Operating Fund (GOF) and Designated Operating Fund (DOF) budget of the unit. Peer institutions that have transitioned to ABB models have reached similar conclusions."

This "hold harmless" provision was implemented at the transition to ABB at the Seattle campus in FY12 by calculating for each "activity based unit" their total GOF and DOF budget, and subtracting from this the "total base ABB budget," the latter being predominantly the formulaically derived tuition and ICR allocation. This difference became known as the "supplement", the supplemental allocations in this first year of ABB (FY12). Said another way, supplement funds were distributed to units as *the difference between the GOF/DOF base and calculated tuition and ICR revenue*.

Illustration of Supplement

> *In FY12 the College of Built Environments (CBE) had a total GOF and DOF budget of $8,663,754. The formulas then in place afforded to CBE $7,337,741 of tuition and $111,008 of ICR funds; the formulaic "total base ABB budget" was thus the sum of these two numbers, or $7,448,749. CBE thus needed a supplemental allocation of $1,215,005 ($8,663,754-$7,337,741) in FY12 to be "held harmless". The original CBE supplement was thus $1,215,005.*

The original calculation for the supplements ranged from a high of nearly $40 million (SOM) to a low of *negative* $9.0 million (A&S; negative as a consequence of the formulaic tuition and ICR funds in FY12 exceeding the sum of the GOF and DOF budgets for A&S). Other than for A&S, the supplements ranged from 12 percent (Foster School) to over 66 percent (Dentistry) of the units' total centrally provided budget.

Supplement funds provide support for (presumably non-instructional) activities that do not generate tuition revenue (e.g. research, service), and for tuition-generating instructional programs that generate insufficient tuition revenue to cover instructional costs. It follows logically that a unit's need for supplement funds could change, rising or falling, as the costs change due to any inflation or evolution of the scope or scale of their programs. Changes that are not appropriately compensated by the formulaic component of ABB should trigger consideration of a change in supplement level.

Changes in unit supplements have been clearly articulated in ABB tables at the beginning of every fiscal year budget cycle. They include specific PRF investments, state provisos, and other state funds, including those intended for compensation and to backfill funding to the UW for legislated tuition levels.

The total of $125 million in supplements in the first year of ABB (FY12), which constituted about 25 percent of the total centrally provided allocation to the Seattle academic units, has grown to $219 million in FY17, about 33 percent of the total allocation.

Despite the very simple calculation that generates supplement values, it has been described as the primary means by which schools and colleges cross-subsidized each other, as well as the primary means by which state support was directly appropriated for unique and specific programs managed by schools and colleges. These descriptions are justified, but the supplement, at its most basic level, is the result *of multiple decades of both Provost-level budgetary decisions and state funding of specific programs. Overall, the supplement reflects historical strategic funding decisions, but also has a certain level of malleability, especially in terms of historical Provost decisions.*

Original Principles Associated with the Supplement

The original report to Provost Wise referenced above clearly anticipated the need for evolution of the supplement allocation:

> "As with other universities that have adopted an activity based approach it will be crucial that we develop an annual reporting process in which Deans, Vice Provosts, and Vice Presidents meet with the Provost to review the financial, academic, and administrative metrics of the unit. These annual meetings can also be the base for determining any Provost decision in the allocation of supplemental (non-formulaic) budget funds."

Subsequently, when ABB was fully implemented, the decision summaries produced for each revenue stream emphasized the need to attend to the allocation of supplement funds. Also critical to highlight is the decision statement concerning cross-subsidies and its relationship to subsidies and the supplement:

> Going forward, the Provost will make decisions on maintaining, increasing, or decreasing subsidies based on a continuing evaluation of the University's mission and the reasonableness of demands on units (and their students) that self-generate the largest percent of funds under ABB as currently defined to cover their costs, (ABB – Decision Summaries, page 9).

