

The University of Michigan

General Fund Budget Review: A Study of Perceptions

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General Fund Budget Review**

Letter from Phil Hanlon, Associate Provost and Rick Francis, Chair of BROG

Colleagues,

In the spring of 2005, Paul Courant (then Provost) commissioned a study of the budget system at the University of Michigan. The review included the system used to budget the academic and administrative units, but excluded all major auxiliary operations, such as the health system and athletics. The study was conducted by consultants Ken Kohrs and Staney DeGraff during the period from May to November, 2005. Their work was assisted and guided not only by the Provost's Office but also by an independent group, the Budget Review Oversight Group (BROG), consisting of faculty and staff each having great familiarity with the budget system.

The budget system study was commissioned to be a review of perceptions of the budget system held by those who work with the system in a wide variety of roles. The consultants did not attempt to validate perceptions. The intent of this review was to identify areas of broad satisfaction or dissatisfaction with the budget system and so the consultants were not charged to include recommendations for changes to the budget system in their report.

Because this is a report of perceptions, care must be exercised when interpreting the findings of this study. It should be noted that the respondents to the survey had highly variable understandings of, and experience with, the budget system. So, a perception of the budget system expressed by a particular set of respondents may reflect any of the following three issues: (1) a weakness of the budget system that should be addressed with changes to the budget process and model, or (2) a breakdown in understanding of the budget system that needs to be addressed with more effective communication and training, or (3) a strength of the budget system that disadvantages this particular set of respondents relative to others, at least in their view. Additionally, the summary of commonly held perceptions should be interpreted in the context of the statistical information concerning sample size, respondent expertise and range-of-responses contained in the chapters and appendices of the full report.

This review was the first step of a two-step process. It will provide the Provost with important input for the second step by identifying areas of the budget system where there is broad satisfaction and focusing attention where the University community perceives improvements are possible. Toward this goal, it will be necessary to separate misperceptions about the budget system from issues around which improvements to the system are needed. Misperceptions will be addressed by improving transparency and communications. The Provost is considering the opportunities for improvements to the budget system and there are likely to be some changes to the budget process, consistent with the results of this study, in the very near term. Greater deliberation and consultation will be required for changes to the budget model and so any such changes will be enacted over a longer period of time.

In the next several sections, you will find a description of the process that the consultants followed in conducting this review and then a summary of the key outcomes of the review. The full review report, including a list of survey questions, a list of respondents and statistical analyses of the outcomes is quite lengthy. It can be obtained in hard copy by sending an e-mail or written request to Pat Kneeland in the Office of the Provost.

Yours truly,

Phil Hanlon, Associate Provost

Rick Francis, Chair of BROG

The University of Michigan General Fund Budget Review

Foreword

This study was sponsored by the Office of the Provost and Executive Vice President for Academic Affairs to assess various viewpoints in the University community regarding the effectiveness, strengths and weaknesses of the University Budget (UB) model and system. The present budget model, implemented in 1999, is an evolution of the Responsibility Centered Management (RCM) model and based on the activity-based budgeting approach. It replaced the Value Centered Management (VCM) model and was designed to address some issues that arose from VCM. Since its inception, however, the UB model has not been systematically evaluated until now. The Provost's Office has charged the study team (Kohrs and DeGraff) to examine the perceptions of the various constituents in the University with regard to the UB model and system. Therefore, this study centers on the perceived impact and effectiveness of the budget model and system.

Accordingly, this report is about *perceptions* and may or may not reflect verifiable facts. This does not diminish the importance of the responses illustrated in this report since they may represent prevalent viewpoints, regardless of any inaccuracy.

Two different but comparable sets of interview questions were developed to accommodate both activity and non-activity based units. They were created with the assistance of the Provost's Office and reviewed by the faculty and staff members in the Budget Oversight and Review Group (BROG). Throughout the study period, the study team has been advised by and has had discussions with the BROG members. However, the study team is solely responsible for producing this report and for any mistakes that may have occurred.

During the months of May to August 2005, the study team interviewed 64 groups comprised of 111 people representing various constituencies in the University community. They were executive officers and their senior staff, ex-officials, deans, directors, budget administrators, and researchers; from both academic and non-academic units, and from both activity and non-activity based units (please see the glossary for the meanings of these terms). The interviews normally lasted between 1 to 1 ½ hours.

The interviews were somewhat freeform, although guided by the sets of questions. Because of time constraint and the respondents' varying levels of involvement in the budget process, the study team, by necessity, omitted specific questions during some interviews. Each team member analyzed the responses to look for both common and emergent themes across interview groups and the diversity of the responses. The study team then created a set of quantitative data, based on those emergent themes, to complement and further measure the diversity of the qualitative responses. A series of statistical analyses were performed to test some hypotheses. The utilization of both the qualitative and quantitative data provides richer analyses and a more vivid portrayal of the responses. The quantitative data set was used to ascertain the points of convergence and divergence in the responses, and the qualitative data set illuminates some explanations, examples, and the strength of emotion.

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Philip J. Hanlon, Associate Provost for Academic and Budgetary Affairs
Glenna L. Schweitzer, Assistant Provost and Director, Office of Budget and Planning

for their support and guidance in initiating the study, providing information to the study team, and for organizing and enabling access to individuals and groups across campus and former officials outside the campus.

The Budget Review and Oversight Group (BROG) who guided the study team throughout the study and provided feedback and constructive ideas:

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The Office of Budget and Planning staff members

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for his invaluable assistance and consultation in the quantitative analysis of the data.

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for her invaluable assistance and consultation in developing a qualitative analysis approach.

The 111 individuals in 64 groups who willingly gave up their time to talk to the study team, provided invaluable insights and expressed candid emotions and responses.

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Summary of Significant Findings

Introduction and Approach

This section highlights the five significant findings and the common themes that emerge from them and from other core issues. In reading this section, it is important for the readers to examine whether these themes and findings are inherent in the budget model and system or whether they are a result of the implementation of the budget model and system. The following common themes and significant findings need to be addressed as interrelated components, and not as independent parts, of an integral budget model and system.

Please note that the report is intentionally written in the present tense to preserve the immediacy of the issues as highlighted by the respondents.

