Summary of Budgetary Issues at the College and University

This summary report provides our perspective about the financial mismanagement at UArizona in relation to changes in budgetary models and accusations of college deficits. Our summary is based on our review of the Responsibility Centered Management (RCM) and Activity Informed Budgeting (AIB) budget models and numbers provided by the Strategic Budget Advisory Committee (SPBAC) and through University Analytics and Institutional Research (UAIR), as well as in-depth conversations with and review of our assessment by leadership and business officers at the college-level. This summary is preliminary, and we will continue to revise and update it as additional information comes to us.

From our review, we conclude that there are three distinct but related issues that are contributing to the budgetary crisis at both the University and the Colleges.

- **The shift from RCM to AIB has drastically reduced the activity-based revenue that colleges earn from delivering their mission**. There is nothing inherently wrong with AIB as a model. What is at issue is the values selected by central admin for rewarding instruction and the focus on reallocating as much money as possible to central admin. Currently, based on a principle of do no harm, ongoing strategic budget allocations (SBAs) are being used to cover the reduction in activity-based revenue between RCM and AIB. This amount will be reduced by 3-5% each year, meaning colleges will have to increase revenue each year just to remain revenue neutral, over and above any cost increases like salary adjustments. Given this, we consider any AIB-induced deficit a *structured deficit,* not a structural deficit.
- **The implementation of a gain share tax[1] which is central administration's (central admin) approach to accumulating a share of academic college reserves, has incentivized colleges to spend down their cash on hand.** The combination of the ongoing reduction in AIB activity-based revenue to the colleges, plus the large increase in one-time spending, has placed some colleges in a more precarious budget place than they would absent either one of these. The outcome has been to shift focus from the academic growth needed to meet rising costs and expanded mission delivery onto academic reduction (layoffs) that will result in consolidated units unable to deliver on their mission.
- **The cash spend-down that former Provost Folks and CFO Rulney incentivized by implementing gain share was a contributing factor to CFO Rulney overestimating University's days cash on hand**. The result was the University needing to reduce spending to replenish days cash on hand. In President Robbins' and CFO Rulney's repeated responses to questions about how to address this issue, they continue to shift blame to operating units (colleges) and claim "we" (central admin and colleges) have overspent and need to reduce costs. But, as CFO Rulney stated in the December 4th Faculty Senate meeting, all colleges "submit plans that do not go into deficit… We don't approve plans unless the budget is breaking or positive." We support her policy that colleges cannot plan to deficit spend. But implementation of that policy also means that college spending is unlikely to make up a majority of the "we" in President Robbin's statement about expenses exceeding revenue, otherwise central admin would be admitting failure in implementing their own policy of fiscal conservatism.

[1] If colleges carry forward cash reserve amounts above 25% of forecasted annual operating expenses, then the excess will be taxed at a rate of 15%. So, if a college's operating expenses were expected to be $20m, then any cash reserves above $5m would be taxed at 15%.

From this analysis, the problem is clear to us. Central admin has implemented a budget model that squeezes the colleges of activity-based revenue in order to maximize funds to be held, spent, and/or distributed by central admin. And, they have exacerbated this problem by overspending on initiatives, using the University's cash on hand. Rulney's miscalculation has taken a chronic problem and made it acute. <u>College spending on mission delivery is not the source of the problem</u>.[2]

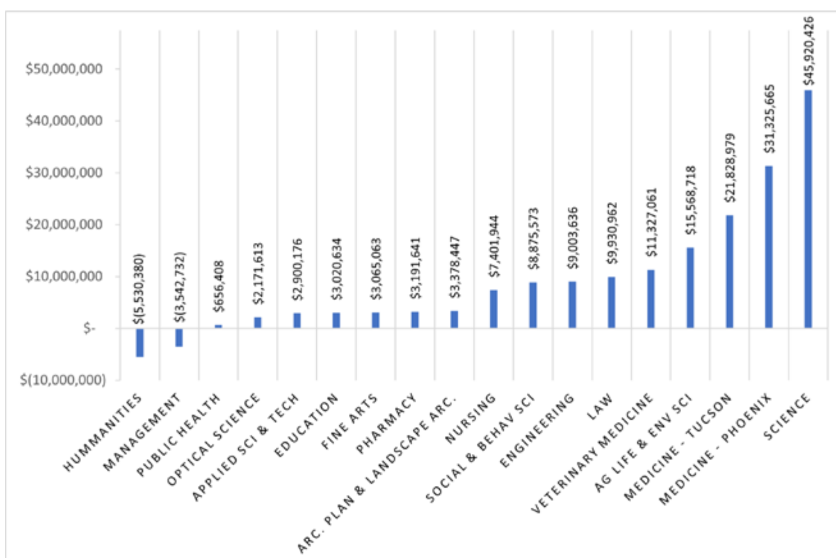
We also provide recommendations which include:

