



TO: Faculty and Staff of the University of Vermont

FROM: David V. Rosowsky, Provost and Senior Vice President

DATE: May 11, 2015

SUBJECT: Incentive-based Budget Model – Campus Update #4

As the academic year draws to a close, I wanted to provide a year-end update on our incentive-based budgeting (IBB) initiative. While excitement over the power and potential of the new model is building as the July 1 launch-date approaches, we also know that any such transition raises questions and can create anxieties. This is normal and fully anticipated. My goal over the last 20 months has been to operate with both transparency and accessibility – being responsive, available, and forthcoming. In keeping with the commitment to openness and transparency upon which the model was built, I'd like to address three important issues around which questions have arisen: (1) FY16 budget reductions, (2) Cost Centers, and (3) subvention.

FY16 Budget Reductions and IBB

The FY16 budget reductions are not related to IBB. The reductions were not caused by the transition in budget model and they did not result from strategies or algorithms embedded within the new budget model. The FY16 reductions resulted from the need to balance expenses and revenues. In other words, and as you have heard over the last year, our expenses (largely driven by increases in salaries and benefits) are growing at a faster rate than our revenues (largely driven by undergraduate tuition). This is a continuing issue, causing what amounts to a structural gap. It has nothing to do with IBB. It is independent of the choice of budget model. However, IBB does provide a platform from which we can not only stabilize our budget (ensuring UVM's short and long-term sustainability), but also transform the University and enhance our value proposition by creating new and compelling academic offerings, creating the best possible teaching and learning environment, and innovating and adapting to meet changes in the world around us. *This* is how we will create a sustainable future (intellectual, financial, and otherwise) for the University of Vermont. It will require commitment, leadership, vision, innovation, and the strategic use of IBB as a management tool – to take bold risks, to realize ambitious goals, to elevate and to secure UVM's position as leading university.

The Cost of the IBB Cost Centers

Some have rightly noted that IBB Model 1.0 does not contain an explicit methodology for determining appropriate Cost Center (CC) budgets. Over the last several years, the burden of university-wide budget reductions has been more heavily borne by the administrative, rather than the academic, units on campus. This was by design, in efforts to minimize impact to the core academic programs of the University. As a result, our administrative units have greatly improved efficiency while continuing to deliver high-quality services to our academic units, our students, and our campus. In addition, just as the Responsibility Centers (RC's) are planning for reductions in their subventions (see next section), the

CC's also are planning for decreases in their annual budgets. In fact, **as part of the FY16 budget process, the Cost Centers were required to submit budgets for FY17 and FY18 that included reductions.**

As we move forward, we will continue to monitor the Cost Center budgets carefully, and Cost Centers will be expected to seek all possible efficiencies. If there are significant and sustained increases *or* decreases in the drivers upon which Cost Center expenses are allocated, Cost Center budgets will be adjusted accordingly. In IBB Model 2.0, we may seek to establish a more formal methodology to drive increases or decreases to Cost Center budgets. In the meantime, I would ask that you consider that, while it may be true that the RC's have no control over the costs of the Cost Centers in IBB 1.0, it is also true that the academic units have *never* had control of these costs. Under IBB, however, we are now able to discuss and evaluate these costs with the benefit of full information and complete transparency.

Subvention

It is fair to say that subvention has raised more questions than any other component of IBB Model 1.0. In its simplest terms, subvention is the redistribution of revenue "outside" of the IBB revenue algorithms. This includes taking a portion of the overall undergraduate net tuition revenue (\$40M), designating that funding as the subvention pool, and then allocating that revenue to Responsibility Centers in a variety of ways for a variety of reasons. In FY16, 100% of the \$40M subvention is allocated back out to the colleges/schools.

Subvention has *always* been part of the University of Vermont budget model. That is, the University budget has always included internal reallocations between colleges/schools with the ability to generate revenue in excess of their costs and those that require support regardless of how efficiently they operate. What has changed? In IBB, this subsidization – or subvention – is now visible. Recall that *transparency* was one of the goals we established for IBB. Now, and as is the case with the Cost Centers (previous section), we can discuss subvention levels and strategies with the benefit of complete information and full transparency.

Responsibility Centers (colleges/schools) have been advised to plan for reductions in their subventions of between 5% and 10% each year for the next four years. This is a target range of reductions *only* to the subvention amount, which is in all cases a small percentage of the overall budget.

Subvention will be used to ensure budget neutrality in FY16. In FY17 and beyond, reductions and reallocations in subvention will allow us to progress toward strategic goals and objectives, recalibrate imbalances among RC budgets, temporarily ameliorate sudden budgetary (enrollment) shifts, and provide ongoing support to RC's that simply cannot generate enough revenue to meet expenses. Part of the planned and phased reduction will be used to create a Strategic Investment Fund to enable the president and provost to invest strategically in new initiatives, respond to opportunities, and continue to invest in the University's physical and intellectual infrastructure. Such a fund is critical to the success of these types of decentralized budget models, according to every university that has made such a transition over the last two decades.

