Incentive-based Budget Model Subcommittee Report

Preface

To fully understand this report, you are encouraged to learn more about IBB by reviewing all of the informational and educational materials on the IBB website.

We are committed to meeting with anyone, anytime, anywhere to discuss IBB. If you would like to schedule a meeting, please contact Alberto Citarella, University Budget Director.

The following report is one of eight separate reports that will be used to develop a comprehensive Incentive-based Budget Model for the University of Vermont. Each of the eight subcommittees was asked to address a particular component of the overall IBB budget model.

The proposed algorithms contained within the reports are not intended to be a perfect accounting of revenue generation and resource usage across the University. They do, however, provide a solid foundation upon which the initial IBB model will be based, and they support the project’s Guiding Principles and the University’s Academic Excellence Goals.

Each report has only been vetted by the subcommittee that wrote it. It is possible that the proposed algorithms presented by the eight IBB subcommittees may, at times, contradict each other.

The IBB Steering Committee will use these reports as the basis for its further discussions and final recommendation on an integrated IBB budget model. It is possible that the Steering Committee may need to adjust the proposed algorithms to create a coherent, comprehensive and workable budget model.

It is strongly recommended that you read all eight subcommittee reports; they are all interrelated. If, after reading a report, you have feedback to share, please complete the survey that accompanies the report.

January 29, 2014
Other Revenue and Fees Subcommittee Report to the IBB Steering Committee  
January 24, 2014

Subcommittee Charge
The Subcommittee on Fees and Other Revenues (the “Subcommittee”, hereafter) was charged to consider alternative ways in which budgets could be developed for units that collect fees and other forms of revenue not directly related to tuition, research, and other core functions of the institution. Specifically the Subcommittee charge was to develop at least two alternative algorithms to allocate the revenues and expenses associated with these revenue-generating activities. In addition, the charge was to consider the following questions:

- Should income/expense activities that reside in academic Responsibility Centers (e.g., the Melosira in Rubenstein School of Environmental and Natural Resources and the Luse Center in College of Nursing and Health Sciences) continue to operate under the umbrella of that Responsibility Center or should their revenues and expenses be handled differently?
- Should income/expense activities that reside in administrative or co-curricular units (e.g. Print and Mail in Administrative and Facilities Services and Telecommunications in Enterprise Technology Services) continue to operate under the umbrella of that unit, or should their revenues and expenses be handled differently?
- Where should existing fees that are currently allocated to the general fund (e.g. admissions and vending fees) be allocated?
- Should existing fees that are currently allocated back to particular units (e.g. course supply fees) continue to be allocated back to a particular unit?

In the following sections we summarize our approach and recommended algorithms and describe how the recommended algorithms help to support the IBB Guiding Principles.

Subcommittee Membership
Breck Bowden, Professor, Rubenstein School of Environment and Natural Resources (Chair)
Joshua Barry, Undergraduate Student, College of Engineering and Mathematical Sciences
Cynthia Belliveau, Dean, Continuing and Distance Education
Dennis DePaul, Assistant Dean for Business Operations, Dean of Students
Stephanie Dion, Director, Administrative Business Service Center
Patricia Eldred, Director, Administrative and Facilities Services Auxiliary Services
Mary Peabody, Extension Professor, UVM Extension
Julia Russell, Associate Chief Information Officer, Enterprise Technology Services
Susan Ryan, Professor and Director, Center on Disability and Community Inclusion
Jeff Schulman, Associate Director, Athletics

Subcommittee Support
Cathy Krupp, Financial Manager, Continuing and Distant Education
Carrie Roy, Analyst/Planner, Division of Finance
Philip Munderville, Deans Office, Rubenstein School of Environment and Natural Resources
Description of the Process by Which the Subcommittee Developed the Algorithms
The Subcommittee met six times during the late fall of 2013 and January 2013 and communicated by email frequently. During that time the sub-committee completed the following:

- Reviewed practices of other Institutions that use IBB
- Gathered specific information and data about fees and other income that flow through the University
- Gathered specific information and data about the number and nature of income and expense activities at UVM
- Select sub-committee members met with Financial Analysis & Budgeting to understand the indirect charges to income and expense activities and the impact those charges have on the General Gund
- Select sub-committee members met to make recommendations for the indirect charges in an IBB model
- Subcommittee Chair Bowden spoke with Polly Parsons, Subcommittee Chair for Cost Pools Methodologies and with Mike Meunier, Assistant Controller, Cost Accounting Services, to seek input about several questions raised by this Subcommittee.