- Central admin must be transparent in their spending related to strategic investments and must immediately reduce these investments. These investments are the root cause of the current overspending at the University – not college expenditures on mission delivery.
- An immediate recalibration of AIB is needed in order to provide the colleges with the funds they need to invest in teaching and research, the primary sources of revenue for the University. Guiding Principle #1 for AIB is to "ensure adequate funds centrally to meet institutional strategic opportunities." This should be shifted to "sustain and incentivize the University's basic academic production units" per the General Faculty Financial Recalibration Committee (GFFRC) recommendation.
- The University should publicly report on every major strategic investment decision made by central admin every year. This should be broken out and separate from central admin costs for operations and no longer reported as aggregated investment categories as they are now in the Provost Investment Fund Report.
- True engagement of faculty shared governance, as well as college leadership teams, in decision making and University plans to mitigate financial mismanagement.

RCM to AIB Reduction in College Revenue

First, under AIB, nearly all colleges earn significantly less than they did for delivering the same mission under RCM. In the switch from RCM to AIB, one would expect that there would be about an even split between winners and losers among the colleges. Yet, as Figure 1 shows, only the Colleges of Humanities and Management actually earn more under AIB than RCM for the exact same level of effort. All other colleges earn less for the same level of activity. These losses range from $650k (College of Public Health) to $46m (College

Figure 1. Historic RCM Revenue(Less) AIB Revenue, FY21

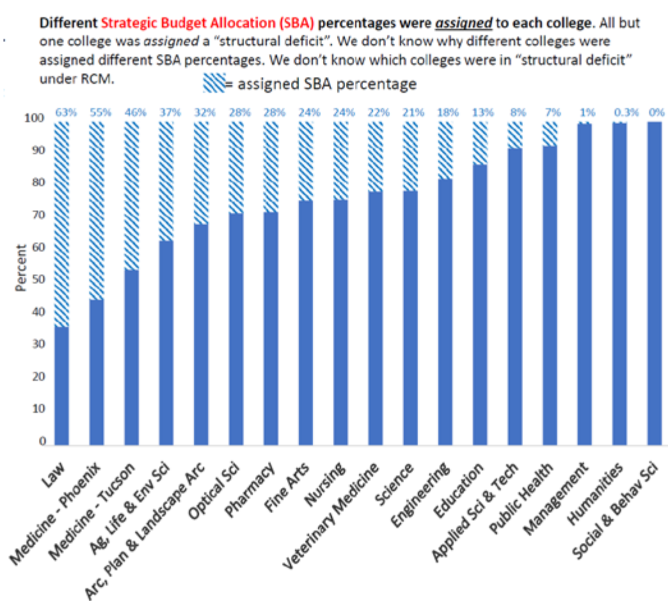


[2] The arguments in this document are not an attempt to deny that operating deficits may and do exist at some Colleges (e.g., CALES, Law, SBS, Science). Nor do we dispute that there could be greater efficiencies in some academic colleges. But our larger consensus, based on data, it that there are systemic issues that Colleges face in their delivery that are a result of Central Administration decisions.

of Science). Based on Guiding Principle #1, AIB is a success. Nearly all colleges are losers and central admin is the primary winner, as it captures a larger share of revenue centrally.

Obviously, central admin could not implement a new budget model that introduced such a large shock to revenue without assisting the colleges in smoothing over centrally-imposed loss. To implement the principle of "do no harm," central admin has offset this lost revenue in most (but not all) colleges by providing an ongoing Strategic Budget Allocation (SBA) that fills the budget hole. Figure 2, which includes numbers across colleges, reports on the percentage of revenue at a college that is made up of SBA. But this amount is not in perpetuity. It decreases 3-5% every year, even in the first year. These reallocated funds are returned to central admin and are used at their discretion. So, while the budget for central admin grows every year, every college has to increase their AIB activity-based revenue by nearly 3-5% in order to maintain current levels of instruction and research. If a college wants to expand its activity, increase its faculty, or account for rising operating costs, it must grow by 4-6% or more.

