



Memorandum

To: Ronald M. Berkman, President
From: Geoffrey S. Mearns, Provost and Senior Vice President for Academic Affairs
Date: May 14, 2012
Re: Financial Incentive Model

Handwritten signature of Geoffrey S. Mearns in blue ink.

I submit this memorandum on behalf of the budget advisory task force as part of the task force's ongoing responsibility to provide recommendations as to how the University should prepare for the possible reduction in state support for higher education.

The third, and final, major component of the task force's mandate was to develop a mechanism for allocating operating resources in alignment with the University's strategic objectives. The first two components, the comprehensive program prioritization and the instructional resource methodology, affect the allocation of permanent funding. The third component would affect only temporary funds, primarily but not exclusively carry forward and tuition revenue margin.

I have attached two documents that were developed by the task force. The first document is a memorandum that describes the task force's recommendations. The second document provides a practical illustration of how those recommendations would have affected the allocation of resources, if the recommendations had been in place during the transition from FY11 to FY12.

You and I had the opportunity to discuss previous, very similar drafts of these documents. If you would like any additional information or explanation, please let me know.

Attachments

**President's Budget Advisory Task Force
Recommendation - Financial Incentive Model
April 2, 2012**

The Financial Incentive Model component of the overall University Resource Model consists of four funding distribution elements:

1. University strategic initiative funding
2. Expense carryover
3. Instructional fee revenue margin
4. Summer instructional fee revenue incentive

These proposed formulas have been designed to provide a clear and consistent framework for distributing available funding to the Academic, Academic Support, and University Support units at the conclusion of each fiscal year (year-ending 6/30).

For purposes of this model, the major segments of the Operating Budget are defined as follows:

Academic Units

Monte Ahuja College of Business
College of Liberal Arts and Social Sciences
College of Sciences and Health Professions
College of Education
Fenn College of Engineering
C-M College of Law
School of Nursing
Levin College of Urban Affairs

Academic Support Units

Office of the Provost
Scholarships
Michael Schwartz Library
Vice Provost - Academic Affairs
Vice Provost - Academic Planning
Vice Provost - Undergraduate Programming
Vice President Research & Graduate College

University Support Units

Vice President - Advancement
Vice President - Business Affairs & Finance
Vice President - Diversity
Vice President - Engagement
Vice President - Enrollment Services
Office of the President

An overriding principle governs the use of the distribution of funds at year end: the overall University operating budget must be balanced before expense carryover funding and instructional fee revenue margin is made available. A number of factors may affect the availability of surplus funds within a given year; achieved enrollment vs. plan, and the level of state funding are two significant factors.

1. Recommendation: University Strategic Initiatives

Establish \$1.5 million in annual permanent funding for University strategic initiatives. These funds will be distributed based upon an evaluation of proposals submitted to the senior staff in a manner similar to the process employed in FY11.

2. Recommendation: Expense Carryover

Two types of expenses comprise expense carryover: cost share (grant commitments) expenses and operating budget expenses. Units having cost share balances at the conclusion of a fiscal year will receive 100% of these balances as carryover into the subsequent fiscal year.

Academic Units

100% of Operating Budget year-end expense balances will be credited to the Colleges (dean's office) as carryover into the subsequent fiscal year.

Academic Support Units

100% of Operating Budget year-end expense balances will be credited to the divisional head (e.g. Vice Provost) as carryover into the subsequent fiscal year. The Provost has the discretion to make adjustments to the Operating Budget expense carryover balances in the Academic and Academic Support areas if the Provost determines that extraordinary circumstances exist.

2. Recommendation: Expense Carryover (Cont'd)

University Support Units

Cost Share (grant commitments) expense carryover distributed to the departments at 100% of the year-end balance. Operating expense carryover is distributed to the divisional head (e.g. Vice President) at 90% of the year-end balance. 10% of the year-end balance will fund University strategic initiatives.

3. Recommendation: Instructional Fee Revenue Margin (Academic Colleges)

Available instructional fee revenue margin will be shared according to the following objective:

- 75% distributed to the Academic Units
- 25% retained by the University for funding University Reserves

The actual allocation is dependent upon the appropriate allocation of margin to University Reserves as it relates to the University's credit rating and financial ratio health, as well as consideration to college needs for a given fiscal year.