Proposed Algorithms and Discussion of How the Algorithms Support the IBB Guiding Principles
The specific questions this Subcommittee was charged to address distinguish between financial activities that involve “fees and other revenue” and financial activities that involve “income and expense units”. Each category will be described in turn. The Subcommittee notes that there is a substantial overlap in the definitions of these two revenue streams, which may require further consideration.

Proposed Algorithms for Fees and Other Revenue
Fees and Other Revenue are income streams that are not directly related to tuition, research income, or state appropriations. This is a diverse class of income streams that are difficult to categorize. Some fees and other revenue are collected for goods and services offered to a client (who may be internal or external to the University). For example, Comprehensive and Acceptance fees are mandatory fees assessed on all students (undergraduate, graduate, or medical; degree or non-degree; full-time or part-time) that are used to provide specific facilities and services of interest and use to the students. These facilities and services include the Center for Health and Wellbeing, the Davis Center, Technology Innovation, Transportation, Library, Academic Transcripts, the Clean Energy fund, Academic Support Programs, and Student Government.

Beverage vendors also pay a “fee” to UVM in consideration of concessions UVM makes to allow semi-exclusive access by the vendors to the UVM market. However, in this case the beneficiary of the fee income is the University in general and not a specific unit within the University. Both of these fee types (Comprehensive and Acceptance, and Vending) are approved by the Board each year.

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1 In this report, these two sections were combined into one.
Other income includes donations, gifts and endowments that may be restricted (i.e., the use is prescribed) or unrestricted (i.e., the use is not prescribed). The recipient of this income could be a specific unit within the University (e.g., a specific college or school) or the University in general.

In summary, fees and other revenue include classes of income that derive from internal as well as external clients, they may benefit a specific unit or the University in general, and in some cases the uses of the income may be restricted while in others it is unrestricted. The Subcommittee was able to identify many – but probably not all – individual types of fee and other revenue sources and we could classify the characteristics of most – by not all of these sources. To unambiguously implement the IBB framework we suggest that it may become necessary to complete this process of identification and classification.

With this background in mind the Subcommittee devised three alternative options to manage fees and other revenues. In both options we distinguish between fees and other revenue that can be unequivocally associated with a specific unit (specified income) versus those that are associated with the University in general (general income).

**Proposed Algorithm 1**
- All specified income currently allocated to units continues to be allocated to units
- All general income goes to the Provost

**Proposed Algorithm 2**
- A majority percentage of specified income currently allocated to units continues to be allocated to units with the remainder allocated to the Provost.
- A majority percentage of general income goes to the Provost with the remainder allocated to units by revenue sharing algorithms defined elsewhere in the IBB report.

**Proposed Algorithm 3**
- A majority percentage of specified income currently allocated to units continues to be allocated to units with the remainder allocated to the Provost.
- All general income goes to the Provost

The Subcommittee concluded that Option 1 best aligns with the IBB guiding principles because it:
- Provides transparency, clarity and predictability to units receiving the fees – Revenue in these categories is tied to expense incurred
- Is easily understood, easy to implement and is flexible – There is no change to implementation and it is easy to understand since fee allocation is tied to expense allocation
- Can operate in all cycles of the economy – General revenue/fees will flow to a Provost controlled fund. This allows the Provost to use these funds strategically in either economic booms or in downturns.
- Encourages innovation and entrepreneurship – Individual units are still encouraged to seek specified income, including gifts and endowments, which will go to the originating unit. There is thus an incentive by the unit leaders to seek and utilize this income in innovative ways.
We concluded that Option 2 would be least transparent and most difficult to implement. Option 3 would maximize the return to the Provost’s allocation fund at the expense of the individual units.

In response to the specific questions the Subcommittee was charged to address regarding this income type:

- We concluded that fees that are currently allocated to the general fund should be divided into those supporting specific services (e.g. the Comprehensive and Admissions fee) versus those that might be used at the Provost’s discretion (e.g., vending fees).
- We concluded that fees that are currently allocated back to particular units (e.g., course supply fees) should continue to be allocated back to that particular unit.

**Proposed Algorithms for Income/Expense Activities**

*Income/expense (I/E) activities* at the University of Vermont are activities that are designed to generate sufficient revenue from the sale of specific goods or services to recover expenses associated with providing those goods or services. These activities support the primary programs of instruction, research, and public service at the University. These activities may service internal, external, or research clients.

The list of I/E activities at UVM is diverse, ranging from units as large as Residential Life, the Davis Center, and the Center for Health and Well-Being to small activities or services such as individual copiers or vehicles owned and operated by colleges or centers. Collectively I/E activities represent an income of about $148 million dollars in the UVM budget. In this report we will distinguish among three generic types of I/E activities, as follows:

*Responsibility Center I/E (RC-I/E)* activities reside entirely within a College, School, or other Responsibility Center as defined elsewhere in this report. The Spatial Analysis Laboratory within the Rubenstein School of Environment and Natural Resources and the Luse Center in the College of Nursing and Health Sciences are examples of this category.

