

# Essentials of College and University Budgeting

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# Agenda

- General considerations
- Operating budget process
  - Projecting revenues
  - Projecting expenses
  - Addressing reserves
- Capital budget process
- Questions

# General Considerations

# Caveats

- No perfect system / process
- Institutional character dictates approach
  - Culture / climate / history
  - Size / mission
  - Centralized / decentralized
  - Public / private
    - Affiliated / independent

# Ideal Approach

- Budgeting should be integrated with planning and measurement
  - Approved budget is only a snapshot
    - Process is continuous
    - Always responding to new information
- Preference for all-funds budgeting
- Focus on accountability versus control
- Broadly participative process

# Premise

- Planning is the hard part
  - When it's done well, budgeting and measurement are easy
- Effective planning identifies what is important and what's not
- Budget is the quantitative representation of what's important
- All resource allocation decisions should support what is important

# Overall Objectives

- Satisfy mission
- Improve while achieving specific goals
- Maintain financial equilibrium
  - Achieve a balanced budget
  - Develop and nourish human capital
  - Preserve physical assets
  - Protect endowment purchasing power

# What Really Matters?

- Resources
  - Dollars
  - Positions
  - Space
  - Technology
    - Planning, budgeting, and measurement must address all four



# Types of Budgets

- Operating
- Capital
- Special initiatives
- Restricted
- Project
- Departmental
- And many more

# Budget Processes

- Overall processes
  - Incremental
  - Formula
  - Zero-based
  - Responsibility center
- Special purpose
  - Initiative-based
  - Performance-based

# Inputs

- Prior year results
- Plans
- Assumptions
- “Soft” (qualitative) inputs
  - Culture / climate / values / norms
- “Hard” (quantitative) inputs
  - Enrollment
  - Specific revenues / expenses

# Data Sources

- Enrollment management process
  - Admissions, Financial Aid, auxiliaries
- Human Resources Department
- Grants and Contracts Office
- Development Office
- Treasurer
- Revenue units (e.g., auxiliaries)
- Others (e.g., Medical Center, Athletics)

# Logistics

- Automated systems
  - Sometimes Web-enabled
    - Interfaced stand-alone budget software
    - Fully integrated budget software
    - Modules in enterprise resource planning systems (ERPs)
    - Homegrown systems
- Manual systems

# Definitions

- Restricted resources must be used in accordance with external stipulations (e.g., purpose or unit)
- Unrestricted resources may be used for any legitimate institutional purpose
- Designated resources represent internal commitments—subject to change...

# Definitions *(contd.)*

- Endowment—funds provided by donor for long-term investment
  - Only income may be spent
- Term endowment—same as above but principal may be spent after specified period of time or occurrence of event
- Quasi-endowment—treated as true endowment but principal can be spent

# Operating Budget Process



# General Approach

- Consider plan and established priorities
- Establish budget assumptions
  - Gain approval from board
- Project revenues
- Project expenses
- Project contributions to reserves
- Identify and prepare for contingencies
  - Gain approval from board

# Review Plan / Establish Decision Processes

- Plans should identify areas of emphasis, establish priorities, and suggest decision criteria
- Determine factors to consider when choosing between alternative uses
- Finalize decision criteria before formal process begins to avoid problems during negotiations

# Project Revenues

- State appropriation (for public)
- Tuition and required fees
- Gifts, endowment income, and investment income
- Sponsored projects
- Auxiliary enterprises
- Other

# State Appropriation

- Public institutions consider state operating appropriation first
  - Formula-driven in many states
    - Direct relationship between appropriation and tuition / fee revenue
  - Even when not a formula, state support will influence tuition rates

# Tuition and Required Fees

- Development of undergraduate tuition / fee budget usually is a top-down process
  - Graduate tuition budget more likely bottom-up
- Enrollment management function is key source of information at undergraduate level

# Basic Inputs

- Projected number of enrolled undergraduate students
- Average credit hours per student
- Tuition rate per student or credit hour
- Relevant fees per student or credit hour

# First-Year Enrollment

- Estimate number of applicants based on recent history, anticipated changes
- Estimate admissions rate based on qualifications (e.g., SAT / ACT, high school class standing, intangibles)
- Estimate total yield
  - Revise based on experience, market conditions, and as plans evolve