The formula for distributing the 75% allocation to the Colleges is comprised of three components weighted as follows:

- 1 Resource Management - measured by a College's operating margin ratio.

Operating margin =
(Instructional Fee Revenue generated by the College + College internal income +
Allocated College Share of SSI), Less College Direct Operating Expenditures

Operating Margin Ratio = Operating Margin / Total Revenue

Weight: 50%

A College is eligible to share in the distribution of Instructional Fee revenue margin if it achieves a certain threshold level of the Operating Margin Ratio. The threshold level is defined as the three-year rolling average of University Support expenditures divided by total Operating Budget expenditures. Currently this threshold is approximately 34%.

- 2 Enrollment Growth - measured by the *growth* in enrollment (combined undergraduate and graduate enrollment) from the average of the prior 6 years to the current year.

Weight: 25%

- 3 Degree Completion - measured by the 6 year average of a College's ratio of undergraduate degrees granted to total undergraduate headcount.

Weight: 25%

Amounts not distributed to ineligible colleges in the three components' calculations will be distributed to the Provost for supporting academic initiatives.

4. Recommendation: Summer Instructional Fee Revenue Incentive (Academic Colleges) *

As an incentive for increasing Summer session enrollments, the Provost has developed a formula that allows the Colleges to retain a share of instructional fee revenue earned in this semester.

If the current fiscal year's Summer enrollment (translated to revenue) exceeds the average of the previous five year period, the Colleges are permitted to retain 50% of this surplus.

This surplus amount is distributed after the end of the fiscal year.

*** This incentive will be tested for Summer 12 (FY13) and Summer 13 (FY14) and is included for consideration. A decision should be made on its inclusion after a two year trial.**

**Recommendation - Financial Incentive Model
Support Calculations - FY11 Data Used As Example**

I. EXPENSE CARRYOVER DISTRIBUTION

	Cost Share Carryover (Grant Commitments)	Operating Expense Carryover	
	Retained by Unit	Retained by Unit	University Strategic Initiatives
Academic Units	100%	100%	0%
Academic Support Units	100%	100%	0%
University Support Units	100%	90%	10%

Academic Units (Colleges)

	FY11 Expense Carryover			Distribution		
	Cost Share Commitments	Operating Expenses	Total	100% Cost Share Commitments	100% Operating Expenses	Total
Business CLASS	\$ 105,453	\$ 61,768	\$ 167,221	\$ 105,453	\$ 61,768	\$ 167,221
COSHP	159,710	402,822	562,532	159,710	402,822	562,532
Education	1,353,418	200,209	1,553,627	1,353,418	200,209	1,553,627
Nursing	407,888	187,015	594,903	407,888	187,015	594,903
Engineering	116,725	30,867	147,592	116,725	30,867	147,592
Law	234,986	358,125	593,111	234,986	358,125	593,111
Urban	-	572,644	572,644	-	572,644	572,644
Total	2,399,694	1,916,267	4,315,961	2,399,694	1,916,267	4,315,961

Academic Support Units

	FY11 Expense Carryover			Distribution		
	Cost Share Commitments	Operating Expenses	Total	100% Cost Share Commitments	100% Operating Expenses	Total
Provost Office	\$ 6,200	\$ 2,746,234	\$ 2,752,434	\$ 6,200	\$ 2,746,234	\$ 2,752,434
Centers of Excellence	-	187,512	187,512	-	187,512	187,512
Continuing Education	-	424,524	424,524	-	424,524	424,524
Vice Provost - Academic Programs	37,989	100,763	138,752	37,989	100,763	138,752
Vice Provost - Academic Affairs	-	98,948	98,948	-	98,948	98,948
Vice Provost - Academic Planning	6,056	175,963	182,019	6,056	175,963	182,019
Vice Provost - Student Affairs	-	80,934	80,934	-	80,934	80,934
Vice President - Research & Grad Std.	637,618	515,678	1,153,296	637,618	515,678	1,153,296
Total	687,863	4,330,556	5,018,419	687,863	4,330,556	5,018,419