Common Themes

These recurring themes reveal positive and negative aspects of the key elements in the budget model and system, which emerge from the interview sessions. Accordingly, these themes reflect the *perceptions* of the respondents, and *may not be factual*. The study team has attempted to present a balanced view of how each theme impacts the overall report findings. They are not listed in any order of priority.

- *Unit autonomy*
Autonomy has led to self-management, entrepreneurship and innovation. Accordingly, it is highly valued. There is a need, however, to find a balance between the units' autonomy and the alignment of priorities among units and between units and the Provost.
- *Financial accountability*
It is crucial to keep a balance between holding units accountable for their financial performance and encouraging innovation and riskier initiatives that may not produce favorable or immediate financial returns.
- *Communication and understanding*
The communications and support provided by the Office of Budget and Planning and the skills of the Provost's staff have elicited numerous praises and created a positive working relationship between the units and the Provost's Office. However, the level of understanding of the budget model and system still varies significantly within the University community, causing some misunderstanding and confusion with regard to the budget process.
- *Model and system complexity*
While the model is considered rational, to many, it appears to be too complex. This perceived complexity hinders certain initiatives (such as interdisciplinary efforts), discourages some University community members from making a real effort to understand the model, and provides a justification for inexpedient decisions.
- *Strategic planning*
The model encourages units to prioritize their initiatives and allocate their resources strategically; both of which require a long-term outlook. However, the system places a

substantial emphasis on the incremental changes in activities from year to year and does not require a thorough examination of the existing activities.

- General Fund Supplement Base Structure*
 The lack of a *full* and *continuing* evaluation of the base / historical component of the General Fund Supplement creates a situation where the units' budgets may no longer represent their current cost structures due to various exogenous variables. Some leaders who inherit the base budget from their predecessors also have an incomplete understanding of the historical element of their budget and thus question the components that make up their base budget.
- Transparency*
 There is a need for more clarity and openness with respect to the University's priorities and strategy, resource allocations, and the reasons for those allocations. Since the resource allocation affirms University's strategy and values, this transparency is invaluable for the purpose of alignment of priorities among units and the building of trust and cohesiveness of the community. The main issue here is to find the right level of transparency. While the lack of transparency breeds rumors and mistrust, excessive transparency may cause antagonism among units.
- Incentives*
 The model seems to highlight the operational independence of each unit and discourage interdependence and collaborations. Independent operations can lead to heterogeneity and diversity of competence, which are crucial for innovation and change. However, too much independence also generates self-serving behavior and the lack of inter-unit alignment, which hinder interdisciplinary efforts. In addition, the incentives to increase revenues and reduce costs may entice units to engage in initiatives that are incompatible with their mission or values in achieving academic excellence.

<i>Common Theme</i>	<i>Positive</i>	<i>Negative</i>
Unit autonomy	Promotes self-management and entrepreneurship	Lack of alignment between the units and the Provost
Financial accountability	Promotes better unit management and responsibility	Impedes innovation due to the emphasis on financial returns
Communication and understanding	Good support from the Provost's Office when needed	Large variation in understanding
Model and system complexity	Rational model	Deemed too complex by some participants and difficult to master
Strategic Planning	Encourages prioritizations and strategic allocation of resources	Emphasizes short-term outlook and incremental changes in activities
General Fund Supplement	Emphasizes incremental	Possible lack of connection

Base Structure	activities and thus, new initiatives	between the base budget and the current cost structure
Transparency	Understanding of own budget allocation	Lack of transparency on the logic of own allocation and the overall university-wide allocation; lack of alignment of priorities
Incentives	Promotes independent operations, which develop the capacity to innovate and change	Perverse incentives that encourage units to (1) develop self-serving behavior and avoid collaboration and inter-unit alignment, and (2) retain or engage in less valuable activities or activities that are incompatible with mission/vision

Significant Findings

This section highlights the five most important findings in this report: (1) the support for an activity-based budgeting model, (2) a general agreement on the goals of the UB model and system, (3) the lack of transparency of resource allocations and the lack of alignment of priorities, (4) a need to review the effectiveness of the embedded incentives, and (5) the opportunity to enhance the effectiveness of the budget conferences. These findings accentuate the common themes discussed in the previous section.

The study team uses a variation of the SWOT (Strengths, Weaknesses, Opportunities, and Threats) analysis on each significant finding. That is, the team analyzes the positive and negative elements of each significant finding with respect to how well the UB model and system function as a strategic tool and serve the needs of the University community. The team uses the word *Observations* in place of Opportunities, since the team merely asserts its observations regarding those strengths and weaknesses, and does not intend to forward specific recommendations for change. Likewise, the team also identifies possible cautionary elements, noted as *Threats*, based on interview responses and those observations.

Each significant finding is illustrated with a diagram of the SWOT summary and a subsequent summary of explanations and some specific comments made by the respondents.

I. The Support for an Activity-based Budgeting Approach

Virtually all respondents support the continuing use of an activity-based budget model and system. They believe that the model is generally effective, rational, stable, and fits in with the University of Michigan’s decentralized culture. They also recognize, however, that the system has shortcomings that need to be addressed. There is virtually no support to return to an incremental budget system, as it is perceived as highly political in nature.