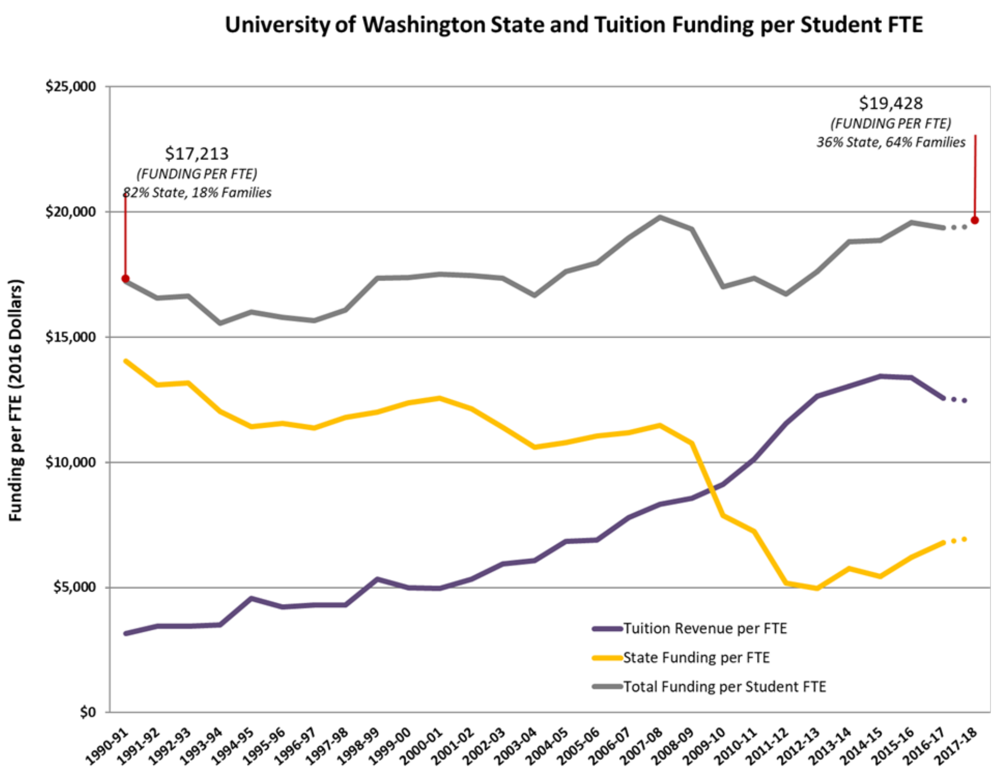
Nature of the ABB Supplement

The formulaic portion of each unit's ABB budget provides 35 percent of the indirect cost recovery funds generated by the unit and 70 percent of net tuition funds generated by the unit's students (using a mix of student credit hours and degrees or majors as the measure of activity). A merit of the formula is that it provides a change in allocation that automatically accompanies any change in grant and contract or tuition-generating activity. A demerit, though, is that the formula does not necessarily provide the correct change in allocation, due to the differential costs structures of the units. The formula could, in principle, provide too much or too little. A change in supplement funds can thus provide an "adjustment" that can help to reflect the diversity of costs actually experienced by the units.

It is clear to this committee that the Provost, working with consultative budget committees and executive leadership, has the authority to change the supplement (e.g. permanent GOF and DOF budgets) of schools, colleges and administrative units. That authority has not been emphasized recently and this committee suggests that we both advance this notion and normalize it as part of the annual budget cycle. Historically, prior to ABB, the re-allocation of funds between schools and colleges was rare as the emphasis was on allocation of new or incremental funds. Under ABB, the expectation is that the Provost would have supplemental funds for investment in new programs and initiatives, however, due to financial challenges and limits on tuition increases, this has not happened at the level anticipated.

The ABB model relies upon a formulaic approach to distributing several revenue sources. The supplement distribution is unlikely to be effectively administrated by a prescribed or formulaic approach, because of the need to exercise judgment. Among many reasons for this are large and rapid swings in state funding associated with changes to resident undergraduate tuition policy that, over time, have complicated any consistent approach to tuition and supplement funding. Figure 1, below, displays per student funding levels generated from tuition and state appropriations, for all student FTE, regardless of tuition category.

Figure 1. UW State and Tuition Funding per Student FTE



Since ABB was implemented, the supplement funding levels have changed, but there has also been a significant shift in the undergraduate tuition pool, resulting from tuition rate increases and enrollment growth, that has generated and distributed significant new tuition funding directly to schools and colleges.