Figure 2. Strategic Budget Allocations (SBA), FY22



While the ongoing SBA is designed to smooth over the differences in activity-based revenue between the two models, centrally assigned SBAs do not always equal the revenue loss (compare values in Figure 1 to Table 1). As an example, Science receives $46m less in activity-based revenue under AIB than under RCM. Yet their ongoing SBA is half this amount: $23m. Another example is the College of Social and Behavioral Sciences (SBS), which gets $8m less under AIB than under RCM. Yet, SBS received no ongoing SBA to make up this difference. appears to be best off with the switch from RCM to AIB. It is unclear why ongoing SBAs to some colleges are relatively equal to their lost revenue while in other colleges there appears to be little correlation. One conjecture is that colleges with larger cash reserves have received smaller SBAs with central admin expecting colleges to spend down college reserves to fill the budget hole created by central admin.

There appears to be two reasons for this sudden change in activity-based revenue generated under RCM and AIB. First, the value of student credit hours (SCHs) and majors have significantly decreased from RCM to AIB.[3] To help compensate for this, AIB now provides a lump sum payment for degrees conferred but even with this payment, colleges still get less from teaching and graduating a major in AIB than they did under RCM. Second, this well-meaning shift to incentivize colleges to graduate students means that colleges which teach large service courses now get much less for doing so, since they will never see the lump sum payment for the non-major students they teach. However, these two reasons do not fully explain

[3] It is difficult to compare value of SCH in RCM to AIB. While AIB has published values that are standard across colleges, under RCM the value of SCHs were weighted using the Delaware Cost Study to account for different costs of instruction. It costs more to deliver a studio class in music than it does to deliver an introduction to economics class. Thus, there was no consistent value for an SCH across colleges.

the difference in activity-based revenue generated by the two models. This requires more in-depth analysis within and across colleges and would require linking data from the two budget models to enrollment and graduation data.

In the short term, central admin fills this gap with the SBA, but as the SBA shrinks every year, the College of Law will have to grow at an incredible (likely impossible) rate or start laying people off and shrinking. When CFO Rulney claims that the College of Agriculture, Life and Environmental Sciences (CALES) and other units/colleges have a structural deficit, she is correct insomuch as it was Robbins, Folks, Rulney, and Perry who implemented a new budget model that structures a deficit for everyone so that central admin can capture more money for investment in central's initiatives.

In summary, mission delivery did not change between RCM and AIB. Only the activity-based revenue that central admin allows the colleges to keep changed. As the SBA shrinks each year, or as cash reserves shrink in SBS and Science, colleges must grow just to avoid cuts. AIB does not sustain the colleges, nor does it provide a foundation or incentive for colleges to grow its mission delivery.

Unit	FY23 Ending SBA
[ARCH] Col Arch Plan & Landscape Arch	2,842,831
[BUSN] Eller College of Management	317,364
[EDUC] College of Education	2,431,003
[ENGR] College of Engineering	5,056,509
[GRDC] Graduate College	727,611
[HMNT] College of Humanities	105,288
[HNRS] W.A. Franke Honors College	996,313
[ISCL] iSchool	-
[LAWC] James E Rogers College of Law	9,122,890
[OPSC] James C Wyant Coll Optical Sci	2,333,235
[SBSC] College of Social & Behav Sci	0
[SCNC] College of Science	22,647,604
[UAZS] College of Applied Sci & Tech	861,692
[VTMD] College of Veterinary Medicine	5,675,814
[AGSC] Coll of Ag Life & Env Sci	17,791,339
[FNRT] College of Fine Arts	4,639,717
	75,549,208
[HSCD] AZ Health Sci Ctrs & Divisions	5,912,472
[MDPX] College of Medicine - Phoenix	16,259,824
[MDTC] College of Medicine - Tucson	18,483,132
[NURS] College of Nursing	5,153,857
[PBHL] College of Public Health	834,124
[PHRM] R Ken Coit College of Pharmacy	2,692,065
	49,335,474

Table 1. Strategic Budget Allocations (SBA)

Gain Share Tax, Directives to Spend Down, and "Overspending"