I. EXPENSE CARRYOVER DISTRIBUTION (Cont'd)

University Support Units

	FY11 Expense Carryover			Distribution		
	Cost Share Commitments	Operating Expenses	Total	100% Cost Share Commitments	90% Operating Expenses	Total
Vice President - Institutional Diversity	\$ 645	\$ 373,143	\$ 373,788	\$ 645	\$ 335,829	\$ 336,474
Vice President - Bus. Affairs & Finance IS&T	-	1,098,007	1,098,007	-	988,206	988,206
Vice President - Enrollment Services	4,450	20,693	20,693	-	18,624	18,624
Vice President - Advancement	-	116,288	120,738	4,450	104,659	109,109
Other	-	211,886	211,886	-	190,697	190,697
Total	\$ 5,095	\$ 2,015,555	\$ 2,020,650	\$ 5,095	\$ 1,814,000	\$ 1,819,095

10% of Operating Expense Carryover
from University Support Units is
allocated to University Strategic
Initiatives

Summary - Expense Carryover

	Grant		Operating Expenses	Total
	Cost Share Commitments	Operating Expenses		
Academic Units	\$ 2,399,694	\$ 1,916,267	\$ 4,315,961	
Academic Support Units	687,863	4,330,556	5,018,419	
University Support Units	5,095	1,814,000	1,819,095	
University Strategic Initiatives	-	201,556	201,556	
Total	\$ 3,092,652	\$ 8,262,378	\$ 11,355,030	

II. INSTRUCTIONAL FEE REVENUE MARGIN DISTRIBUTION

Step 1 Determine the instructional fee revenue margin (Per the university's 6/30/11 financial statements).

FY11 Instructional Fee Revenue Actual	\$ 134,901,610
FY11 Instructional Fee Revenue Budgeted	<u>125,191,849</u>
FY11 Instructional Fee Revenue Margin	\$ 9,709,761

Step 2 - Determine the distribution of instructional fee revenue margin

75.00% Colleges	\$ 7,282,321
25.00% University Reserves	<u>2,427,440</u>
Total	\$ 9,709,761

Step 3 - Criteria for distribution to the colleges

A. Distribution based on resource management.

Total College Revenue Share	\$ 7,282,321
Weighting Allocation	50.00%
	\$ 3,641,160

34.00% is the minimum operating margin ratio that must be achieved in order to compete for margin. If it is below this benchmark, the college is not eligible to compete for margin.

FY11 Operating Margin Ratio Calculation

College	Actual Instruct. Fee Revenue (A)	Actual College Revenue (B)	Actual SSI (C)	Actual Total Revenue (D)	Actual Expenditures (E)	Operating Margin (F)	Operating Margin Ratio (G)	Eligible (H)
				(A) + (B) + (C)	(D) - (E)	(F) / (D)		
Business	\$ 22,669,062	\$ 65,514	\$ 10,664,110	\$ 33,398,686	\$ 16,964,668	\$ 16,434,019	49.206%	Y
CLASS	36,626,388	414,166	15,496,481	52,537,035	24,229,645	28,307,390	53.881%	Y
COSHP	30,477,200	582,160	21,399,121	52,458,481	22,322,729	30,135,752	57.447%	Y
Education	17,587,557	219,463	8,414,442	26,221,462	13,824,186	12,397,276	47.279%	Y
Engineering	6,934,374	331,438	5,978,024	13,243,836	10,450,762	2,793,074	21.090%	N
Law	9,902,799	44,195	6,491,134	16,438,129	14,017,301	2,420,828	14.727%	N
Nursing	2,745,429	119,581	2,657,192	5,522,203	3,235,408	2,286,795	41.411%	Y
Urban	<u>7,958,800</u>	<u>337,776</u>	<u>2,273,685</u>	<u>10,570,261</u>	<u>6,813,217</u>	<u>3,757,044</u>	<u>35.544%</u>	Y
Total	\$ 134,901,610	\$ 2,114,293	\$ 73,374,191	\$ 210,390,094	\$ 111,857,916	\$ 98,532,178	46.833%	

- (A) = actual instructional fee revenue by college. Enrollment priced at the instructional fee rate.
- (B) = revenue credited to the colleges directly - lab fees, course fees, material fees, indirect cost revenue, etc.
- (C) = state subsidy attributed to each college in accordance with the current state funding model.
- (E) = actual expenditures by college from YE financial statements.
- (G) = operating margin divided by total revenue = operating margin ratio.

