Incentive-Based Budget Model
Frequently Asked Questions

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1. What is the new budget model and how does it differ from the previous way we built budgets?

The new budget model both increases transparency and provides incentives more in line with our fiscal requirements. It starts by establishing a new structure that “recolors” campus funds and makes it easier to identify the sources of funds flowing to individual schools, colleges and units. In future years, the model will ensure that funds related to any growth go to the areas providing the essential services that drive and support that growth. For the first year, 2012-13, the new budget model does not drive changes in budget allocations beyond guiding the distribution of a small amount of funds related to expected growth.

Today, for example, departments and units are accustomed to receiving general fund dollars, which are a combination of tuition and state support. But beginning July 1, for the 2012-13 budget year, units that generate undergraduate tuition revenue through instructional activities will be able to identify a portion of their general fund money, or “19900” funding, as coming directly from tuition. The portion of undergraduate tuition allocated to each unit will be based on a formula that considers its number of undergraduate student credit hours, majors and degrees awarded.

In addition, units that conduct research will keep more of the indirect costs, or overhead, that sponsors pay to the university for that research. These overhead reimbursements are based on direct research expenditures and, under the new budget model, more of these funds will remain with the units that generate them.

The new revenue model goes together with decentralized responsibility for the costs of faculty and staff benefits, which will make the true costs of programs and activities much more transparent.

Our new model represents a step away from incremental, centralized budgeting. In the past, the budget process involved the provost and chancellor assigning increases or decreases to each unit’s current budget, with little obvious connection to particular revenue sources. The new model will deliver significant parts of the budget to units on the basis of formulas that reflect activity. Our model is a hybrid, and we will continue to allocate the balance of the budget through an incremental process. Based on the experience of other institutions with this sort of model, we believe it is important for us, going forward, to maintain a balance between formulas and leadership judgment.

2. What process did we go through to develop the new model?

Provost and Executive Vice Chancellor Ralph J. Hexter asked the campus’s Office of Budget and Institutional Analysis to research budget models at other institutions, identify the critical components for a new budget model and develop options and present them in the form of white papers and presentations to campus. We designed this approach to give everyone something concrete to discuss, allowing for substantive input and deliberation. With these white papers, the goal has been to start with a plausible approach for UC Davis and to anticipate questions about how it might work. After issuing the white papers as starting points, we asked for comment from many groups on campus, including the deans, the Academic Senate and fiscal officers. We listened to the issues raised in meetings and
incorporated them into revised white papers that either have been or will soon be posted. The documents prepared in developing the model are available at the website for the new budget model, http://budget.ucdavis.edu/budget-model.

3. **What differences will we see on Day 1 of the new model?**

As the new budget model is implemented, people should not notice much difference. This change is not meant to be disruptive and, in fact, many elements of the new budget overlap with the old. In addition to the funds generated by the unit’s research and undergraduate teaching activity, units also will receive a provost allocation, which is funded largely by the provost’s keeping a portion of each of the revenue streams and pooling these funds with state funds. Assuming that state support for the campus is not cut any further, the provost will use this allocation to assure that 2012-13 allocations to units are roughly equivalent to their 2011-12 allocations. (For a more detailed explanation of the provost allocation, see Nos. 14-16 below.)

However, the new budget model gives an opportunity for more focused and strategic discussions between the colleges and the provost and the central budget staff. In future years, we’ll be able to look together at performance in certain areas and understand what funds the units have generated, and try to ensure that the resources grow appropriately with each unit’s strategic goals and achievements.

4. **Why is this called an incentive-based model?**

The new model is called an incentive-based budget model because colleges, schools and divisions will see clearly how increases in undergraduate enrollment or research activity will translate into additional monies flowing to them as part of the budget model. That gives them very clear incentives to organize their efforts in ways that contribute to increases in these critical sources of funds for the university, since their units will experience direct benefits for their contributions. Thus, this new budget model and its incentives better align with the campus’s Vision of Excellence (http://vision.ucdavis.edu).

5. **Why are we making this change now?**

Reflecting trends in public higher education nationwide, UC Davis and the rest of the University of California are growing increasingly dependent on funds generated on campus, particularly tuition and indirect costs recovered from research activity. These sources have always been vital to the university, but their importance is now clearer than ever. The campus needs to align its management systems and incentives to support these activities. This reflects not just the importance of these activities as sources of income, but also their status as central aspects of our mission to serve society. Also, recent changes to simplify the flow of funds between the UC Office of the President and the 10 campuses make it more feasible to adopt a model like this within the UC system.
6. **What is the relationship between the new budget model and the 2020 Initiative?**

They are separate and distinct initiatives. The changes in the budget model provide new mechanisms for aligning revenue with the activity that generates it. The 2020 Initiative is a planning process designed to identify how the campus will build on existing strengths and resources to further academic excellence, innovation and economic development. The new budget model will provide tools and incentives to pursue whatever directions we establish in the 2020 plan. Both initiatives are coordinated out of the Office of the Provost, so we will make sure that the new budget model will support goals as they emerge from the 2020 planning process. For more information on the 2020 Initiative, go to: [http://chancellor.ucdavis.edu/initiatives/2020_Initiative/index.html](http://chancellor.ucdavis.edu/initiatives/2020_Initiative/index.html).

