MEMORANDUM

To: Board of Regents

From: Board Office

Subject: Budget Issues for FY 2004

Date: May 12, 2003

Recommended Actions:

1. Consider policy issues related to constructing FY 2004 budgets.
2. Approve the revised policy on reallocations in Attachment A.

Executive Summary:

Budget Issues

Policy issues affecting preliminary FY 2004 general fund operating budgets are presented for Board consideration and discussion. These discussions will assist the institutions in shaping the preliminary detailed budgets for the Board's review at the June meeting.

The Regent institutions have experienced significant reductions in state appropriations in prior years including FY 2003 reductions of $42.6 million and FY 2002 reductions of $81.9 million.

The Regent universities have sustained another year of reductions in state appropriations. The FY 2004 base operating appropriations were reduced by $17.9 million. In addition, the Regent universities will not receive funding to implement the state salary policy increases.

In prior years, the special schools received appropriation reductions that are included in the numbers identified above. However, in FY 2004 the special schools received a 2% increase in base operating appropriations and are expected to receive some salary increase funding from state appropriations.

Construction of budget details is directly related to key budget policy issues, which include:

1. Revenues changes
2. Reallocations
3. Salary increase policies
4. Unavoidable mandatory and inflationary costs
5. General fund support for athletics
6. Economic development issues
7. Capital projects / building repairs

Strategic Planning:

The Board's strategic planning goal 4.1.1.0 requires the Board annually to review and approve institutional resource allocations and reallocations consistent with and supportive of the Board and institutional strategic plans. In developing the individual budgets, the institutions are guided by the strategic plans of the Board and each respective institution.

Background:

Board Budget Process

The Board considers key policy issues in May prior to its review of preliminary details for all general fund budgets in June. This allows the Board time to consider institutional plans and provide guidance prior to final approval of budgets. In July, the Board will receive final detailed general fund and restricted fund budgets for approval.

Analysis:

ISSUE:
Revenues

The Regent universities rely on several funding sources for general fund operating budgets. The Special Schools rely mostly on state appropriations.

The Regent universities funding consists of state appropriations, tuition and fees, federal support, indirect cost reimbursements, and other sources.

Appropriations Reductions

The Regent institutions have had significant reductions in state appropriations during the five-year period of FY 2000 – FY 2004. These amounts do not include shortfalls in state funding to implement the state salary policy.

The most recent legislative reductions total $17.9 million (2.9%) for the Regent universities for FY 2004.

The legislature funded $28 million for salary increases for state agencies. Of the Regent institutions, only the two special schools are expected to receive any salary increase dollars.

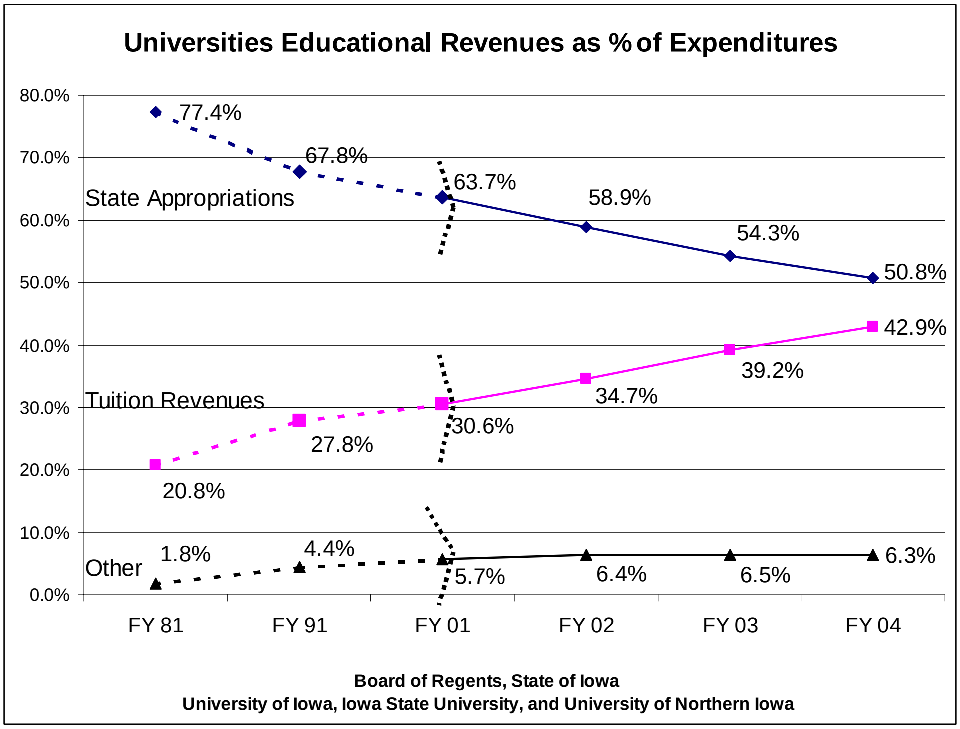
Total State Appropriation Reductions

FY 2000	$ 3.4 million
FY 2001	2.7 million
FY 2002	81.9 million
FY 2003	42.6 million
FY 2004	17.9 million
Total Reductions	$148.5 million

Tuition

The Regents have significantly increased tuition rates over the last several years. The increases approved by the Board in November for FY 2004 will net approximately $39 million. The net Regent tuition increases over these years have not covered the shortages and the state salary policy.