The gain share tax, which was initiated in 2022, created an environment in which colleges were incentivized to spend down their cash reserves or have them forfeited to central admin. While the goal of gain share, according to Budget and Planning's FAQ was "to reasonably balance any single unit's need for resiliency with the needs of the University "as a whole this clearly did not happen. The tax, not unexpectedly, resulted in much more rapid spending by a majority of colleges, including but not limited to CALES. In fact, the tax incentivized spending that fit with the campaign from Provost Folks to spend down cash balances since as early as 2019. She provided Deans with reports of their accrued cash balances and directed them to spend in writing, verbally, and in meetings through the end of FY23. The spend-down by colleges should not have been a surprise to central admin as it was by intentional design or acquiescence of Provost Folks and CFO Rulney. Yet, CFO Rulney now presents this as unexpected and a key cause, in addition to the reduction in activity-based AIB revenue, of the "structural deficits" at certain colleges.

Table 2 presents data from the SPBAC budget meeting presented on 21 November. Table 2 show three examples from the thirteen colleges that spent more than they got back from RCM/AIB in the last two years.

		FY2019	FY2020	FY2021	FY2022	FY2023
[AGSC] Coll of Ag Life & Env Sci						
	Revenue	55,559,570	54,719,814	53,315,092	57,298,705	64,017,742
	Expense	52,801,468	52,247,137	51,806,285	60,332,355	83,473,986
	Net Change	***2,758,102***	***2,472,677***	***1,508,807***	***(3,033,650)***	***(19,456,243)***
	Beg Fund Bal	26,605,710	29,363,812	31,836,489	33,345,296	30,311,645
	End Fund Bal	29,363,812	31,836,489	33,345,296	30,311,645	10,855,402

		FY2019	FY2020	FY2021	FY2022	FY2023
[SBSC] College of Social & Behav Sci				-		
	Revenue	82,479,250	84,523,003	78,224,418	72,824,213	76,901,084
	Expense	81,731,890	83,320,291	75,033,832	75,713,996	83,977,780
	Net Change	***747,360***	***1,202,712***	***3,190,585***	***(2,889,783)***	***(7,076,696)***
	Beg Fund Bal	25,817,902	26,565,262	27,767,974	30,958,559	28,068,776
	End Fund Bal	26,565,262	27,767,974	30,958,559	28,068,776	20,992,080
[SCNC] College of Science						
	Revenue	140,076,378	146,842,554	137,828,961	158,545,412	159,700,005
	Expense	145,003,484	159,039,962	135,996,247	142,687,699	168,097,686
	Net Change	***(4,927,106)***	***(12,197,408)***	***1,832,714***	***15,857,713***	***(8,397,680)***
	Beg Fund Bal	10,384,171	5,457,065	(6,740,342)	(4,907,629)	10,950,085
	End Fund Bal	5,457,065	(6,740,342)	(4,907,629)	10,950,085	2,552,404

Table 2. CALES, SBS, and COS Expenditures and Revenue, FY219 – FY23

CFO Rulney has, as recently as 5 December, pointed to these numbers as evidence of colleges spending more than they took in. However, these SPBAC numbers are a composite of all spending in a year and do not provide *prima facie* evidence of a structural deficit. For instance, CALES saved up $33m dollars over a number of years and then spent $23 of that in the last two years. If all that money was spent to cover ongoing operating costs, then these numbers might suggest overspending or a structural deficit. But, if the money was spent on one-time expenses, like spending start-up funds, then as long as the college has a positive cash balance, no structural deficit exists. A helpful analogy is: *You save up for three years to take a nice vacation. In the year that you take the vacation, you spend more than you earn. But as long as that spending was from your savings, nobody would consider you financially unsound and in a structural deficit or deficit spending.*

While CFO Rulney blames colleges for overspending, the University, in fact, does not allow colleges to deficit spend. The Office of Budget and Planning requires colleges to provide spending reports that are limited to never be below zero. Spending more than we take in cannot happen since the Provost, CFO, and CBO would/should never approve such a budget and should have taken preventative action to stop deficit spending when they saw it occurring. CFO Rulney's comments to Faculty Senate on 4 December confirm this. **The claim, if true, that colleges are overspending, or deficit spending, could be interpreted as an admission by CFO Rulney of her and Perry's failure in their fiduciary responsibility**. Beyond that, the SPBAC numbers do not appear to suggest evidence of the overspending that CFO Rulney claims nor can they be used as definitive evidence for or against a structural deficit.