<p><i>Strengths</i></p> <ol style="list-style-type: none"> 1. Agreement on many positive outcomes of the UB model and system 2. Proper incentives to effectively manage operations 3. Appropriate emphasis on financial accountability 4. Clear revenue and cost attributions 5. Excellent support from the Provost's Office and OBP 6. Rational model which allows for differentiated but appropriate level of funding for each unit 	<p><i>Weaknesses</i></p> <ol style="list-style-type: none"> 1. Too much emphasis on short-term planning 2. Disincentive for interdisciplinary efforts and innovative initiatives 3. Tuition attribution that is too complex to facilitate meaningful forecasting 4. Perceived complexity of the model in general due to varying levels of understanding 5. Lack of connection between the tax rates / formulaic cost attributions and the real cost structure 6. Limited connection between the units' financial system and that of the University, which leads to data discrepancies and perceived complexity of the UB model 7. Wide variance of budget understanding which compromise the effectiveness of the incentives 8. Lack of discussions of total fund budget
<p><i>Observations</i></p> <ol style="list-style-type: none"> 1. Possible improvements in annual budget conferences 2. Incorporation of performance indicators or matrices in the budget allocation consideration 3. Clarification of hold-harmless strategy and the development of guidelines for one-time requests 4. Reevaluation of formulas, datasets and systems use to derive revenue and cost attributions and the development of managerial tools to lessen complexity 5. Greater transparency of the usage of taxes and the reevaluation and readjustment of attribution formulas for a more accurate representation of the current real costs 6. Development of customized educational programs in management skills and financial system 	<p><i>Threats</i></p> <ol style="list-style-type: none"> 1. The need for strong and highly competent leaders in both academic and management at all levels who will make difficult, but necessary decisions to achieve excellence 2. A match of skills between unit leaders and their budgetary staff is essential to ensure the unit's financial success 3. Possible impression of a concealment of the political nature of the budget system, which can compromise model integrity and trust in the system 4. Possible rifts between units and hindrance to innovation caused by high attention to performance indicators

Strengths

There are six important strengths of the present model and system:

1. The respondents generally agree on the most important positive outcomes achieved by the UB model and system. The three most frequently stated outcomes encompass 67.5% of the total responses, as illustrated below with a few specific comments from the respondents. Please note that the percentages in the following list reflect the frequency with which the respondents identify the corresponding positive outcomes. For instance, 26% of respondents consider the unit's autonomy as one of the most important outcomes

of the UB model and system. The rest of the respondents (74%) volunteer other outcomes. Therefore, it does *not* mean that those 74% disagree that the UB model and system promote unit's autonomy; rather, those respondents do not explicitly state that the unit's autonomy is one of the most important outcomes of the budget model and system.

- a. Unit's autonomy and resources to achieve goals – 26%
 - The budget model and system give flexibility to units to adjust to various situations.
 - Units are encouraged to grow and allowed to retain funds to support their strategic plans.
 - The autonomy and the empowerment of unit leaders (Deans and Directors) enable them to develop high quality programs. Decisions are made at the appropriate level.
 - b. Unit's financial accountability – 26%
 - The budget model and system encourage units to understand their cost and revenue structures, including their future commitments.
 - The budget model and system facilitate critical discussions of units' goals and the resources needed to achieve those goals.
 - c. Strategic resource allocation – 16%
 - The budget model has allowed academic units to grow faster than non-academic units. It breaks the linkage between academic growth and administrative growth.
 - The budget model and system enable the Provost to influence policy and priorities through the General Fund Supplement and allow for differentiation in financial support among units, as strategically appropriate.
 - The budget model enables units to prioritize their operations and stimulates better unit management and business practices.
2. Many respondents believe that the budget model provides the appropriate incentives for the unit leaders to intelligently manage their units by understanding their revenue and cost structures, prioritizing the use of resources, and planning for new initiatives. Forty-six percent of respondents believe that the incentives to generate revenues are effectively emphasized in the model. Thirty-eight percent hold a similar belief regarding the incentives to reduce costs.
 3. Most respondents (57%) assert that financial accountability is sufficiently emphasized and effective. This financial accountability encourages unit autonomy and decision making at the unit level. Correspondingly, 62% of respondents state that unit autonomy is also emphasized and effective.
 4. Cost and revenue formulas or calculated attributions are generally clear, except for tuition. The majority of respondents (67%) believe that the attributions are clear or partially clear. Tuition attribution, however, is deemed too complex or unpredictable to be a useful forecasting tool by 52% of respondents. This point will be expounded in the Weaknesses section. There are some patterns to these responses: the units with larger amount of General Fund budget and the respondents with more sophisticated understanding of the budget model and system are more likely to consider the attributions clear.

5. The respondents who have had some experience in seeking clarification regarding the attributions and/or the budget process from the Provost's Office and the Office of Budget and Planning give favorable comments with respect to the support they have received.
6. An activity-based model is also considered to be more rational and less political than an incremental model. In addition, it allows a differentiation of funding levels among units. Accordingly, the allocated funding is customized to the specific needs of each unit.

Weaknesses

There are eight broad categories of issues frequently cited by the respondents:

1. A large number of respondents (54%) voice their concerns that the present budget system has come to put too much emphasis on short-term operational planning to the detriment of strategic discussion and long-term planning. Others believe that frequently held discussions between the units and the Provost effectively encourage strategic planning. In this context, strategic long-term planning refers to a multi-year strategy development and management, which includes and encompasses much more than a multi-year financial projection. There are two components to the issue of strategic planning:
 - a. There may be some miscommunication or unclear expectations with regard to the budget creation process, in which long-term strategic planning is assumed to serve as a blueprint for the budget, but not explicitly required.
 - b. There is a perception that the UB model and system focus on incremental changes in activities and budget instead of on *all existing* activities and the *total* budget (with a full examination of the General Fund Supplement base budget). Some respondents mention that this perception is partly due to discussions that center on incremental activities and not on the existing ones.
2. The majority of respondents (62%) believe that neither the model nor the system sufficiently encourages interdisciplinary efforts and riskier but innovative initiatives. There is a contention whether the system truly hinders interdisciplinary efforts or whether it is in fact flexible enough to allow interdisciplinary efforts. A part of this disagreement stems from the fact that selected respondents differentiate the budget model from the budget system, while others do not. Regardless of this difference in opinion, there is a general agreement that the current budget model or the *implementation* of the system does not satisfactorily promote interdisciplinary efforts.
3. Tuition attribution is considered by many (52%) to be too complex to be used as a meaningful forecasting tool. Some mention that while they understand the formula to calculate tuition, they cannot produce the same tuition data that drives their revenue as the one used by the Provost's Office. This situation creates a real problem for some units since the difference between the forecasted amount and the real tuition received can be large enough to significantly influence their operations.
4. The units' inability to forecast tuition and the perceived multiplicity of the cost and revenue attributions create an impression to 32% of respondents that the budget model is complex. This impression is largely due to a large variance in the understanding of the UB model and system within the University community. Those who understand the model very well and who are familiar with the prior VCM model believe that the current UB model is actually much simpler than VCM. For instance, there are only three types of taxes in the UB model, while there were twenty-four different formulas to calculate