The following table summarizes funding sources for all three universities as a percent of total general university budgets. (The percentage numbers vary by institution).



Shifting Revenue Sources

A considerable shift in revenue sources has occurred since FY 2000. Students and their families must now pay a larger percentage of the cost of public higher education.

<u>ISSUE:</u>
Reallocations

The Regent reallocation program is an integral part of the Board's strategic planning and budgeting process. This program requires each Regent institution to reallocate at least 2% of its budget each year. This reallocation policy is intended to ensure that the institutions use existing resources to improve quality but also to achieve efficiencies. The significant appropriations reductions of the last several years have impacted the ability of the institutions to reallocate resources to improve quality.

The institutions are still working through the details of the FY 2004 appropriations reductions and salary shortfalls and will quantify reallocations with the June budget submissions.

In September 2002, the Board reaffirmed the need for a reallocation policy for the next five years and requested that the Board Office work with the institutions to 1) develop a clear definition of reallocations, and 2) design a consistent reporting mechanism.

Attachment A defines reallocations. The Regent institutions are currently working with a template to report planned reallocations with the budget submissions for the June docket.

ISSUE:
Salary Policies

The Board of Regents highest priority for the FY 2004 budget requests was full funding of salaries from state appropriations. State funding of salaries is a beneficial investment which allows the institutions to compete with other states for the best talent. Salaries comprise more than 75% of the institutional general fund budgets, excluding the University of Iowa hospital operations.

Quality faculty and staff are essential to the implementation of the Board's and institutions' strategic plans. To recruit and retain top faculty in a global marketplace, the Regent universities must remain competitive by paying competitive salaries in each discipline.

The Regent institutions have several bargained employee contracts that will require the institutions to fund salary increases for FY 2004 even though there has been no funding provided for the increases. This includes AFSCME, for which the state is completely responsible for the bargaining agreement.

The state, during its process of negotiating collective bargaining agreements, determines the statewide salary increase policy.

With the states continuing budget challenges, the Regent universities will not receive funding for salary increases in FY 2004. The special schools are expected to receive some salary increase funding.

The institutions are currently working through the budget details including salary increases. Information on the salary policies of the institutions will be presented to the Board in June.

ISSUE:
Unavoidable Mandatory / Inflationary Costs

The Regent institutions must also deal with cost increases that cannot be avoided. Some examples include increases in library costs, utilities, insurance premiums, and state auditor fees.

The Regent institutions must also provide funding for operations, maintenance, and utilities as new buildings are opened. The McCollum Science Building addition at the University of Northern Iowa and the new Gerdin Business Building at Iowa State University are expected to open for operation during FY 2004. State capital appropriations funded a significant portion of the construction of these buildings, however, no state funds were provided for operating these facilities.

These increases will require the Regent institutions to use other revenue sources or reallocations for funding.

<u>ISSUE:</u>
Economic Development Appropriations

The Legislature reduced the base FY 2003 economic development appropriations by almost 60%. The current bill for FY 2004 appropriations provides status quo amounts that continue the significant reductions.

The Governor has called a special session for May 29th to discuss economic development initiatives and tax issues. The Regent universities have been included in several legislative drafts for possible for economic development initiatives.

The following is a list of the current economic development appropriation units at the Regent universities.

SUI

The SUI economic development appropriation units include the Center for Advanced Drug Development (CADD), the Oakdale Research Park, and the Technology Innovation Center. The FY 2004 appropriations total $253,338.

ISU

The ISU economic development appropriation units include the Institute for Physical Research and Technology, the Small Business Development Center, and the ISU Research Park. The FY 2004 appropriations total $2,424,161.

The legislation mandates that $550,000 of the ISU appropriation must be allocated to the small business development center, which represents a $75,903 increase for the small business development center and a decrease to the other two economic development – the science and technology research park and the institute for physical research and technology.

UNI

The UNI economic development appropriation units include the Institute of Decision Making and the Metal Casting Center. The FY 2004 appropriations total $370,555.

<u>ISSUE:</u>
Athletics

Intercollegiate athletics at the Regent universities are not self-supporting activities. Each University provides some general fund support to its athletic department. Athletic budgets will be presented separately to the Board in June.

When the athletic department awards athletic scholarships, it becomes responsible for paying the tuition related to those scholarships. Thus, these tuition payments are an expense to the Department and a source of revenue for the general university. The increases in tuition for FY 2004 will impact the athletic budgets.