II. INSTRUCTIONAL FEE REVENUE MARGIN DISTRIBUTION

A. Distribution based on resource management (Cont'd)

College	Operating Margin		Weighting Based on Operating Margin	Weighted Operating Margin Ratio	% of the total Allocation	Eligible Colleges	To Provost Academic Initiatives
	Ratio	Amount					
Business	49.21%	16.68%	8.21%	16.26%	\$ 591,960	\$ 591,960	\$ -
CLASS	53.88%	28.73%	15.48%	30.66%	1,116,524	1,116,524	-
COSH	57.45%	30.58%	17.57%	34.81%	1,267,308	1,267,308	-
Education	47.28%	12.58%	5.95%	11.78%	429,071	429,071	-
Engineering	21.09%	2.83%	0.60%	1.18%	43,121	-	43,121
Law	14.73%	2.46%	0.36%	0.72%	26,098	-	26,098
Nursing	41.41%	2.32%	0.96%	1.90%	69,323	69,323	-
Urban	35.54%	3.81%	1.36%	2.68%	97,755	97,755	-
Total	320.58%	100.00%	50.48%	100.00%	\$ 3,641,160	\$ 3,571,942	\$ 69,219

B. Distribution based on growth in enrollment from the average of the prior 6 years to the current year.

Total College Revenue Share	\$ 7,282,321
Weighting	25.00%
Allocation	\$ 1,820,580

FY05-FY10 Six-year Enrollment Average

College	FY06 SCH	FY07 SCH	FY08 SCH	FY09 SCH	FY10 SCH	FY11 SCH	6 Yr. Average
Business	51,921	53,532	54,318	56,353	62,645	64,552	57,220
CLASS	111,451	107,189	112,628	111,125	118,784	122,719	113,983
COS	76,368	78,020	86,870	90,202	97,369	104,709	88,923
Education	59,663	54,135	52,939	53,160	52,997	44,548	52,907
Engineering	15,828	15,216	15,882	16,052	17,340	20,527	16,808
Law	19,218	18,768	18,677	17,489	17,240	16,355	17,958
Nursing	7,699	7,811	8,158	8,504	9,644	9,747	8,594
Urban	16,118	17,981	19,981	22,177	22,811	24,527	20,599
Total	358,266	352,652	369,453	375,062	398,830	407,684	376,991

FY06-FY11

College	FY06-FY11 Average	FY11 SCH	Change	%	Amount	Eligible Colleges	To Provost Academic Initiatives
Business	57,220	64,552	7,332	18.13%	\$ 330,067	\$ 330,067	\$ -
CLASS	113,983	122,719	8,736	21.60%	393,295	393,295	-
COSH	88,923	104,709	15,786	39.03%	710,660	710,660	-
Education	52,907	54,295	1,388	3.43%	62,485	62,485	-
Engineering	16,808	20,527	3,720	9.20%	167,446	-	167,446
Law	17,958	16,356	(1,602)	-3.96%	(72,112)	-	(72,112)
Nursing	8,594	9,747	1,153	2.85%	51,914	51,914	-
Urban	20,599	24,527	3,928	9.71%	176,825	176,825	-
Total	376,991	417,432	40,441	100.00%	\$ 1,820,580	\$ 1,673,333	\$ 95,334

II. INSTRUCTIONAL FEE REVENUE MARGIN DISTRIBUTION

C. Distribution based on undergraduate degree completion

Total College Revenue Share \$ 7,282,321
 Weighting 25.00%
 Allocation \$ 1,820,580