*Administrative Service Center I/E (ASC-I/E)* activities reside entirely within administrative units and provide services that are of use to the wider University and not one specific unit. These include, for example, the Wilderness TREK program in the Division of Student Affairs or Facilities, Design and Construction in the Division of University Relations and Administration.

*Large Self-Sustaining I/E (LSS-I/E)* are a special class of ASC-I/E activity. The LSS-I/Es have large budgets (>~$750,000) and have traditionally operated as stand-alone I/E activities. In many cases these entities pay their own utilities, custodial expenses, and rent/debt.

*Indirect Cost* is a contribution by I/E activities to the General Fund that is intended to offset some of the administrative costs of the institution that are not charged directly to the I/E activity but help to support it at least indirectly. The Subcommittee focused on indirect costs because this is the primary component of the budgets for I/E activities that affects the General Fund. The indirect cost rate is a flat amount, a percentage of the budget, or a space-based charge depending on the clients that the I/E activity charges. Historically, I/E activities that charge predominantly internal clients have paid a 3% indirect cost while I/E activities that charge predominantly external clients have paid a 15% indirect cost. I/E activities that charge research clients must, by regulation, charge a federally-negotiated indirect cost.
The algorithms reviewed by the Subcommittee for I/E activities were:

**Proposed Algorithm 1**
- RC-I/E: Continue with current practice of paying an indirect cost
- ASC – I/E: Continue with current practice of paying an indirect cost
- LSS – I/E: Continue with current practice of paying an indirect cost

**Proposed Algorithm 2**
- RC - I/E: Eliminate the current practice of paying an indirect cost
- ASC – I/E: Continue with current practice of paying an indirect cost
- LSS – I/E: Continue with current practice of paying an indirect cost

**Proposed Algorithm 3**
- RC-I/E: Eliminate the current practice of paying an indirect cost
- ASC-I/E: Eliminate the current practice of paying an indirect cost
- LSS – I/E: Continue with current practice of paying an indirect cost

The subcommittee recommends Option 3. Appendix Table 1 summarizes how this recommendation would be applied to each of the three I/E activity classes defined above, by the clients they serve, and provides a rationale for each category. Our supporting rationale for recommending option 3 is as follows.

**For I/E activities in Responsibility Centers:** We recommend to eliminate the practice of charging an indirect cost to I/E activities in RCs because this resource simply goes to the General Fund, which in a circuitous and not particularly transparent way might return to the RC in the form of a lower “charge” from Cost Pools that have been supported from the General Fund. We think that it would be simpler and more transparent to allow the RC leadership to decide whether or not to maintain a particular I/E activity that resides within the RC. The Cost Pools charged to the RC are an expense that has to be borne. The RC leadership can then decide whether to impose an “internal charge” on the I/E activity if it is a positive net asset or to subsidize the I/E activity if there is a need to do so and the activity is sufficiently valuable to retain.

**For I/Es in Administrative Service Centers:** We also recommend eliminating payment of indirect costs by I/E activities in ASCs. In cases were ASC-I/Es revenues exceed expenses, the net positive revenue should be used to reduce the dollar amount of the cost pool allocations made from the ASCs to RCs (or other ASCs). In cases where an ASC-I/E activity’s expenses exceed its revenue, the deficit would have to be made up from subvention funds. As a general principle, the university should strive to have ASC-I/E activities just “break even”. This would cover the costs of the ASC-I/Es with the lowest possible Cost Pool charge to the RCs, which benefits everyone. If ASC-I/E activities routinely generated a deficit that had to be subsidized, this should generate a discussion about the need or ability to retain the services of the ASC-I/E.

**For Large Self-Sustaining I/Es:** The Sub-Committee identified thirteen I/E activities across the university that have budgets in excess of $750,000. These thirteen I/E activities are CatCard, the Center for Health & Well-Being, the Davis Center, Orientation, Global Gateways, Parking, Transportation, Telecommunications, Residential Life, Dining Commissions, the Bookstore, Instrument & Model Facilities/Technical Services Partnership, and Conference & Events.
The Subcommittee recommends that there should be further analyses to determine the costs and benefits to move at least two of these I/E activities (Orientation and Telecommunications) to the General Fund (both revenue and expense). Due to the current financial structure of these activities neither one meets the definition of a true income expense activity. In addition, discussions were previously underway to make this change prior to the introduction of IBB, but those discussions have not yet concluded.