It is only in the last two biennia, when resident undergraduate tuition rates were both frozen and decreased, that the ABB model, which relies on growth, began to return less formulaically derived revenue to schools and colleges, dramatically constraining some unit-level plans and emphasizing the tradeoffs in cross-subsidization that were always present, but less acute, when revenue dependably increased.

This committee believes that the Provost should develop a transparent and collaborative process that allows for the modification of supplement levels to maximize the academic and financial health of the University. Under the prior budget model, funds rarely shifted between schools and colleges; the UIF initiative in the 1990's was the last major effort to move GOF between schools to meet identified UW initiatives. The committee recognizes that a change in supplement funding may be financially prudent, and that the Provost should do so only after consultation with the President and executive leadership, and to the extent possible based upon specific and well-understood principles. Ideally, any changes should be based on detailed planning, especially with the school(s) or college(s) identified for reduced funding, and include at least a one-year advance notification to prepare for new, lower funding levels.

As such, the committee agreed that a set of principles, documented in policy, understood by many and adhered to whenever possible, would reduce concerns that an arbitrary or capricious approach to supplement funding changes would prevail.

Appendix 2: Differential Tuition Update, December 2017

Overview

For purposes of this brief, differential tuition is defined as variation in tuition rates, based on student or instructional characteristics such as residency (in-state or out-of-state), level of study (undergraduate, graduate or professional), type of instruction (in class or online), class standing (under or upper classmen), or major or program of study (e.g. history or business). Some types of differential tuition, such as those by residency and level of study, have become a widespread, accepted practice among public institutions of higher education in the US, while others have remained more controversial and are enacted on a limited basis. Similarly, many institutions charge the same tuition but greater fees for classes or programs that have greater costs, such as lab requirements.

As state funding has declined, universities have increased tuition rates to help offset the loss of state funds, to help address inflationary increases in costs, and to help meet workforce demand for relatively more expensive programs, like engineering. Some programs cost more than others due to differences in faculty salaries, costs related to labs or other experiential learning techniques, specialized supplies, and student to faculty ratios. In conjunction with a responsibility-centered management or activity based budgeting model, differential tuition can help align resources and activities with the varying costs housed by colleges and departments. Most universities already partially do this by charging students higher course fees or lab fees for more expensive programs; differential tuition simply takes this a step further.

Like many institutions, the UW currently charges different tuition rates for our graduate, fee-based and certificate programs, and has higher tuition charges for non-resident students. This brief will therefore examine differing tuition charges for *undergraduate* students by class standing, major or program, or type of instruction, focusing on differential tuition for major or program.

Washington State Tuition Laws and Policies

The UW's ability to enact differential tuition for undergraduates is constrained by the fact that our undergraduate resident tuition rate is legislatively mandated. According to RCW 28B.15.067, the UW Board of Regents may reduce or increase full-time tuition and fees for all students other than resident undergraduates (including nonresident students, summer school students, and students in other self-supporting degree programs). Resident undergraduate tuition is set by the state legislature and, beginning with the 2017-18 academic year, full-time tuition and operating fees for resident undergraduates may increase by no more than the average annual percentage growth rate in the median hourly wage for Washington for the previous fourteen years (approximately 2 percent per year).

With laws as they currently are, the UW *is* able to change or increase the tuition and fees for non-resident undergraduates to allow for differential tuition. **The only option for resident undergraduate tuition differential would be to implement the maximum increase allowed by the legislature (roughly 2 percent per year) for our most expensive programs and lower increases for other programs.** This would result in very little tuition differentiation and would not be an economically viable option, as it would decrease the total revenue that the UW would bring in from resident undergraduate students.

The UW faces another challenge to implementing differential tuition due to the unit pricing model used by Washington's Guaranteed Education Tuition 529 plan. GET unit payouts are tied to the highest tuition charged by a public institutions in the state, and the highest public tuition in Washington is currently charged at UW. If the UW were to adopt differential tuition by program, it would trigger a new, relatively higher rate that exceeds current actuarial assumptions. GET payouts would consequently increase to the new, higher level and the funded status of the program as a whole could be compromised. This was more of a concern, however, during the economic downturn, when GET ran into funding woes due to the combined forces of double-digit tuition growth and the falling value of its investments.