	FY05	FY06	FY07	FY08	FY09	FY10	6 Year Average
Business							
# Bachelor's Degrees	431	364	380	398	388	400	394
Total UG Headcount	1,792	1,740	1,842	1,926	2,066	2,223	1,932
#Degrees / Total UG HC							0.2037
CLASS							
# Bachelor's Degrees	540	574	546	576	586	598	570
Total UG Headcount	2,702	2,670	2,643	2,697	2,843	3,070	2,771
#Degrees / Total UG HC							0.2057
COSHP							
# Bachelor's Degrees	230	252	317	306	332	358	299
Total UG Headcount	1,525	1,564	1,611	1,685	1,942	2,340	1,778
#Degrees / Total UG HC							0.1683
Education							
# Bachelor's Degrees	209	201	190	150	137	129	169
Total UG Headcount	1876	916	900	878	944	1,012	1,088
#Degrees / Total UG HC							0.1557
Engineering							
# Bachelor's Degrees	100	138	131	98	97	119	114
Total UG Headcount	637	620	680	739	856	929	744
#Degrees / Total UG HC							0.1531
Nursing							
# Bachelor's Degrees	105	94	120	112	125	119	113
Total UG Headcount	291	383	405	474	515	537	434
#Degrees / Total UG HC							0.2591
Urban							
# Bachelor's Degrees	90	67	90	68	76	87	80
Total UG Headcount	245	277	259	258	292	327	276
#Degrees / Total UG HC							0.2883
Total UG Degrees	1,705	1,690	1,774	1,708	1,741	1,810	1,738
Total UG Headcount	9,068	8,170	8,340	8,657	9,458	10,438	9,022
#Degrees / Headcount	18.80%	20.69%	21.27%	19.73%	18.41%	17.34%	19.26%

C. Distribution based on undergraduate degree completion (Cont'd)

College	FY05-10 Average Degrees/Total HC	Weighting		Total HC Ratio	% of the total	Allocation	Eligible Colleges	To Provost Academic Initiatives
		Based on Degree Completion FY05-10	Weighted Average Degrees/ Degrees/					
Business	20.37%	22.64%	4.61%	23.33%	\$ 424,674	424,674	\$ -	-
CLASS	20.57%	32.80%	6.75%	34.12%	621,155	621,155	621,155	-
COSH	16.83%	17.21%	2.90%	14.65%	266,683	266,683	266,683	-
Education	15.57%	9.74%	1.52%	7.67%	139,653	139,653	139,653	-
Engineering	15.31%	6.55%	1.00%	5.07%	92,325	92,325	-	92,325
Nursing	25.91%	6.47%	1.68%	8.48%	154,422	154,422	154,422	-
Urban	28.83%	4.58%	1.32%	6.68%	121,669	121,669	121,669	-
Total	143.39%	100.00%	19.77%	100.00%	\$ 1,820,580	\$ 1,820,580	\$ 1,728,255	\$ 92,325

SUMMARY - INSTRUCTIONAL FEE REVENUE MARGIN DISTRIBUION

College	A.		B.		C.	
	Resource Management	SCH Growth	SCH Growth	Degree Completion	Total	Total
Business	\$ 591,960	\$ 330,067	\$ 424,674	\$ 424,674	\$ 1,346,700	\$ 1,346,700
CLASS	1,116,524	393,295	621,155	621,155	2,130,974	2,130,974
COS	1,267,308	710,660	266,683	266,683	2,244,652	2,244,652
Education	429,071	62,485	139,653	139,653	631,210	631,210
Engineering	-	-	-	-	-	-
Law	-	-	-	-	-	-
Nursing	69,323	51,914	154,422	154,422	275,658	275,658
Urban	97,755	176,825	121,669	121,669	396,249	396,249
Provost-Academic Initiatives	69,219	\$ 95,334	\$ 92,325	\$ 92,325	256,877	256,877
Total	\$ 3,641,160	\$ 1,820,580	\$ 1,820,580	\$ 1,820,580	\$ 7,282,321	\$ 7,282,321

