Subject: Budget Model

Date: October 10, 2008

From: Joseph Alutto
Steve Gabbe
Bill Shkurti
Chip Souba

To: E. Gordon Gee

The purpose of this memo is to follow up our previous discussions regarding the University's budget model. Pursuant to your request, we have synthesized our recommendations based on the May 2008 Budget Review Committee Report and our own continuing conversations with Senate Fiscal Committee and other stakeholders. We have identified eight key areas for improvement:

➢ Implementation in the Colleges
➢ Central Resources
➢ Links to Quality
➢ Space
➢ Multi-disciplinary Research
➢ Impact of Enrollment Shifts
➢ Start-up Costs
➢ Transparency

Implementation in the Colleges

The current budget model is designed to provide a great deal of flexibility at the college level. We feel this puts financial decisions affecting academic programs as close as possible to where they ought to be made with enough discretionary resources to address academic needs across departments and programs.

We still feel the colleges are the appropriate focal point for these decisions, but this does not mean "every tub on its own bottom," or a totally decentralized model. But, after five years of experience, it has become clear that we should take additional steps to make sure deans exercise
discretion within a framework that strengthens our academic goals under the One University concept and that those decisions and actions are transparent.

ACTION STEP - All colleges have been asked to provide a document that explicitly links its strategic plan with its five year budget plan. Those documents were due October 1, 2008 and will be reviewed by the Office of Academic Affairs to assure alignment with the academic goals of the University. These plans will be posted on college websites with links from the OAA website to improve transparency. The annual performance review of deans will focus on progress towards the success of their college's strategic plan and it will be expected that deans will have similar discussions with college leaders, department chairs and school directors.

Central Resources

Because the current budget model devolves a lot of financial decisions and resources to the colleges, there has always been a concern this would leave insufficient resources at the center to pursue institution-wide goals. That is why 25% of all increases in subsidy and base tuition revenue is reserved for the center, including 5% specifically for the Provost to invest in new and innovative academic programs. The Office of Research, now reporting to the Provost, derives resources through the model that are also distributed to stimulate academic excellence.

A 2007 review of top tier universities commissioned by the OSU Board of Trustees found that Ohio State University's budget system compared favorably to our competitors in the ability to generate funds for central investments, although the channels for such investment varied considerably between institutions. The attached table summarizes the use of those funds since the current budget model was implemented in FY 2003. It shows a strong and diverse use of central funds to promote University-wide goals, including development of new programs, retaining key faculty, attracting more qualified students, investing in necessary enterprise solutions and promoting cross-disciplinary, world class research through the Targeted Investment in Excellence and other strategic reputation enhancing programs such as the Third Frontier Initiative. Importantly, over $120 million in targeted one time and continuing funding was provided from these central funds to augment allocations made by colleges, providing incentives for programs and activities consistent with overall University objectives.

ACTION STEP - Nevertheless, we feel strongly that in order to accomplish our academic goals, additional resources will need to be generated centrally without reducing resources to the colleges. This can be accomplished by building up the President's Strategic Investment Fund as called for in your October 2007 speech to the faculty. A proposal to establish such a fund with the goal of generating over a quarter of a billion dollars in investment funds over the next six years will be implemented this Fall. That funding flexibility, in addition to currently projected central resources, will provide significant incentives to secure the actions and outcomes necessary for overall success. In addition, the Office of Academic Affairs and the Office of Research will coordinate the allocation of central resources to assure the greatest effectiveness in achieving our aspirations.
Tying Funding to Quality

Moving away from a purely enrollment driven model to a more quality driven one was a key objective of the budget model when it was introduced in 2003. At that time, it was agreed that the place to start was with doctoral education. Unfortunately, the Graduate School was not up to leading this effort until Pat Osmer assumed the position of Dean of the Graduate School in 2007. Consequently, little was done to address this issue until very recently; a lapse in follow-up that will not be repeated.

Dean Osmer led a comprehensive effort to identify our highest quality programs and to indicate how others may be improved. The outcome of this report is available on the web at http://gradsch.osu.edu/Content.aspx?Content=223&itemid=43. During the FY 2009 budget planning cycle, $3.6 million was set aside from central resources to be distributed in alignment with the Graduate School’s recommendations. This amount is expected to grow in future years and is an essential component for implementing one of the most comprehensive and strategic assessments of doctoral program quality in the country.

ACTION STEP - The next step will be to align professional, masters and undergraduate programs with measures of academic quality. This needs to be done in alignment with the Chancellor’s University System of Ohio proposal, which will be finalized over the next 12 months. The Chancellor has promised us that quality will be an important component of the funding model. We need to help assure this is the case and we need to be prepared to make certain this is implemented successfully.