Unlike other components of the model, the method for determining a Responsibility Center's overall subvention, or the rate at which that subvention should decrease, is not tightly prescribed. It will involve the managerial judgement and discretion of the dean, the provost and the president. Even if it were possible, and I have my doubts that it is, developing a budget model that is entirely prescribed (i.e.,

algorithms only) allowing for no management discretion would be ill-advised. An organization as complex, and subject to as many external variables, as ours requires management discretion, flexibility, and the ability to both respond and invest strategically.

That said, subvention does *not* materially impact the predictability or effectiveness of the model. Close to 90% of IBB Model 1.0 is dictated by well-defined rules (algorithms). And the remainder also is largely fixed since the RC's know they should plan on a 5%-10% reduction in their subvention amount (only, *not* their entire budget) in each of the next four years. Depending on the degree of dependence of each college/school on subvention (i.e., to ensure budget neutrality in the FY16 transition year), this planned annual reduction in subvention averages about 0.6%-1.2% of their overall budgets. Thus, RC's have solid information with which to target revenue growth, both to accommodate the very modest reduction in subvention and develop resources to grow or create new programs, in the coming years. Recall that *predictability* was also a goal established for IBB.

Closing Thoughts

Year 2 of our IBB development/implementation process is drawing to a close and we are on-target for a July 1st launch. In the past year, the Implementation Team and its many subcommittees have worked hard to ensure a smooth transition – with listening sessions, training sessions, development of new planning and reporting tools, and one-on-one and group discussions with financial and budget personnel across the University. New tools have been created, new efficiencies have been realized, questions have been answered, and both understanding and confidence have been raised.

This second year has also been our “parallel” year during which we operated both the old and new budget models concurrently, to watch and study the performance of the new IBB model. We anticipated seeing perhaps half a dozen issues arise that would need to be addressed (algorithm or model adjustments) during the parallel year. We did see three such issues and each was addressed by the Steering Committee, in consultation with the appropriate subcommittee(s), in turn. The resulting three modifications were described in the three previous [*Campus Updates*](#).

While it is certainly reasonable to expect that some minor issues may become apparent in the next year, our experience in this parallel year raised no red flags and we are confident we're well-positioned for the July 1st launch. The Steering Committee will continue to meet regularly in FY16 to assess the model's performance and respond to any issues that arise.

As I have said often, IBB Model 1.0 is not perfect – no budget model is. It does not incent every desired behavior or outcome – no budget model ever could. Nor does IBB Model 1.0 optimally serve any one college/school – no one model ever will. But the model is *transparent*, it is *predictable*, it is *easily understood*. The model supports *academic quality*, it distributes *budgetary responsibility*, it provides *clear incentives*, and it *allows multi-year planning*. We will continue to refine the model over time, and have kept careful track of enhancements and modifications that might be considered for Model 2.0, which is likely only three to four years away.

It has been my privilege to work with the 240 members of our campus community involved in the development and implementation of IBB, and to witness such a collaborative, inclusive, and authentic process. This bodes very well for the future of the University of Vermont.

Thank you.

From February 2015 *Across the Green* [memo](#):

“IBB will enable innovation, strategic planning linked to resources, and the forward-planning that will ensure our sustainable financial future. In short, our new budget model has the potential to harness the power of the entire campus in support of our core academic mission.

Our continued commitment to transparency and effective communication is critical to the success of our transition to IBB. We must all understand that while our budget model has changed, our *core values* as a university have not; that our ongoing budget challenges fully mirror what is happening at universities across the country; and that IBB did not create, nor will it solve, our budget challenges. IBB is not a panacea. In and of itself, it will not reduce expenses, create efficiencies, or create new revenue. But the new model *will* enable thoughtful and strategic decisions to be made – following robust discussion and with benefit of full information and transparency – about how to address these challenges.”



From *IBB* [Final Report](#):

“While we are all excited about the opportunities for transformation that IBB affords, I caution that IBB is not the solution to the very real and pressing challenges we face. It, in and of itself, will not reduce our expenses, create efficiencies or generate new revenue. It is not a surrogate for leadership, vision or innovation. It is a management tool that will empower our academic leaders to develop and manage their resources strategically, efficiently, and effectively as the academic units continue to elevate the quality and reputation of academic programs in order to meet the needs of our students. IBB links strategy with resources at the appropriate level. I have every confidence that it will support a positive transformation – but we all must play a role in that process. We must be willing to examine and question long-held practices and beliefs. We must be willing to change, to create, and to innovate.”