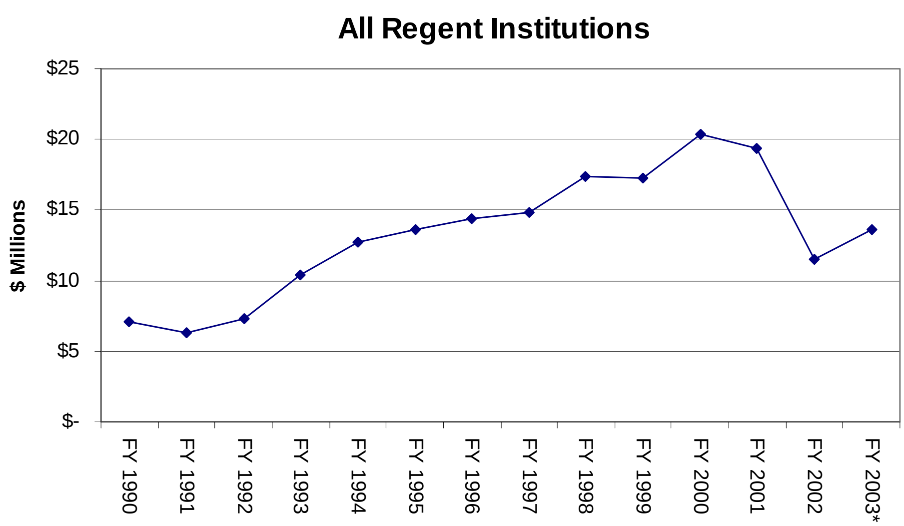
Some of the mandatory and designated tuition student fees directly relate to support for athletic programs. The Board will consider for approval the allocation of mandatory student fees and designated tuition (G.D. 12).

ISSUE:
Capital Projects / Building Repairs

The Board's Strategic plan, Objective 4.3, provides for the maintenance and acquisition of physical facilities and equipment to meet stewardship responsibilities.

Because of the appropriations reductions in recent fiscal years, the Regent institutions have significantly reduced building repair budgets. This reduction is likely to increase deferred maintenance and hinder the institutions' ability to correct fire and environmental safety deficiencies. The inability of the institutions to make needed repairs/replacement of roofs, exterior building envelopes, windows, plumbing and electrical systems because of reduced funding can cause further damage to the facilities, thus increasing the cost of future repairs.

The following table illustrates general fund budgets building repair expenditures over the last 14 years.



* FY 2003 budgeted amount, as approved by Board in July 2002.

Deb A. Hendrickson
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Approved: Gregory S. Nichols
Gregory S. Nichols

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Definition of Regent Required Reallocations

Reallocations will require approval at a central level of authority such as President/Superintendent, Provost, Vice-President, or Dean. Reallocations that are strategic, ongoing, and meet one of the following criteria will be viewed as appropriate. Examples of appropriate reallocations include:

1. Funds reallocated to meet a reduction in state appropriations.

2. Funds reallocated between central administrative units (e.g., funds reallocated from units reporting to the provost to units reporting to the vice president for student affairs); from central administrative units to colleges; among colleges (e.g., funds reallocated from the College of Business to the College of Liberal Arts and Sciences), among departments and/or separate units within a college or other major administrative unit.

   To meet this criterion, the departments or units involved must have distinct and identifiable budgets that are managed separately.

   Example: Funds reallocated from one department to another department in the same college for any reason would be counted as reallocated (e.g., moving funds from one department to another department that takes away a faculty line in one department and adds a new faculty line in another).

3. Funds reallocated across expenditure categories

   The broad categories of expenditures are faculty salaries, Professional and Scientific salaries, merit salaries, graduate assistant salaries, hourly wages, supplies, and equipment. The case can be made for movement between other expenditure categories (e.g., printing, ADP computer support, etc.) if the unit has a budget that specifically defines the category and they monitor actual expenditures against that budget.

   Example: Funds are reallocated from a faculty salary line to a P&S salary line to increase professional staff support in information technology.

4. Funds reallocated from one programmatic category to another within the same department.

   To meet this criterion, the programs between which funds are moved must both exhibit some of these following characteristics:

   - A named official position such as “Director” or ”Coordinator”
   - Separate, identified budgets that are monitored against actual expenditures
   - An advisory group that provides input into programmatic decisions and changes
   - A specific identifiable client/customer group
   - One named program to another named program

     Example: Funds for staffing are reallocated from the undergraduate program to the graduate program in a particular department. Moving a faculty line from one area of a department to another area in the same department would not automatically meet this criterion unless at least some of the above characteristics are true or further justification is provided. If a department contains a number of different majors, the presumption is that reallocation would be considered as legitimate if funds were reallocated from one major offered by the department to another major in the department (e.g., the Department of Logistics, Operations and Management Information Systems has three different majors with distinct faculty for each; a reallocation of a faculty line from Operations to Logistics would be considered an appropriate reallocation.)