III. SUMMER REVENUE INCENTIVE

**Summer Revenue Incentive
Summer Student Credit Hours (SCH) by College - 5 Yr. Avg**

College	FY06 (Summer 05)			FY07 (Summer 06)			FY08 (Summer 07)		
	Undergrad	Grad	Total	Undergrad	Grad	Total	Undergrad	Grad	Total
Business	5,623	4,193	9,816	5,803	4,216	10,019	5,863	4,595	10,458
CLASS	10,791	1,230	12,021	10,343	1,005	11,348	9,667	985	10,652
Education	4,090	10,549	14,639	3,780	8,547	12,327	3,747	8,133	11,880
Engineering	424	151	575	364	159	523	333	97	430
Science	7,983	2,275	10,258	8,098	2,051	10,149	8,595	2,417	11,012
Urban Aff.	1,608	879	2,487	2,040	870	2,910	2,306	975	3,281
Law	-	1,130	1,130	-	1,049	1,049	-	970	970
Graduate St	0	6	6	0	6	6	0	20	20
Other	23	0	23	121	14	135	180	4	184
Total	30,542	20,413	50,955	30,549	17,917	48,466	30,691	18,196	48,887

College	FY09 (Summer 08)			FY10 (Summer 09)		
	Undergrad	Grad	Total	Undergrad	Grad	Total
Business	5,757	4,336	10,093	5,922	4,853	10,775
CLASS	8,874	912	9,786	8,460	946	9,406
Education	3,446	7,898	11,344	3,788	7,543	11,331
Engineering	439	222	661	91	98	189
Science	7,581	2,732	10,313	7,760	2,429	10,189
Urban Aff.	2,600	902	3,502	2,812	642	3,454
Law	-	915	915	0	944	944
Graduate St	-	-	0	0	0	0
Other	138	222	360	115	608	723
Total	28,835	18,139	46,974	28,948	18,063	47,011

College	5 Yr. Avg.		
	Undergrad	Grad	Total
Business	5,794	4,439	10,232
CLASS	9,627	1,016	10,643
Education	3,770	8,534	12,304
Engineering	330	145	476
Science	8,003	2,381	10,384
Urban Aff.	2,273	854	3,127
Law	-	1,002	1,002
Graduate St	-	6	6
Other	115	170	285
Total	23,805	14,463	48,459

III. SUMMER REVENUE INCENTIVE

Summer Instructional Fee Revenue Baseline
 5 Yr. Average SCH
 Instructional Fee Revenue @ Summer 2010 Rates

Actual Summer 2010 Revenue

Baseline Calculation		Actual Summer 2010 Revenue					
	Undergrad	Grad	Total Baseline	Actual Summer 10 SCH Undergrad	Actual Summer 10 SCH Grad	Actual Summer 10 Grad Revenue	Actual Total Revenue
Rate Per SCH	\$ 304.25	\$ 420.75					
Business	\$ 1,656,941	\$ 1,755,488	\$ 3,412,429	6,146	4,897	\$ 1,936,788	\$ 3,694,513
CLASS	2,753,274	401,675	3,154,949	10,041	948	374,939	3,246,615
Education	1,078,258	3,375,240	4,453,498	4,137	6,967	2,755,483	3,938,645
Engineering	94,436	57,506	151,942	466	98	38,759	172,033
Science	2,288,932	941,618	3,230,551	8,813	2,370	937,347	3,457,821
Urban Aff	650,124	337,603	987,727	2,454	722	285,555	987,386
Law	-	396,138	396,138	0	890	351,999	351,999
Graduate St	-	2,531	2,531	0	-	-	-
Other	33,004	67,078	100,081	207	442	174,813	234,014
Total	\$ 8,554,968	\$ 7,334,878	\$ 15,889,846	32,264	17,334	\$ 6,855,684	\$ 16,083,026

College	Total Actual Revenue vs. Baseline	50% College Retention	Factor
Business	\$ 282,084	\$ 141,042	0.51171
CLASS	91,666	45,833	
Education	(514,853)	-	
Engineering	20,091	10,046	5,140
Science	227,270	113,635	58,148
Urban Aff	(341)	-	-
Law	(44,138)	-	-
Graduate St	(2,531)	-	-
Other	133,933	66,966	34,267
Total	\$ 193,180	\$ 377,522	\$ 193,180

Factor of .51171 is necessary because certain colleges Summer 10 enrollment is below the five year average and there is less than a full 50% of Instructional Fee revenue to share.