The Subcommittee debated at length whether the remaining eleven LSS I/E activities should operate under the algorithm that we suggest for RCs and ASCs in which they pay no indirect cost or whether LSS I/E activities should continue make a negotiated contribution to the General Fund. These entities are at least as large and complex as RCs or ASCs. However, they do not have the same fundamental service obligations to the university’s mission and they are not as responsive to the primary cost pool drivers as are the RCs and ASCs. In most cases these units already pay most of their utilities, facilities expenses, and rental fees. Furthermore, the Subcommittee determined that the General Fund would forego a large amount of revenue (estimated at $2 million/year) if these LSS-I/E activities were relieved of the obligation to contribute to the General Fund. Thus, we recommend that for the time being these other LSS I/E activities should continue to operate as they do now with a commitment to review this recommendation, ideally before full implementation of the IBB model, but otherwise prior to the first reevaluation of the IBB model.

Our recommendation of Option 3 for I/E activities aligns with the guiding principles for the IBB Model as follows:

- Creates incentives that promote academic quality and excellence. These recommendations will contribute to a culture in which budget decisions regarding I/E activities focus on the core service of the activity to internal and external clients without regard to budget impositions from central administration.

- Creates incentives at all levels of the University that promote financial sustainability. These recommendations address I/E activities that span the entire breadth of the university’s operations and places the responsibility to maintain, alter, or eliminate I/E activities with the unit leaders best positioned to make those decisions.

- Encourages innovation and entrepreneurship throughout the University. Because all budget decisions are made “locally” there will be an even greater incentive to ensure that I/E activities maintain net positive assets and benefit clients that are important to the unit and to the University.

- Provides transparency, clarity, and predictability. Eliminating IDC charges and contributions to the General Fund administered by central administration and shifting these costs (with offsetting revenues) to RCs and ASCs will lead to a clearer understanding of the source and use of funds available to these units.

- Can be easily understood, is easy to implement and operate, and is flexible. Eliminating IDC charge simplifies the development of budgets and is easy to implement.

- Can operate in all cycles of the economy, whether robust or downturn. These recommendations do not prescribe how net assets (reserves) should be used in time of plenty or how cuts should be made when deficits arise. However, it does place all of the decision-making tools, information, and authority in the hands of RC and ASC leadership who are closest to the needs and capabilities of their unit. Thus, we expect that efficient (if difficult) decisions will be made by leaders who are close to the home unit. The Subcommittee notes
that as the new IBB model is implemented, it will be necessary to provide training for RC and ASC leaders and their budget advisors so that the intended objectives and benefits are achieved.

In response to the specific questions the Subcommittee was charged to address regarding this income type:

- We recommend that I/E activities that reside in academic Responsibility Centers should continue to operate under the umbrella of that Responsibility Center.
- We recommend that I/E activities that reside in administrative or co-curricular units (ASCs as defined in this report) should continue to operate under the umbrella of those units.

Related Issues for Subcommittee Consideration

Here we summarize several issues that the Subcommittee suggests should be considered further:

- It would be helpful to clarify the definitions of “fees”, “I/E activity”, and “other income”. This could become important if certain characteristics of these income types (e.g., specified or general, restricted or unrestricted, internal or external) affect the way that revenue or expenses are allocated by algorithms defined elsewhere in the IBB report.
- Further consideration should be given to whether LSS I/E activities should continue to operate as they do now (the recommended option for the time being) or whether they should be treated as RCs and operate under those algorithms.
- The Subcommittee recommends that the discussions to move Orientation and Telecommunications to the General Fund rather than to consider them to be LSS I/Es should be renewed and concluded.
- While there was general agreement about most points in this report, there was a concern by a minority of Subcommittee members that there was inadequate time to available to consider all aspects of how implementation of the IBB framework would affect entities that collect fees and other revenues or operate as I/E activities. The Chair notes this concern and concludes that this report reflects as faithfully as possible the majority view based on the information available at this time.
### Table 1

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<tr>
<th>Activities</th>
<th>Light</th>
<th>Center</th>
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<tbody>
<tr>
<td>I/E Active in a Responsibility: 1/E</td>
<td>I/E Active in a Responsibility: 1/E</td>
<td>I/E Active in a Responsibility: 1/E</td>
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*Active in I/E* means the active has an income and expense (I/E) activity classification and recommended practices by type of management unit.

A small majority of these activities either pay no contribution to the General Fund or a flat dollar amount (e.g., not a % of expenses).

*Primary Audience: Federal.*

**Relevant Cost:**
- Space costs
- Pay a contribution to the General Fund

**Advisories:**
- Pay a contribution to the General Fund
- Pay a contribution to the General Fund

**External Customers:**
- Pay a contribution to the General Fund

**Appendix**
- Table 1: Matrix of income and expense (I/E) activity classes and recommended practices by type of management unit.