When a more enrollment sensitive budget model was implemented in 2003, there was some concern it could lead to increased class size, course poaching between colleges, and "dumbing down" of courses to attract enrollment. The Council of Academic Affairs was strengthened and asked to monitor enrollments and grades to make sure this did not happen. CAA has monitored these trends and, to date, no evidence of this behavior has been found, which was also confirmed by the Budget System Advisory Committee report. What has happened is the closed course problem has been virtually eliminated, thus advancing the University’s goals of attracting top students and making sure they graduate in a timely manner. This had been a major problem generated by the previous budgeting model. In addition, as discussed further below, subsidy for undergraduate courses is now distributed by a weighting methodology that distributes 40% of funds according to a cost of instruction methodology.

Space

One of the goals of the current budget model was to make the operating costs of space more transparent, which would hopefully lead to better decisions at the college and unit levels about utilization of space. While we have made some progress here, a combination of rising energy costs and no growth in state support in the first three years under the new model placed units with a lot of space at a relative financial disadvantage compared to others. State funding support has always reflected differences in costs among academic programs, including space; undergraduate tuition has not. When the current budget model was adopted in FY 2003, it was assumed past trends would continue, where state support provided about 40% of the increased
revenue growth. Instead, state support fell dramatically in this period, while tuition increased disproportionately. This disadvantaged colleges such as Engineering and FAES that are more space intensive.

The recommendation of the Senate Fiscal Committee to treat 60% of combined income as tuition and 40% as state support should help ameliorate this problem in the future, but this merits additional conversations to make sure distributions are appropriate. Interestingly, the ability to make this adjustment, consistent with our budgeting principles, is one of the advantages of our current system.

In keeping with this principal, we have embarked on a pilot project with the College of Food, Agricultural and Environmental Sciences to assist them in reconfiguring space to meet changed academic needs, while simultaneously reducing operating costs. We have also created a fund that will help us demolish buildings more quickly when strategically appropriate.

ACTION STEP: We will extend opportunities for space reconfiguration to other units based upon our experiences with FAES. We will support strategic demolition. We are totally changing the capital process to align academic strategies with knowledge of building function and condition to assure there is only essential new construction. This will improve the quality of space sooner by leveraging state, local, and development funds for capital priorities. We are also evaluating the use of our instructional space to determine if course offerings might be adjusted to more effectively utilize available instructional space.

Multi-Disciplinary Research

For the University to meet its academic goals regarding research, it must be able to successfully engage in research that crosses disciplinary boundaries. The challenge for the University has been that its organizational structure, including hiring, tenure, and promotion of faculty, is built around traditional disciplines.

With the implementation of the current budget model based on colleges as the main budget unit, there was a great deal of concern as to how this would affect research across colleges. A special committee of faculty members involved in inter-disciplinary research and chaired by Professor William J. Mitsch looked at this issue in 2004. They found no evidence that the new budget system created additional barriers, but they identified a number of areas where the University could do more to promote a culture of inter-disciplinary success. Virtually all of these recommendations focused on clarity and consistency of decision making at the local level and not the need for changes in the budgeting model.

Since that time, OSU's research portfolio has continued to expand, including the amount of inter-disciplinary research. In addition, the Office of Research has successfully stabilized funding for some key inter-disciplinary centers such as the Byrd Polar Center. Certainly, the Targeted Investment in Excellence process has tied funding incentives to inter-disciplinary initiatives. In fact, the faculty of two TIEs and one Center have initiated inter-related and collaborative activities themselves realizing additional transinstitutional collaborations. We also
expect that one outcome of the consolidation of the Arts and Sciences is more inter-disciplinary collaboration.

We feel there is still room for improvement. We have discussed this issue with Caroline Whitacre, who was a member of the 2004 task force, and we agree now would be a good time to take another look at this issue.

ACTION STEP - We have agreed to support a task force led by the Office of Research that will look at all the institutional barriers to inter-disciplinary research, including budgetary processes, and report back with recommendations by no later than the end of Spring Quarter 2009. We should also point out that the initial discussion of the Provost's proposal for Centers of Innovation is consistent with such efforts and has been seen in that light by faculty.

Impact of Enrollment Shifts

One of the questions raised to us is what happens when a highly rated academic program undergoes a shift downward in enrollments. While the budget model is still largely enrollment driven on the Masters and Undergraduate level, there are tools available to address questions of this nature. First of all, enrollment related income is based on a two-year moving average, so the affected unit has some time to make adjustments. In addition, the department has recourse to the college for additional support and the college has recourse to the Provost. A special Enrollment Reserve, under control of the Provost, has been set aside for this purpose. In the case of the Arts and Sciences, the Federation is also expected to play a constructive role.

ACTION STEP – We will make clear to the deans and department chairs the role the college and the Provost has in making sure high quality departments are funded appropriately. This will align with performance expectations of deans, department chairs and school directors through activation of college strategic plans and program reviews.

Start-up Costs

Some of the Deans have brought to our attention the escalating costs in start-up packages, particularly in the lab sciences. This is a problem across the country not just at OSU. Our budget model is probably better than many because it allows units to accumulate one-time funds to use for this purpose.

Nevertheless, the escalating cost of these packages has placed a strain on unit budgets. Over the last five years a growing portion of the central funds distributed to colleges has been used for this purpose, yet it still remains a major concern.