- cost attributions in VCM. Other respondents, on the other hand, have likened the UB model to the U.S. tax code where there are various rules and exceptions. Unfortunately, this perceived complexity only further dissuades some community members from deepening their understanding and therefore, taking ownership of the model and system.
5. Some units also express their concerns that the cost attributions may no longer appropriately reflect their current cost of operations. The tax rates are based on detailed calculations on the units' real costs, but they have not been reevaluated since the implementation of the UB model.
 6. All units utilize their own financial operating systems to manage their operations, which may have limited connections to the UB model and system. They also generate their own financial data, which may differ from the data used by the Provost's Office. Therefore, 50% of respondents do not find the budget documents useful. Another 26% find the documents useful even if they have to reconcile the data in the documents with their own data. This limited connection between the unit's financial system and the University's may exacerbate the perceived complexity of the model and further discourage a deeper understanding of the model. This is a contentious issue that will likely prove difficult to resolve. Please see a related discussion of incentives below.
 7. The UB model is designed to influence organizational level behavior and decision making practices. It is, however, not well understood by others beside unit leaders and their budget administrators. Forty-one percent of respondents report only a limited understanding in their units at all levels. During the interview process, the study team also observes a considerable difference among the respondents regarding their own understanding. Thirty-nine percent of respondents have a very sophisticated understanding of the model and system. Thirty-four percent have a good understanding that facilitate good financial management. Twenty-seven percent, however, have a limited understanding of the budget model and system. This wide variance may compromise the effectiveness of the embedded incentives in influencing behavior and the alignment of priorities among all members of the University community.
 8. Some respondents are also concerned that the budget discussions between the units and the Provost revolve around the General Fund Budget only. Since the units need to understand their total funds budget (which includes revenue from other sources) to effectively manage their operations, it is important to look at the units' total financial health in its entirety. This is cited as the top issue or missed opportunity of the UB model and system.

Observations

The primary observation is the potential to improve support and ownership of the UB model and system through improved communication and some modest, not major, structural changes. These improvements may include the following actions:

1. Enhance the annual budget conferences by facilitating a better communication of goals, a greater clarity of commitments, and a sharper focus on critical issues. Currently, 40% of respondents deem the budget conferences to be ineffectual. In addition, the budget discussion may be extended to include a review of the units' total funds and their financial management as a whole. These changes would increase the units' satisfaction with the system, enhance alignment of priorities and cultivate a meaningful long-term relationship between all parties involved.

2. Establish a stronger / visible relationship between the unit's financial performance (as well as specific indicators, stretch goals / targets, and matrices) and resource allocation. These indicators or matrices may be customized to each unit to reflect its strategy and mission. Thirty-six percent of respondents feel that the system does not effectively hold the units accountable for their financial performance. Some others feel that their past financial performance does not seem to have much bearing on the budget allocation. Creating a stronger link between the units' financial performance and their budget allocation would reaffirm the unit's sense of accomplishment, deepen the impact of incentives and sharpen the unit's focus on excellence.
3. Clarify technical processes such as the hold-harmless strategy and establish guidelines for the process and purpose of one-time requests to improve their effectiveness and further foster unit innovation and strategic orientation. Some respondents are not familiar with the hold-harmless strategy or have misconstrued it. Forty-six percent of respondents find the process for submitting one-time requests to be unclear. Many respondents believe that one-time requests should be used for strategic initiatives only and submitted in conjunction with the annual budget request. By doing so, the Provost would be able to allocate the budget more strategically. However, it is also important to maintain the flexibility of the process to allow for unplanned but important items that occur at mid-year.
4. Lessen the perceived complexity of the cost and revenue attributions by reevaluating the formulas, datasets and systems needed to derive those attributions. One possible consideration is the tuition attribution. A customized tool (software) to model various scenarios for forecasting and strategy formulation would greatly enhance the management of the units and foster long-term strategic outlook.
5. The reevaluation of cost attributions is also important to ensure that the attributions reflect the units' real costs. In addition, a greater transparency of the usage of taxes, in the forms of services rendered to the units, and the allocation of funds at the institutional level would promote a better understanding, establish trust, and cultivate a more effective decision making process.
6. Develop a more formalized and highly targeted *managerial* and budget educational program to enhance understanding and further lessen the perceived complexity. This program should be developed to not only improve the participants' understanding of the budget model and system, but more importantly, to enhance the business management skills of unit leaders, which includes much more than financial management. The budget understanding and managerial skills are critical elements in enhancing the effectiveness of the budget model and the units' performance. In addition, there may be an opportunity to provide more advisory and managerial, but non-financial, support for the smaller units in managing their operations, should they need it.

Threats

The findings that can most easily be construed as threats are common among all organizations, and not unique to the University of Michigan.

1. The respondents assert that the model and system work well with strong leaders (both in terms of academic accomplishments and managerial skills) at all levels: the Provost, deans, executives, and directors. These leaders need to understand the budget process

and must be willing to make difficult decisions. Conversely, leaders who do not expend an effort to understand the system or who are unwilling to make difficult choices threaten system integrity.

2. A less than optimal match of skills between the unit leaders and their (budgetary) staff could result in an ineffectual management of their units. This issue is particularly important when there is a change in the leadership position.
3. The model may mask the political reality of the budget system. Since the Provost has discretion relative to funding allocations, certain units may appear to have unfair advantage and receive more favorable treatments and funding. This perception may be curtailed by increasing the level of transparency of the allocation decisions and thus, establishing a deeper trust in the system.
4. The incorporation of performance indicators in the process of budget allocation may create rifts and further impede collaboration and innovation if they are not suitably balanced with other criteria or do not include specific stretch goals concerning collaboration. In addition, while an increased transparency of the budget allocation decision will engender more trust in the system and in other units, excessive transparency may cause or escalate antagonism between units. Moreover, some units may be tempted to engage in initiatives that are less innovative and add little value to their academic missions when they see that Provost funds other units' initiatives in the corresponding topic.