7. **What other institutions use this sort of budget model?**

Our new budget model is a version of a model known elsewhere as Responsibility Center Budgeting or Activity-Based Budgeting. It was pioneered by private universities like Harvard and Pennsylvania. This approach first came to the public university sector at Indiana University, and is increasingly being adopted by major public universities. Our new budget model is closest to the models at the universities of Washington, Oregon and Michigan. Other institutions with this sort of budget model include:

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8. **How will undergraduate tuition be distributed and shared in the new model?**

1. Net undergraduate tuition will be distributed to schools, colleges and divisions according to the following formula: 60 percent based on student credit hours, 30 percent based on degree majors and 10 percent based on degrees awarded.
2. Net undergraduate tuition is equivalent to the total undergraduate tuition charged, less waivers and the return to financial aid.
3. All units will receive credit for the campuswide blend of resident and nonresident supplemental tuition for undergraduates.
4. Undergraduate tuition distributed to the units will be charged an assessment rate of 30 percent. The provost will use the revenue from the assessment to fund administrative units, provide supplemental funding to all units and support central initiatives.
5. Student credit hours are determined by the department to which the course is assigned (course department) and the instructor’s home department (pay department).
   a. The allocation will be based on a two-year average of the most current available data, excluding Summer Session (Summer Session will be added to the model at a later time).
   b. When the pay and course departments are different, each unit is given credit for the student credit hour.
6. A degree major is determined by the unit in which a student registers in a given term.
   a. The allocation will be based on a two-year average of the most current data available.
   b. For students pursuing joint degrees, units will be allocated equal shares.
7. A degree awarded is determined by the unit that grants the degree.
   a. The allocation will be based on a two-year average of the most current data available.
   b. For students who earn multiple degrees from different units, each degree is allocated an equal share.
8. The total dollars distributed will be based on the institutional undergraduate enrollment projection, including allowances for changes in blend of resident and nonresident tuition.

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9. **Some programs and courses cost more than others to deliver – how will that be handled in the new model?**

The cost of instructional delivery varies by discipline and method of instruction (lecture, lab, etc.) and by lower and upper division. One way to deal with that is to charge differential tuition for the higher-cost programs. While this is the practice at many of our peer institutions, UC Davis does not have that sort of differential tuition. The new model accommodates differences in instructional cost through a differential distribution of the provost allocation, and asks the deans to manage their programs as a portfolio that includes a mix of less expensive and more expensive courses and programs. Less expensive courses generate some surplus that helps cover the cost of other activities. One of the financial requirements for the university as a whole and for individual schools will be to establish the proper balance of activities to fulfill the mission.
10. **How will graduate tuition and support be allocated in the new model?**

Graduate tuition and aid are critical to the mission and identity of UC Davis, and they are complex. For those reasons, we will defer consideration of how to treat them under the new budget model until 2012-13. We will develop proposals during the fall quarter to take effect in the 2013-14 academic year. We will need to make sure our proposals respect the diversity of graduate programs, and support both departmental and graduate group programs. Meanwhile, graduate tuition will continue to be centrally managed and incrementally distributed, and support for graduate academic students will continue to be allocated through the Graduate Program Fellowship Allocation Funds administered by Graduate Studies.

11. **How will professional and self-supporting degree fees be distributed and shared in the new model?**

In the first year of the new budget model, 2012-13, there will be no change in the way funds from professional and self-supporting degree fees are distributed. These fees already go in large part to the unit that generates them, which is consistent with the spirit of the new model for undergraduate tuition. Similar to graduate tuition, we will review these fee types during the fall quarter of 2012 and determine if we should adjust the way we handle them in light of the principles and methods of the new budget model.

12. **How will indirect cost recovery (ICR) be distributed and shared in the new model?**

   1. Net ICR will be distributed to schools, colleges, divisions or offices based on which unit was responsible for generating the funds.
   2. Net ICR is equivalent to the total amount of ICR generated in the prior year, less any categorical set-asides (e.g., specialized facilities and administrative costs negotiated with the federal government).
   3. The responsible unit is defined as the administrative home of the award (either the lead school, college or division dean or the vice chancellor-research for organized research units and some centralized research facilities).
   4. For FY 2012-13, net ICR distributed to the units will be 34 percent. The balance of funds (66 percent) will be used to: (1) provide transition funds for the schools of Medicine and Veterinary Medicine; (2) meet long-term commitments such as debt service; (3) support investment priorities (e.g., faculty start-ups, graduate student support); and (4) partially fund the administrative units that support research but do not generate ICR.
   5. For FY 2013-14, net ICR distributed to the units will be 40 percent and the assessment rate will be 60 percent. The use of the assessment will be similar to what is described in No. 4 above, except that transition allocations will not continue.
13. **What will happen to state funds?**

State funds will provide one of the primary sources of funds for the provost allocation (see No. 14), along with the provost's share of tuition and ICR, and institutional overhead assessments on auxiliary enterprises and similar activities. After being combined with these sources, the provost will allocate them to different units and purposes.