Differential Tuition at Peer Institutions

According to the undergraduate tuition charges available on each institutions website, **half of our *U.S. News* Top 25 Public Universities peer institutions have differential tuition rates**. If the University of California (UC) schools are combined into one group (there are six UC schools in the Top 25 list), then 65 percent have differential tuition. When using other peer groups, a slim majority of our peer institutions have differential tuition: 64.3 percent of Global Challenge State (GCS) peers, 50 percent of Office of Financial Management (OFM) peers, and 60.9 percent of Higher Education Coordinating Board (HECB) peer institutions have differential tuition. For those institutions with undergraduate differential tuition rates, most were by major or program area (engineering, nursing, and business being the most common), with a few by level of study or both.

Many of the UW's peer institutions have debated or considered differential tuition over the last few years. Reasons for considering or adopting differential tuition include:

- The decline in state funding and increased reliance on tuition revenue;
- The need to remain competitive amongst their peers[2]; and
- The balancing act between providing high quality education and keeping education affordable and accessible[3], especially for low-income students in low-diversity, high-demand fields, as considerations in the debate.

Other Considerations

While differential tuition for undergraduates is becoming more common, it is not generally popular among the student body or their families. This can be especially concerning for lower income students who may have a harder time paying increased tuition, even if their major is likely to have a higher salary after graduation. Low-income students, who are also disproportionately minorities and students of color, typically take on a greater debt-load to finance their tuition, fees, and living expenses[4]. Without strategic investment in financial aid and student support services, increased cost of a program with differential tuition could dissuade these students from more expensive areas of study, acting as another barrier to high-demand degrees and higher paying jobs in growing fields. Many high-demand, high-pay fields already lack diversity, and differential tuition could make this problem worse without thoughtful aid and support services strategies.

Another concern is how increased tuition in some programs could impact overall enrollment in those programs. A 2013 study[5] found that engineering and business enrollments saw small declines in

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[2] http://sec.tamu.edu/upload/documents/LCOE%20Differential%20Tuition-11_08_10.pdf
[3] http://senate.universityofcalifornia.edu/_files/underreview/rev_diff_fee_proposal.pdf
[4] http://www.demos.org/sites/default/files/publications/Mark-Debt%20divide%20Final%20(SF).pdf
[5] https://www.insidehighered.com/news/2013/07/15/study-finds-differential-tuition-can-influence-enrollment-levels

enrollment three years after the imposition of higher tuition in public research universities with differential tuition, and that enrollment decisions of female and minority students were more likely to be influenced negatively by those higher rates. A decrease in graduates in high-demand fields would impact the local supply of educated workers, leading to gaps in some fields.

Peer Institution Differential Tuition Comparison

US News & World Report Top 25 Public Universities	**Has differential tuition?**	**By division (lower vs. upper division)**	**By subject, major, or college**
Georgia Institute of Technology-Main Campus	No	N/A	N/A
University of California - Berkeley	No	N/A	N/A
University of California-Davis	No	N/A	N/A
University of California-Irvine	No	N/A	N/A
University of California-Los Angeles	No	N/A	N/A
University of California-San Diego	No	N/A	N/A
University of California-Santa Barbara	No	N/A	N/A
University of Connecticut	No	N/A	N/A
University of Georgia	No	N/A	N/A
University of Florida	No	N/A	N/A
Ohio State University-Main Campus	**Yes**	No	**Yes**
Pennsylvania State University-Main Campus	**Yes**	**Yes**	No
Purdue University-Main Campus	**Yes**	No	**Yes**
Rutgers University-New Brunswick	**Yes**	No	**Yes**
The University of Texas at Austin	**Yes**	No	**Yes**
University of Illinois at Urbana-Champaign	**Yes**	No	**Yes**
University of Maryland-College Park	**Yes**	**Yes**	**Yes**
University of Michigan-Ann Arbor	**Yes**	**Yes**	**Yes**
University of Pittsburgh-Pittsburgh campus	**Yes**	No	**Yes**
University of Virginia-Main Campus	**Yes**	No	**Yes**
University of Wisconsin-Madison	**Yes**	No	**Yes**
University of North Carolina at Chapel Hill	**Yes**	No	**Yes**