II. General Agreement on the Goals of UB Model and System

The following is a non-prioritized list of the goals of the UB model and system, provided by the Provost's Office and utilized during the interview process:

1. Engage academic units in collaborative efforts to ensure an appropriate allocation of the necessary resources to support the agreed upon activities, priorities, and directions
2. Provide monetary support and resources to academic units
3. Reflect commitment to academic units' priorities in the budgeting decisions
4. Align resources and cost attributions to activity priorities and needs instead of non-activity related incremental adjustments
5. Provide an adequate amount of information to facilitate meaningful discussions between the Provost and the units
6. Foster short-term and long-term strategic planning
7. Encourage more careful attention to revenue and costs

There is general agreement on the suitability of the goals. However, some respondents take offense to the lack of certain elements or the wordings of the goals. Others deem the goals too broad and uninspiring.

<p><i>Strengths</i></p> <ol style="list-style-type: none"> 1. General agreement on the goals 2. Meaningfulness and appropriateness of the goals 	<p><i>Weaknesses</i></p> <ol style="list-style-type: none"> 1. Lack of awareness of the goals 2. Perception of stratification among units 3. Lack of specificity to the University’s mission and ambiguity of some wordings and intents 4. Missing goals
<p><i>Observations</i></p> <ol style="list-style-type: none"> 1. Collaborative and inclusive process to generate suitable goals 2. Clear communication of goals to the University community 	<p><i>Threats</i></p> <ol style="list-style-type: none"> 1. Possible imbalance between generality and specificity of goals which may unfairly favor certain units

Strengths

1. When the goals are clearly defined, openly communicated and well understood, they can bring about effectual management and effective practices. There is a general agreement regarding the goals of the UB model and system.
2. Most respondents (73%) find the goals meaningful and appropriate.

Weaknesses

1. A significant number of respondents have minimal awareness of the goals prior to the interview session.
2. Eighteen percent of academic units and 58% of non-academic units have some issues with the goals. The use of “activity / non-activity” stratifies units into classes and creates rifts instead of alignment and collaboration.
3. In addition, some respondents find the goals too broad (13%) or ambiguous (11%). While the goals are deemed “politically correct,” they neither capture the uniqueness of the University of Michigan nor showcase the University’s core strengths. There are opinions that the goals do not explicitly convey the University’s commitment to student development along the social and moral dimensions as well as their academic achievements.
4. Twenty-five percent of respondents feel that the goals are complete. However, others find some missing elements in the goals or feel that the current goals do not explicitly refer to selected critical issues. The top missing goals are:
 - a. To promote university-wide transparency of goals and priorities – 20%
 - b. To promote institutional values: diversity, excellence, and access – 12%
 - c. To enable strategic alignment, consolidation, and efficiencies across units – 10%

Observations

1. A collaborative and inclusive process may be used to modify existing goals or to develop others that reflect the University’s mission and values more clearly.
2. Communicating the goals to the entire community may increase the understanding of the budget model and system, create ownership and cohesiveness, and give units incentives to make decisions apposite to units’ financial health and academic mission.

Threats

1. While there is some room to include more specific goals in the current list, it is very difficult to develop ones that serve the needs of every unit. Some specific goals may

seem to give unfair advantage to some units. Therefore it may be necessary to keep the goals as general as possible to facilitate individual units' interpretation.

III. Non-Transparency of Resource Allocations and Lack of Alignment of Priorities

All units generally understand the dollar amount in their General Fund budget, since it is itemized quite clearly in their allocation report. However, some do not understand the *reasons* behind those allocations. Several even claim some confusion regarding the intended purpose of the itemized allocation. Others indicate a disagreement with the allocation priorities, but not a confusion over the amount. That is, an initiative that they consider to be a high priority item is not funded, while another initiative of a lower priority is funded by the Provost. Therefore, they feel that sometimes their priorities are not aligned with the Provost's.

In addition, most units do not understand the allocations at the institutional level. They do not have a clear knowledge of the University's priorities. Hence, many find it difficult to determine if their priorities are aligned with those of the University or other units. To illustrate, one respondent emphasizes that a unit's budget should be a translation of its goals and mission, which in turn, should be an extension of the University's goals and mission. A reasonable level of transparency regarding the General Fund budget allocations and an enhanced visibility of institutional priorities are important to engender trust in the budget system and encourage alignment of units with the University and with each other.

<p><i>Strengths</i></p> <ol style="list-style-type: none"> 1. Clear budget documents and instructions. 2. Provost's ability to influence unit's strategy and directions 	<p><i>Weaknesses</i></p> <ol style="list-style-type: none"> 1. Lack of clarity regarding the unit's own budget allocation 2. Lack of clarity concerning the resource allocations and the decisions made for the University as a whole 3. Lack of clear University's priorities that can promote alignment between the units and the Provost and among units
<p><i>Observations</i></p> <ol style="list-style-type: none"> 1. Greater transparency of budget allocation and important decisions critical to the University's mission 2. A more meaningful discussion regarding priority alignment 	<p><i>Threats</i></p> <ol style="list-style-type: none"> 1. Excessive transparency in budget allocation that may cause units to second-guess the Provost and further hinder collaboration among units 2. Clearly defined University's priorities may hinder grassroots innovations, obscure other opportunities, and constrain the University's action and ability to anticipate and adapt to external changes

Strengths

1. The documents and communications that accompany the final budget allocations are clear and useful to units in tracking changes from prior year budgets. Sixty-eight percent of respondents are satisfied with the communication and budget instructions. Fifty percent find the documents useful. The respondents also appreciate the exercise of putting together their budget since it enhances their understanding of their operations and facilitates better management.

2. Most respondents also recognize that the model and system, particularly the General Fund Supplement (GFS), provide the Provost with a means to influence strategic direction and to assist units when they need additional supports. Forty-three percent of respondents like the current balance between the Provost's influence and the units' autonomy.