# Upper Class Enrollment

- Start with current freshman class
  - Apply historical persistence rate
    - Adjust for any anticipated changes
- Add estimated incoming transfer sophomores and current-year sophomores returning as sophomores
- Repeat steps to project next year's junior and senior classes



# Refinement

- More sophisticated or complex institutions will distribute final projections by intended major
  - Essential if using differential tuition pricing
  - Also very useful for expense planning

# Tuition Pricing

- Simplistic approach
  - Tuition / fee increase equals increase in direct / indirect instructional costs
  - Not very practical
    - Subsidies from other revenues
    - Competitive considerations
    - Students' ability to pay
    - Political environment

# Formula Approach

- Tuition increase based on established index (e.g., CPI, HEPI, disposable family income)
  - Public institution tuition increase may be set by system or state board
    - Same may be true for out-of-state tuition surcharge

# Pricing Strategy

- Historically more art than science—lots of guesswork OR across-the-board percentage increase
- Recent trend of managing the process more aggressively—several consulting firms specialize in pricing and / or enrollment management
  - Tuition discounting modeling is becoming much more common

# Tuition / Fee Revenues

- Total tuition revenue is headcount (or credit hours) multiplied by tuition rate (per head or unit) plus fees
  - Usually requires some determination of full-time-equivalents
    - More complicated in variable tuition situations

# Financial Aid

- Tuition only part of equation
  - For financial reporting, institutions must reduce tuition by aid they award
  - No more double-counting revenues and inflating costs
  - Only cash outlays are expenses
- Budgeting financial aid can be as challenging as budgeting tuition

# Forms / Sources

- Three forms of financial aid
  - Grants
  - Loans
  - Work-Study
- Sources of aid
  - Unrestricted institutional resources
  - Federal and state government
  - Donors

# Categories of Aid

- Two basic types of aid
  - Need-based aid driven by overall cost of attendance and student's ability to pay
    - Usually includes sponsored aid
  - Merit aid
    - Much more variable
    - Usually not sponsored



# Merit Aid

- Two major purposes
  - Attract a student body with particular characteristics
    - Diversity
    - In-state, out-of-state
    - Specialized skills or talents
  - Maximize net revenues through tuition discounting

# Financial Aid Budget

- Consider all factors to establish total investment required for financial aid
  - Amounts from external sources will both impact and be influenced by revenue budgets
  - Merit aid absorbs institutional resources
- Separately account for allowance and expense

# Graduate Tuition/ Aid Budgets

- Bottom-up approach
  - Within established guidelines, departments propose enrollments and related financial aid
    - Departmental resources (e.g., endowment income), sponsored programs, and gifts all influence final estimates

# Gifts

- Development Office is primary source of gift revenue information
  - Annual fund / endowment
  - Planned giving / major gift
  - Capital campaign
    - All should be budgeted
      - Difficult in large institutions with decentralized operations

# Budgeting Gifts

- Budgeting gift revenues is challenging
  - Even more so in highly decentralized environments
- Makes it more crucial to have all-funds approach to budgeting

# Endowment Income

- Linked closely to gifts due to similar rules
- Treasurer and Board's Investment Committee provide critical input with respect to payout / spending policy
- Budgeted amount available is known
  - Based on historical results

# Spending Plan

- Portion of income and / or gains made available for spending
  - Various approaches used
    - Yield only
    - Percent of rolling average market value
    - Snake-in-the-tunnel
    - Blended approach

# Gifts / Endowment Income

- Concern regarding resource hoarding
  - Understandable preference for using institutional resources
- All-funds budgeting mitigates
- Forced use of local resources
  - Reduction of unrestricted support
- Foundation may be added complexity for public institutions



# Investment Income

- Treasurer provides estimates based on experience and projections
  - Budgeted activities will influence amount of investment income
- Depending on policy, investment income may be solely a central resource or also a departmental resource

# Sponsored Programs

- Direct costs—main portion of award
  - Funds controlled by principal investigator (PI)—treated as restricted
- Indirect costs—supplemental funds contractually provided to reimburse institution for support of program—unrestricted
  - Frequently shared with PIs / units to create incentives...