The one exception to the above arguments is the College of Law (Table 3). Based on SPBAC numbers and the AIB budget numbers, it does appear that Law likely has a structural deficit. For five years they have spent more than they took in (unlike all other colleges, including those that recently increased spending to avoid the gain share tax). And they have been deficit spending for five years (unlike other colleges which spent down cash reserves). The College of Law also has the largest SBA to cover losses in activity-based revenue from the switch to AIB, suggesting that they are in serious financial difficulty for many years, and that this deficit was known by central admin and condoned through the ongoing financial support well before CFO Rulney's $240m miscalculation. But this is unique among academic colleges. All other colleges ended the fiscal year with a positive cash balance.

		FY2019	FY2020	FY2021	FY2022	FY2023
[LAWC] James E Rogers College of Law				-		
	Revenue	18,614,417	18,894,253	19,211,560	18,899,976	19,723,872
	Expense	19,547,075	20,933,255	19,656,996	22,358,522	25,106,576
	Net Change	***(932,657)***	***(2,039,001)***	***(445,436)***	***(3,458,546)***	***(5,382,704)***
	Beg Fund Bal	422,071	(510,587)	(2,549,588)	(2,995,024)	(6,453,570)
	End Fund Bal	(510,587)	(2,549,588)	(2,995,024)	(6,453,570)	(11,836,274)

Table 3. College of Law Expenditures and Revenue, FY19 – FY23

Spend Downs and Miscalculation of Cash on Hand

The rapid spend down of college cash likely contributed to CFO Rulney's mistake in calculating days of cash on hand. It seems that CFO Rulney and Provost Folks did not realize that taxing cash reserves would incentivize colleges to spend down those reserves. Why they didn't understand this basic tenant of economic behavior is unclear, especially since Provost Folks had been advocating for spend-downs since 2019. At the end of the day, Provost Folks and CFO Rulney told the colleges to spend and the colleges listened. At the end of FY23, all colleges (main and health) have spent $44m more than the revenue allocated to them that year. This reduced total college cash on hand from $393m to $349m (see Table 4). Note though that some colleges still retain substantial cash in their end fund balances.

		FY2019	FY2020	FY2021	FY2022	FY2023
Total Colleges						
	Revenue	1,225,394,637	1,201,935,238	1,114,899,818	1,236,792,688	1,281,927,504
	Expense	1,210,940,699	1,196,734,121	1,073,100,947	1,195,529,079	1,325,893,067
	Net Change	***14,453,939***	***5,201,117***	***41,798,871***	***41,263,608***	***(43,965,563)***
	Beg Fund Bal	290,453,449	304,907,388	310,108,504	351,907,375	393,170,984
	End Fund Bal	304,907,388	310,108,504	351,907,375	393,170,984	349,205,420
University Total						
	Revenue	2,840,443,777	2,972,011,512	2,741,929,420	3,113,028,820	3,322,678,076
	Expense	2,892,402,971	3,042,320,861	2,576,500,079	3,088,671,001	3,447,552,183
	Net Change	***(51,959,193)***	***(70,309,349)***	***165,429,341***	***24,357,819***	***(124,874,107)***
	Beg Fund Bal	652,347,114	600,387,921	530,078,572	695,507,913	719,865,732
	End Fund Bal	600,387,921	530,078,572	695,507,913	719,865,732	594,991,625

Table 4. Main Campus Expenditures and Revenue, FY19 – FY23

To Rulney's claim of structural deficits, colleges have taken in more than they spent in four of the last five fiscal years. The SPBAC numbers do not speak to overspending by the colleges. When President Robbins and CFO Rulney say, "we are overspending" it does not look like college spending makes up even close to a majority of that "we." Colleges may have overspent last year, but this under at the direction of central admin and in the CALES case, the spending came from existing cash reserves.

Where it looks like overspending is occurring is within central admin. Business Affairs (which contains many subunits) spent $64m more than it took in last year in revenue. This is half of the total $124m that was spent down University-wide. In fact, Business Affairs completely exhausted its cash reserves and ended FY23 with a negative cash balance of $32m. Again, the SPBAC numbers do not appear to show that colleges are recklessly spending nor do they show that college spending is even a plurality of the spending.