Weaknesses

1. There is not enough clarity with respect to the decisions regarding the General Fund budget allocation to the unit itself. Many respondents (53%) indicate that while they understand and can track year-to-year changes (including GFS items), they do not have a clear understanding of the *decision logic* that resulted in the allocations to their respective units. It is therefore difficult to determine if the units' allocations are due to their contribution to the University's priorities or rather, to economic circumstances. Most indicate that subsequent discussions with the Provost's Office clarify some issues or answer some questions.
2. There is a definite lack of clarity concerning the resource allocations and the decisions made for the University as a whole. The respondents uniformly indicate that they are not aware of any strategic objectives that guide the financial allocations to other units across campus. Information gaps range from the lack of knowledge regarding how non-activity units are funded to the lack of insight into why a certain academic initiative is funded while others are not. As a result, there is an impression that some allocations are political in nature, and that there are too many "side deals" outside the UB model. This impression compromises the perceived fairness of the system and the units' trust in it.
3. Some respondents state that with significant effort, they can partially understand the University's priorities, strategies, and allocations. All recognize the University's commitment to diversity and academic excellence. However, these broad priorities do not provide sufficient information that can promote alignment of priorities among units and between the unit and the Provost. Therefore, 66% of respondents believe that they set their own priorities independently from the Provost. The rest believe that the frequent discussions between the units and the Provost effectively align the units' priorities to those of the University.

Observations

The emerging observations center on the issue of communication:

1. The decisions taken by the Provost's Office or other units that affect the University in general and the logic behind those decisions need to be communicated more efficiently and thoroughly. Doing so would promote greater confidence in the budget system and engender trust within the University community. The respondents realize that the Provost's decisions cannot and should not be fully transparent. However, they would appreciate a greater level of transparency at the Dean/Executive level regarding the university-wide allocation in general and some specific allocations that are more substantial or critical to the University's mission.
2. As noted in the subsequent section concerning the budget conferences, most respondents would also like a more meaningful discussion regarding priority alignment between units and the Provost and among units.

Threats

1. Although it is important to increase transparency in the budget allocation process, too much transparency may cause units to second-guess the Provost. In addition, the sense of competition among units may escalate. Increased transparency can engender trust in the budget model and system (and also the Provost) if the Provost's decisions are perceived to be fair. However, any perceived unfairness or injustice may destroy units' trust and faith in each other and in the Provost.
2. There needs to be a balance between a clear sense of direction for the entire University community and grassroots (and divergent) initiatives. An initiative instigated by the University that carries no supports from the faculty and the community may fail. In addition, a concentrated effort in one initiative may lead to missed opportunities in other areas and hamper the University's ability to anticipate changes in the external environment and quickly adapt to those exogenous shocks.

IV. A Need to Review the Effectiveness of Incentives: Revenue Generation, Cost Efficiency, Interdisciplinary Efforts, and Innovation.

There are two components to this issue:

1. Who needs to understand the incentives? How much should they understand?
While the incentives are meant to drive certain behavior, there needs to be a balance between the intent of the incentives and the units' academic mission. The incentives should work only *within* the units' strategy; they should neither constrain nor encourage behavior or initiatives that do not fit the units' strategy and mission. Thus, it is important to consider which faculty/staff and who in the larger University community need to understand the embedded incentives, or how much understanding is really beneficial. A general understanding may contribute to financial awareness and the units' financial health. On the other hand, too great an emphasis may impede grassroots academic initiatives and innovation. It is thus important to review if the incentives are sufficiently influential, but not overly so.
2. Do the individuals who are directly involved in a unit's financial management really understand what the incentives are intended to accomplish? There seems to be a wide variance in the level of understanding among the respondents interviewed for this study, as already discussed in the previous section.

Moreover, there are questions if the current incentives are effective to promote interdisciplinary efforts and innovation or if they actually inhibit those activities.

<p><i>Strengths</i></p> <ol style="list-style-type: none"> 1. Clear incentives for those with good understanding 2. Ability to develop reserves, which is an effective mechanism to achieve revenue generation and cost efficiencies 	<p><i>Weaknesses</i></p> <ol style="list-style-type: none"> 1. Too much focus on incremental activities, and not enough on quality or existing activities 2. Cost shifting and self-serving behavior that hinder inter-unit collaboration 3. Insufficient incentives in the model and system for interdisciplinary efforts and innovation 4. Too much emphasis on revenue generation that may impede innovation
<p><i>Observations</i></p> <ol style="list-style-type: none"> 1. Sharing of best practices regarding cost efficiencies across units 2. Feedback forum regarding major initiatives to reduce costs and increase mindfulness to other unit's operations 3. Highly targeted budget training programs that include a discussion of incentives. 	<p><i>Threats</i></p> <ol style="list-style-type: none"> 1. Possible increase of negative perceptions regarding the business aspect of the University and the compromise of academic values

Strengths

1. Data analyses indicate that units with an excellent understanding of the budget system are more likely to think that the incentives are clear. The reverse is also true.
2. The ability to build reserves (or carry forward balances) is a very effective driver in achieving revenue generation and cost efficiencies. While the policy to build reserves has been implemented prior to this budget model, it seems to fit especially well in an activity-based model. The respondents appreciate it and still recognize it as one of the strengths of the current UB model.

Weaknesses

1. The model has placed sufficient emphasis on activities but may have neglected to accentuate the quality of those activities. Furthermore, some respondents believe that the model has become too incremental, focusing on changes in units' activity (and new initiatives) but not on units' base budget in its entirety. This lack of full examination of the base budget undermines the budget system's ability to stimulate a review of existing programs and a possible elimination of those that are neither valuable to the units nor to the University as a whole.
2. The activity-based model and its embedded incentives promote self-management and independence. However, when pushed too far, the incentives may advocate self-serving behavior that impedes cross-unit collaboration. Eighty-seven percent of respondents believe that the budget model and system encourage units to shift costs, reduce their service level, or transfer their tasks to other units. This topic elicits very strong emotional responses from the respondents.
3. In addition, a significant number of respondents bemoan the lack of easily accessible and visible budget goals and the insufficiency of incentives for interdisciplinary efforts (88%). Some believe that the model may be neutral in this regard: it neither hinders nor

fosters interdisciplinary efforts and innovation. Others, however, believe that the model actually impedes these activities, especially because of its complexity and the specific revenue / costs attribution formulas (including the 75/25 tuition split). Nevertheless, many agree that the budget model and system should more actively promote interdisciplinary efforts and innovation through the availability of additional funding or longer range commitments by the Provost.