14. **What is the provost allocation?**

The new budget model is intended to strike a balance between unit-level independence and institutional coordination and cooperation. The provost and chancellor and the units need a role in deciding funding levels. Furthermore, there will always be initiatives that the center is in the best position to identify and promote. The provost allocation is the vehicle for the central role in budgeting.

The funds for the provost allocation come from the following sources:

1. State appropriation – All of the state-appropriated general funds will be distributed through the provost allocation.
2. Undergraduate tuition – The provost will receive 30 percent of net tuition to include in the provost allocation pool.
3. Graduate tuition – For 2012-13, the provost will receive 100 percent of the net tuition from graduate students to include in the provost allocation pool. That share will change with incorporation of graduate tuition in the budget model beginning in 2013-14.
4. Indirect Cost Recovery (ICR) – The provost will receive 60 percent of ICR (66 percent in 2012-13 to address transitional effects).
5. Institutional overhead assessments – Auxiliary enterprises like Student Housing, and Transportation and Parking Services contribute a portion of their revenues toward the central administrative services that support them.

15. **How will the provost allocation be used?**

The provost allocation will fund mission-based activities as well as maintain baseline funding and cross-subsidies. Key uses for the provost allocation will encompass:

- Priorities such as targeted hires, matches or start-ups.
- Institutional Initiatives.
- Augmentations for shortfalls due to changes in state funding or increases in fixed costs.
- Continued support for basic operations of academic units.
- Faculty merit and promotion increases.
- Campuswide services from administrative and academic support units with no independent source of funding.
The campus budget also contains cross-subsidies among units. In the current budget model, these subsidies are mostly hidden. They exist for good reasons that reflect the diversity of areas of inquiry and services that any university must master. Some of these things “pay for themselves” in a fairly direct manner, others do not, or they do so more subtly. The campus also has priorities, missions, identities and special areas of contribution to society that in some cases need support. Until revenue streams grow or new revenue streams emerge, or priorities or mission change, cross-subsidization will continue to be necessary to keep UC Davis engaged in its current programs to the degree and at the level necessary. These subsidies will be visible and funded through the provost allocation.

The provost allocation is also the key means to fund campuswide services. These services tend to have the following characteristics:

1. Deliver benefit to all or most members of an organization.
2. Provide an economy of scale or meet needs that are generally cost prohibitive and ineffective if parts of the organization were to provide the service independently.
3. Require consistent functionality and service levels across the institution.
4. Are not easily supported by recharge rates because it is difficult or cost prohibitive to measure usage by and set a price for individual users.

**16. How will the provost allocation be distributed?**

Initially, the provost allocation is the self-balancing part of the budget model. For 2012-13, the first step is to distribute significant undergraduate tuition revenue per the formula to each unit. Second, the tuition revenue is compared with the sum of the general fund base budget and benefits from the central pool. Finally, the provost allocation is used to reconcile the difference between the two. That is, funds will be distributed so that the transition to the new model replicates current budget levels as nearly as is appropriate given changes in state funding.

In subsequent years, the levels for provost allocations to units will be adjusted to reflect changes in funding and support institutional priorities. It is important to stress that we will take an incremental approach. We are not embarking on zero-based budgeting, where allocations are reset to zero each year, and we will avoid sudden shifts in funding. When major changes are warranted, we will apply transition plans when possible to phase in changes over time.

We expect the process for setting the provost allocation to be similar to the current budget process, with units submitting plans that will be reviewed by and discussed with the provost and chancellor.

**17. How will units handle increases in fixed costs?**

In the campus budget process, we refer to mandated cost increases like changes in benefits as increases in fixed costs. We plan to manage general fund fixed cost increases under the new budget model in as coordinated a fashion as possible. In some cases, we expect tuition increases to be authorized by the UC
Board of Regents to fully or partially fund fixed cost increases—in those cases we will adjust the provost allocation to make sure additional funds from tuition increases align with the location of the fixed costs that are increasing. In cases where there is not a dedicated revenue source, the cost increases will contribute to the overall campus budget shortfall. This has been the case for the last four years; budget shortfalls have been the combined impact of state budget cuts and unfunded (or underfunded) fixed cost increases. As has been the case in the past, we will develop coordinated strategies to deal with major campus shortfalls in the future.