# Sponsored Programs *(contd.)*

- Grants and Contracts Office is primary source for both revenue / expense information
  - Direct revenues linked to awards
  - Effective indirect cost rate drives indirect revenues
  - Expenses are fairly predictable based on past experience / awards

# Auxiliary Enterprises

- Generally expected to be self-supporting
  - Leads to tendency by some to budget on a net basis
    - Not a good idea unless service is outsourced
    - Unit may focus on its bottom line rather than overall institutional needs...

# Auxiliary Enterprises (contd.)

- Largest auxiliary units' level of activity driven by enrollment
  - Strong linkage for revenues and expenses
- Auxiliaries sometimes subsidize academic / student life activities
- On some campuses, auxiliaries are charged for all services they receive...

# Auxiliary Enterprises (contd.)

- Traditional activities
  - Housing
  - Dining
  - Bookstore
  - Parking
  - Potentially many others, including internal units organized to provide services to other campus departments

# Other Revenue Centers

- Medical centers (e.g., hospitals, clinics)
- Intercollegiate athletics
- University press
- Major affiliated research institutes
  - Treat as auxiliaries and apply same general approach

# Project Expenses

- Multifaceted approach
  - Major expense objects
    - Salaries and benefits
    - Supplies and services
    - Utilities
  - Other categories
    - Facilities maintenance
    - Technology



# Salaries

- Typically largest expense component
  - Frequently benchmarked against peers or aspirants
  - Projections based on some form of market assessment
  - Common to separate staff / faculty
    - Ultimate approach should link to institutional plan and priorities

# Benefits

- Large, important expense component
  - Usually linked with salaries for benchmarking
  - Projections
    - Frequently influenced by salaries
    - Others by contractual rates (e.g., health insurance)
      - Link to plans and priorities

# Services, Supplies, and Small Equipment

- Various approaches depending on category
  - Frequently driven by price indexes
  - Important categories subject to market surveys (e.g., medical supplies used in research)
    - Link to plans and priorities

# Other Expense Categories

- Internal service units (e.g., facilities maintenance, information technology)
  - Requires establishment of performance standards
  - Development of priorities
  - Specific approach varies based on status as chargeback or cost center

# Auxiliary Enterprises

- Expense considerations usually addressed along with revenues
- Performance standards very important
- Key issues relate to unit reserves
  - Program expansion
  - Facilities renewal and replacement
  - Contingencies

# Reserves

- Reserves are needed at institutional level
  - Reserves for program expansion
  - Reserves for facilities maintenance
  - Reserves for technology infrastructure replacement
  - Reserves for self-insurance
  - Reserves for contingencies...

# Reserves (contd.)

- Effective institutions manage reserves
- Additions to reserves just as important as other investments
  - Should not be left to chance
- Various formulas exist for establishing reserves
  - Specifics vary based on type of reserve and circumstance

# Contingencies

- Recognize that projections will not be 100 percent accurate
- Establish a contingency to address unanticipated revenue shortfalls, expense overruns, other budgetary impacts
  - If contingencies don't materialize, consider special year-end allocations linked to plan or additions to reserves



# Capital Budget Process

# Capital Planning

- Equally important as operational planning
  - Fewer variables but greater risk
    - Large dollars at stake
    - Long-term commitments
    - Reduced flexibility
    - Mistakes harder to overcome...

# Capital Planning *(contd.)*

- No capital project should be undertaken without clear linkage to plan and established priorities
  - Very difficult when donor is ready to write a check
    - Just say no!

# Capital Budget

- Acquisition or construction of new facilities
- Major renovations of existing facilities
- Acquisition of major equipment
- Budget aggregates all projects
  - Extends over more than one year
    - Six-year capital plans / budgets typical for public institutions

# Link to Operating Budget

- Capital budgets impact operating budgets
- Facilities maintenance cost is operating expense
  - Even donor-financed projects rarely provide for maintenance
- Cost of borrowing (e.g., interest) is operating expense once project completed
- Revenues must cover debt repayment

# Financing Sources

- Gifts
- Reserves (i.e., savings)
- Borrowing (internal or external)
  - Internal borrowing tends to be short-term due to high opportunity costs
- Overall cost of capital varies based on market / institution's financial health



# Questions