4. There is also a concern that too much emphasis on financial accountability and attention to costs and revenue (which are promoted by the budget model) can impede innovation (53%). The units may not be willing to engage in an initiative that cannot guarantee a profitable financial return or whose expected return may be realized in a much longer time frame.

Observations

1. Improve the communication of best practices regarding cost efficiencies across units.
2. Employ a more open approach to developing, implementing, and providing feedback with respect to major cost efficiencies that may have a positive impact on the University but an adverse effect on individual units. Be more mindful of other units' needs and operations.
3. Develop a more formalized and targeted budget training program that includes a discussion of incentives.

Threats

1. The attention to incentives to maximize revenue and reduce costs creates some concerns in the minds of academics about the commercialization of higher education. In addition, misconceptions of the incentives themselves may lead to inexpedient decisions that do not further the academic mission. This situation can cause resentment within the University community and a perception that the University's business practices compromise its academic values.

V. An Opportunity to Improve the Effectiveness of Annual Formal Budget Conferences

There are mixed views regarding the effectiveness of the formal budget conference, which is a key element of the budget preparation process. In general, the respondents have similar expectations for the conferences. However, they disagree on how well the conferences meet those expectations.

<p><i>Strengths</i></p> <ol style="list-style-type: none"> 1. Similar goals and expectations regarding the budget conference across all units 2. Perceived usefulness of the conference 	<p><i>Weaknesses</i></p> <ol style="list-style-type: none"> 1. Limited effectiveness of the budget conference for some respondents 2. Perceived pro-forma nature and seemingly cursory discussion
<p><i>Observations</i></p> <ol style="list-style-type: none"> 1. Changes in conference format 2. Guidelines and expectations for the conferences 3. More efficient long-term strategic discussions 4. More indicative response regarding the Provost's approval and commitment 	<p><i>Threats</i></p> <ol style="list-style-type: none"> 1. Increased suspicions among units if the budget conferences are conducted in private 2. Possible imbalance between unit autonomy and the Provost's influence (and oversight) if budget conferences are conducted every few years

Strengths

1. The following list reveals the three most frequently cited ideal goals for the budget conferences:
 - a. Discuss strategic planning and align priorities – 33%
Many respondents assert that they would like to discuss long-term strategic plans including their capital planning, instead of financials for the coming year only.
 - b. Communicate the units' mission and vision (information sharing) – 20%
The units want to establish a long-term relationship with the Provost, so that the Provost can understand the units' real issues and challenges.
 - c. Discuss the units' total financial health, including their total funds budget – 12%
The units want to use their total funds budget as a reflection of their financial health and complete operations, particularly as they engage the faculty and/or staff to create a sense of ownership and empowerment. They would also like the Provost to understand their total operations.
2. Many respondents (47%) believe that the conferences are effective and helpful. They appreciate the willingness of the Provost and his/her staff to provide some guidance to their operations. They also recognize the conferences as an opportunity to showcase their respective unit, and find the budget preparation exercises to be a good venue to inform and involve faculty and staff within the unit.

Weaknesses

1. A considerable number of respondents (40%) find the budget conferences to be only partially effective or effective in limited ways. They consider the conferences to be short-term oriented and too operational, at the expense of a longer term strategic outlook. This is a substantial issue since the units who are most satisfied with the budget conferences are the ones who feel that they have effectively aligned their priorities with the Provost's.
2. Many respondents consider the conferences to be pro-forma and lacking challenging discussions. This is attributed to the annual nature of the conferences, the presence of a large audience, and some digressions into what may be irrelevant details. There is an opposite opinion that the conferences should be pro-forma by design, since all critical strategic discussions should have already taken place during the frequent discussions

between the units and the Provost throughout the year. Hence, the conferences serve as a formal event, a milestone, and should not contain many surprises.

Observations

Since the respondents have similar expectations (goals) for the budget conferences, there are opportunities to:

1. Revise some elements of the conferences, such as the time frame, the attendees, and the location.
2. Clearly define and communicate some guidelines and expectations for the conferences. This may be an inclusive process that elicits some suggestions from the units and creates goals that are mutually beneficial to the units and the Provost.
3. Utilize the limited time frame more efficiently to accommodate meaningful discussions with a long-term outlook.
4. Convey a more definitive response to the units' budget requests at the end of the conference. Most units are very aware that the Provost cannot make a definitive commitment to their requests, especially with the uncertainty of state support. Some units (33%) feel that they have a good understanding by the end of the conference what initiatives are more likely to be supported by the Provost. However, the rest feel very uncertain of their budget results and would appreciate a clearer indication of support.

Threats

1. The public nature of the budget conference and the large audience prevent in-depth discussions between the unit leader and the Provost. However, this element also gives a sense of transparency to the conferences. As units have advocated increased transparency in budget allocation, they may find that the private setting of the conferences is a step backward that breeds some mistrust in each other and the Provost.
2. Conducting the budget conferences every few years (instead of on an annual basis) may create an oversight issue. Such format will be beneficial only if all units are well managed, since it assumes much regarding the unit's competence in management. Units that are not well managed or that are in financial trouble will only be disadvantaged by this change. Furthermore, the conferences will need to be supplemented by more frequent strategic discussions between the units and the Provost to maintain alignment and enhance the unit's ability to respond to the environment.

Conclusion

As mentioned in the beginning of this section, all the above themes and significant findings need to be examined together and treated as interlocking components in the current budget model and system. Any modifications would need to be administered carefully as they would impact most if not all of these issues. The key point that has emerged in this study is the importance in finding equilibrium in these different components.