ACTION STEP – Work with the Office of Research, Council of Deans, Senate Fiscal Committee and Senate Research Committee to develop a set of guidelines on when central funds are appropriate to assist colleges for start-up purposes. We will also explore earmarking a portion of the President’s Strategic Investment Fund for this purpose.
Transparency

It is clear to us from the conversations we have had across campus that there is still considerable confusion and misinformation about how the budget system works. Some of this is inevitable given the size, complexity and multiple funding sources of the University. In addition, some deans told their faculty and department chairs that the budget model "forced" them to make unpopular decisions, when in fact, those decisions reflected financial priorities of the college itself. But it is also clear that we have not devoted enough time and energy to training and to the assessment of interactions between local policies and University objectives. This will be partly addressed by the new strategic planning process and better preparation of fiscal officers, but also by more focused discussions with department chairs and faculty.

ACTION STEP - We do not think the budget model is inherently complex – it is based on the principle that colleges should be allowed to keep 75% of the additional income they generate, as long as they are advancing the University's academic goals. Unfortunately, this core principle has often been lost in the discussions of marginal net revenue, assessments, PBA v. cash, etc. To help with this, college fiscal profiles have been redesigned and are available for review and use by the colleges, and new templates for sources and uses have been developed to facilitate planning. In addition, we will be focusing on a strengthened effort, in partnership with the Integrated Financial Planning Group, Council of Deans and Senate Fiscal Committee, to engage in a dialogue with the campus on both the changes that have occurred and have been proposed and on the successes of the budget model. We think this is very timely as we move forward to both refresh the academic plan and set goals for the next five years.

Additional Considerations

Given the rapidly changing nature of the University's financial environment, it is important for the budget model to be refreshed regularly. On the other hand, it is equally important to preserve and strengthen those elements of the model that advance the University's academic goals. During the first five years of the current budget model, OSU's academic reputation has, in fact, improved. There are three areas in particular where incentives in the budget model have strengthened the University's ability to support key elements that underlie these goals. Specifically:

- Providing more flexibility to the deans has meant the University was able to reverse the trend of the previous five years where faculty salaries were falling behind our aspirational peers, particularly in our high visibility, high quality programs.

- The ability to target resources has allowed the University to centrally invest in recruiting and retaining more qualified freshmen, which in turn has improved retention, graduation rates, stabilized enrollments and strengthened our academic reputation.

- The incentives to grow sponsored research have given the deans and faculty the opportunity to capture a larger share of research dollars and advance OSU's national research ranking and academic reputation.
The tremendous success this University has enjoyed over the last five years reflects primarily on the good work of our faculty, staff and students. But, it also reflects an overall allocation of resources that advanced the University's academic goals. The Integrated Financial Planning Group is committed to working with you and other stakeholders to make sure the next five years are even more successful. We feel the changes we have recommended will provide the improvements needed in the budget model for the University to continue to move ahead.

c: Donna Hobart
   Lee Walker
   Vice Provosts
   Senate Fiscal Committee
   Council of Deans
### Office of Academic Affairs (OAA) and Office of Research (OR) Cash and Continuing Funds Distribution by College (FY 03-09)

<table>
<thead>
<tr>
<th>College</th>
<th>Cont. Funds</th>
<th>% of Cont. Funds</th>
<th>Cash</th>
<th>% of Cash</th>
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<tbody>
<tr>
<td>OAA</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Arts &amp; Humanities</td>
<td>$5,162,055</td>
<td>16.52%</td>
<td>$6,346,288</td>
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<td>Biological Sciences</td>
<td>$1,378,844</td>
<td>4.41%</td>
<td>$4,919,340</td>
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<td>Business</td>
<td>$563,389</td>
<td>1.80%</td>
<td>$1,409,991</td>
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<td>Dentistry</td>
<td>-$782,500</td>
<td>-2.50%</td>
<td>$210,000</td>
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<td>Education and Human Ecology</td>
<td>$611,644</td>
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<td>Engineering</td>
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<td>FAES</td>
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<td>Law</td>
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<td>MAPS</td>
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<td>10.21%</td>
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<td>Pharmacy</td>
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<td>Social and Behavioral Sciences</td>
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<td>Veterinary Medicine</td>
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<td>1.01%</td>
<td>$2,888,913</td>
<td>3.19%</td>
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</tbody>
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Cancer Center/CTR TIE funding          | $0          | 0.00%            | $977,312   | 1.08%      |
Central Units                          | $1,700,000  | 5.44%            | $0         | 0.00%      |

| Total Commitments                      | $31,239,284 | 100.00%          | $90,454,611| 100.00%    |

* Includes TIE funding. Office of Research funding is not included.

**NOTES:**
- FY03 TO FY09 DOES NOT INCLUDE
  - * FY03 CASH FUNDING FROM RESEARCH
  - * FY08 CASH FUNDING FROM OAA
  - * FY09 CASH FUNDING FROM RESEARCH OF ~$5M
- FY03 TO FY09 PBA TOTAL IS NOT CONSISTENT WITH PBA DETAILS