	FY2019	FY2020	FY2021	FY2022	FY2023
Business Affairs					
[BUGN] Business Affairs General					
Revenue	528,965,885	630,171,498	604,615,097	693,547,408	712,933,600
Expense	584,378,955	694,279,590	528,926,904	737,508,353	778,279,096
Net Change	***(55,413,070)***	***(64,108,091)***	***75,688,192***	***(43,960,946)***	***(65,345,496)***
Beg Fund Bal	121,314,266	65,901,197	1,793,106	77,481,298	33,520,352
End Fund Bal	65,901,197	1,793,106	77,481,298	33,520,352	(31,825,144)

Table 5. Business Affairs Expenditures and Revenue, FY19 – FY23

Central admin seems to be trying to blame colleges for their financial mess and frequently point to recent increases in spending by colleges as seen in the SPBAC numbers. Yet, as Figure 3 shows, which comes from the ABOR presentation on November 2nd, cash reserves have decreased in every year since Robbins became President in 2017 except for the COVID years when the University received COVID Higher Education Emergency Relief funds. The cash on hand problem has been brewing since Robbins became President and has become acute with Rulney's calculating error. Central admin had put the university on this trajectory for years before the shift to AIB and the ordered spend down, which have shrunk the revenue and cash reserves of the colleges.

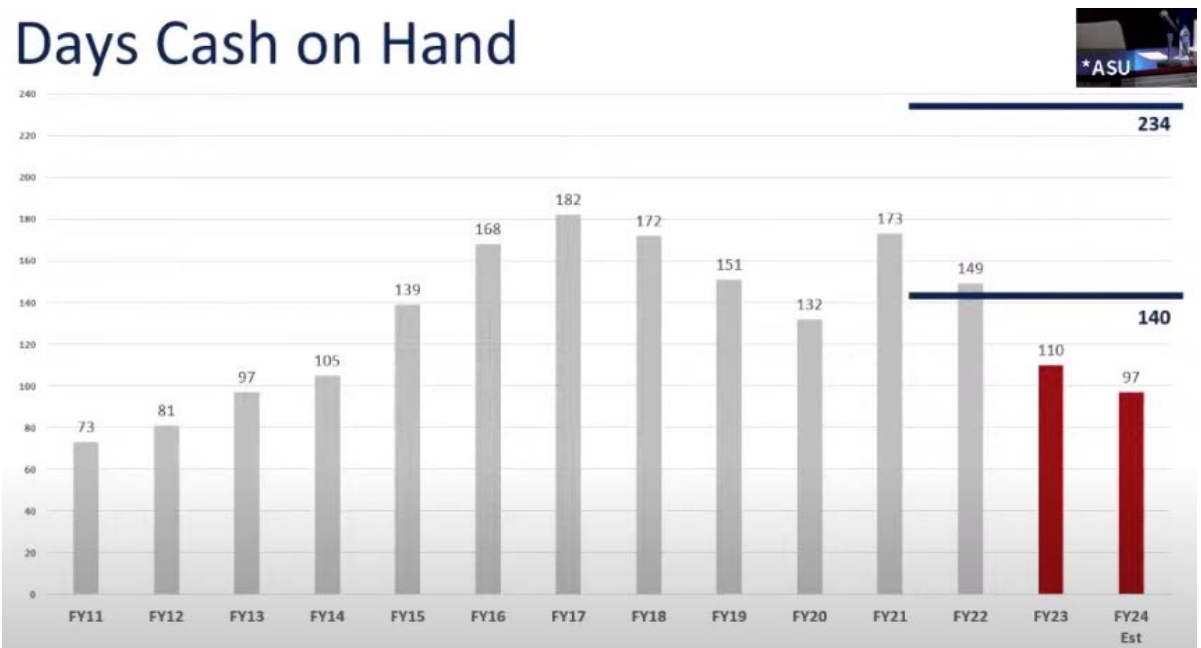


Figure 3. Days of Cash on Hand

Summary

Based on the data available and a reading of the evidence, it is clear that the University's days of <u>cash on hand problem and the forthcoming budgetary issues at all colleges are both due to a misalignment of University priorities and mismanagement of reserves by central admin</u>. CFO Rulney repeatedly claims that the Deans of the colleges are to blame for overspending. The truth is, the University is profitable. The problem in cash on hand has arisen because central admin made decisions centrally to draw down reserves and invest them specific activities (e.g., strategic initiatives, tuition discounting, athletics, etc.) believing that either they could pull back when needed or that the investments would somehow pay dividends. Unfortunately, the budget models they used proved unreliable given the shifts in incentives from gain share and AIB. **Central admin gambled with funds that were never intended to be gambled away.** The reserves were there to be RESERVES not a slush fund with which to make bets.

The SPBAC numbers that central admin frequently point to only provide (inconclusive) evidence that any cash shortfall is not due to "us" (colleges) spending more money than we take in. The University operates at a profit and all colleges, except Law, ended FY23 with positive cash balances. The recent increase in spending is likely due primarily to Provost Folk's and CFO Rulney's insistence that colleges spend down reserves. But even with that increased spending, no college ended the year with a negative balance, except Law. Data within each college is needed to actually show if colleges have increased spending on ongoing operational expenses or on one-time spending. The SPBAC data CFO Rulney points to does not justify her conclusions.

Even if some colleges may be on spending trajectories that will continue to draw down their fund balances, any financial danger that might exist is exacerbated by the shift from RCM to AIB. Colleges engage in strategic planning and the shift to AIB, which greatly reduces the activity-based revenue to colleges, has more than likely placed some colleges, like CALES, on precarious footing. But again, this is not due to reckless overspending by colleges. Rather it is due to the implementation of a budget model that structures in a deficit for every college (except SBS). This enforced deficit is solely due to central admin retaining a larger share of the activity-based revenue that colleges generate. And the ongoing shrinking of the SBA "subsidy" means that colleges must grow activity-based revenue just to be able to pay the operating expenses they had in FY22. There is little hope under the current budgeting model that colleges can grow their faculties and, by extension, their teaching and research.

From this analysis, the problem is clear to us. First, central admin has implemented a budget model that squeezes the colleges of activity-based revenue in order to maximize funds for central admin to spend on their own initiatives. Second, they have exacerbated this problem by overspending on these initiatives, using the University's cash on hand. Third, Rulney's miscalculation has taken a chronic problem and made it acute. <u>College spending on mission delivery is not the source of the problem.</u>

Recommendations and Solutions

Based on this statement of the problem, the solutions are also clear. **First, central admin must reduce investments in central initiatives and increase investment and revenue sharing in colleges that deliver on the Land Grant mission**. This requires a full public accounting of those central initiatives so that they can be subjected to basic financial accounting metrics, like benefit-cost analysis and return on investments (ROI). It also requires a recalibration of activity-based revenue allocation in AIB in order to provide the colleges with the funds they need to invest in new tenure track hires to increase research and teaching, the primary sources of revenue for the University. This recalibration will require central admin to give up funds that they had expected to have and will likely result in a reduction in planned future spending on certain projects and hiring freezes for those affected units. If implemented correctly, it should not necessitate any layoffs.

Second, the University cannot afford to continue spending on central initiatives at the rate that it has. These investments are the root cause of the current budgetary issues at the University. The University should propose rebuilding its cash on hand through a steady wind-down of some of these initiative based on benefit-cost analysis and ROI. It should propose a deliberate approach so as to prioritize hiring freezes as opposed to immediate layoffs. Budget cuts should not be imposed on revenue generating units engaged in mission delivery.

Third, the University needs to provide more transparency around what strategic investments central admin is making. The current reporting system, which presents investments in broad categories, is insufficient. Central admin should provide the names of new and existing centers, projects, programs, units, and labs that it is investing in. Additionally, some statement should be provided regarding the purpose of the investment, why it was deemed beneficial, a benefit-cost analysis, and expected ROI. Not every investment needs to be profitable nor do all investments need to be made based on financial metrics. Investments in initiatives that advance our core values cannot and should not be monetized into dollar values. In those cases, a justification should still be provided why the investment is valuable to our core mission.

Fourth, the University *must* work to involve key shared governance committees, as well as college leadership, in decision making. Time and time again, elected faculty representatives have voiced concerns about decisions of Senior Administrators—the Ashford acquisition, University furloughs, and concerns of athletic bailouts—and we find ourselves in familiar positions where input is sought after the fact or in a rushed manner.

The guiding principles of the recalibration of spending and rebuilding of cash on hand should be 1) a prioritization of growing mission delivery through the colleges, 2) re-assessing and reducing funds to central initiatives, 3) being deliberate in the process so as to avoid cuts to staff and faculty who are central to the mission of our University, and 4) ongoing, meaningful input from key shared governance committees, including Faculty Senate. With these in principles, the University can emerge from the current budgetary issues stronger and better positioned to not only delivery on its Land Grant mission.

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