**The University of Michigan
General Fund Budget Review**

Glossary of Frequently Used Terms and Definitions

Activity-based budgeting	An approach to budgeting and resource allocation that incorporates changes in revenues and costs that accompany changes in activities. It is a variation of “Responsibility Centered Management” (RCM), with some modifications. The University of Michigan uses activity-based budgeting approach. This term should not be confused with the terms “Activity units” or “Non-Activity units” described below.
Alignment	A state or condition of a relationship between the Provost and units or among units. Usually applied as part of a descriptive statement, such as priority alignment. A priority alignment between two units indicates that both units have shared goals or an understanding of each other’s roles in achieving those goals. An organization may either intentionally attain alignment among its units to achieve efficiency or strategically promote some misalignment among units. The latter is done to encourage heterogeneity that can promote creativity and reliability, through diversification and hedging.
Allocation	Usually refers to the net funding distributed to units, including General Fund Supplement, attributed revenues (such as tuition) and attributed costs (such as financial aid and taxes).
Attribution	Used in the context of financial attribution. Attributions are usually formulaic, designed to calculate revenues and costs. They may or may not represent the actual/real revenue generated or the cost incurred by the unit, although they are intended to be a proxy for them.
Base Budget	A part of the General Fund Supplement budget allocated to units that has become a base or a starting point for any adjustments. Funding for one-time requests and initiatives may or may not be added to the units’ base budget. Base budget reflects the current funding commitment from the Provost for the units’ ongoing operations given that there are no changes to the situations, operations and the underlying assumptions. See <i>General Fund Supplement</i> and <i>One-time Requests</i> .
Budget/model Understanding	At the conclusion of the interview process, the study team members jointly assessed respondents’ general understanding of the budget model and system based on respondents’ comments and dialogue. This is a subjective assessment. Respondents’ understanding are categorized as: <i>Excellent, Good, or Limited</i>

Budget Type	<p><i>Activity</i>: Units that are able to generate revenue from their operations as a direct function of their teaching, research, and service mission. Their budget model is an activity-based model: developed to recognize changes in activity. All but one school are activity units.</p> <p><i>Non-Activity</i>: Units that do not generate sufficient revenue to fund a considerable portion of their operations and thus depend heavily on the allocated General Funds. They do not directly conduct teaching or research, but provide valuable and critical resources to support those activities. Their budget is developed without specific formula attributions based on changes in activity. They are funded as deemed appropriate to fulfill their mission.</p>
Discriminating Characteristics	All interviews are categorized based on a number of discriminating characteristics that best describe respondents. These categories are utilized to determine possible relationships between responses and different types of respondents. Discriminating characteristics used are budget type, unit type, General Fund budget, General Fund % of Total Funds, Total Funds budget, respondents' positions, and budget/model understanding. See these specific terms for more details.
General Fund Budget (GF)	The operating funds where attributed revenues and costs directly relate to the University's academic mission. Its revenues include state appropriation, tuition and fees, indirect cost recovery, interest income, application fee, and General Fund Supplement. Its costs include financial aid, facilities, and taxes. We use 2003-2004 figures in our analysis.
General Funds as percent of Total Funds budget (GF%)	The allocated General Fund budget for the year 2003-2004 divided by the Total Funds budget for the same year.
General Fund Supplement (GFS)	A part of the General Fund budget that represents an additional funding distributed to units outside their attributed costs and revenues, to supplement their operations. GFS for each unit reflects the historical funding level for that unit and additions and subtractions that follow from the Provost's policies and decisions. It is through General Fund Supplement that the Provost can exert his influence and shape the University's strategy and priorities.
Hold-harmless	Refers to the policy that the Provost will compensate related units for technical or programmatic changes that affect them through no fault of their own. Hold-harmless policy is designed to preserve equity and ensure that any unit is not disadvantaged when changes occur. For example, when tuition attribution was changed to a 25/75 split, the Provost's Office made a budget adjustments to all units affected by this change.
Office of Budget and Planning (OBP)	An organization reporting to the Office of the Provost that is responsible for gathering information, conducting institutional research and analyses, developing the University's budget model, providing support, and communicating the annual budgets to the units.

One-time Requests	A funding request submitted by units to the Provost to support certain initiatives or issues. As the name suggests, one-time funding usually refer to a non-continuing funding and often functions as seed funding, where the Provost helps the units to jumpstart certain initiatives and gives time to the units to develop self-funding for those initiatives. One-time funding can reflect a multi-year commitment from the Provost. One-time requests can be submitted at any time in the academic year and used for various purposes, such as PFIP (Provost's Faculty Initiatives Program), strategic initiatives, or emergency funding.
Process	Refers to an organized approach to accomplish a stated goal, such as a budget process, decision process, or collaborative process.
Reserves	The carry forward balance of funds that is retained by units. Reserves can be built by adding yearly net income (revenues minus expenses) and can diminish with yearly net loss. Reserves are fungible. Some are saved for a specific purpose and some have a more general purpose.
Respondent	Generic term used to represent a participant or a group of participants interviewed in this study. Each interview session is considered as one respondent unit, regardless of the number of participants in each interview. Where views differ within the interview, alternate views are recorded.
Respondent's positions	Each interview is categorized into one of five types of employment positions within the University: <i>Deans and/or Staff.</i> All but one Dean participated in this study. This category also includes Deans' staff such as Associate Deans and budget administrators. The study team interviewed members of all schools and colleges. <i>Executive Officers.</i> Six out of eight Executive Officers participated in this study. <i>Executive Officers' Senior Staff.</i> Operating personnel directly reporting to the Executive Officers. <i>Directors and/or Staff.</i> This category includes operating personnel responsible for administrative or service units across campus and also for academic units with specialized research or academic functions. <i>Ex-Officials.</i> Ex-official respondents in this study include selected former University executives who played a major role in previous administrations with regard to the activity-based budgeting system. They also provide historical perspective regarding prior budget systems and the development of the current system.
Responsibility Centered Management (RCM)	A budgeting and resource allocation system that gives units (schools, colleges, organized research units, etc.) credit for revenues generated and costs incurred. The basic principle is to treat units as "profit/cost centers." Implementations of RCM vary in the existence or lack of interdependency of funding between units. Some implementations imply self-funding for the units and some do not.

Sources and Uses	Similar in concept to Income and Expenses. Sources are revenues distributed to units, including General Fund appropriation, General Fund transfer, endowment income, investment distribution and external department revenue. Uses are expenses borne by the units, including personnel compensation, supplies, and equipment.
Taxes	Based on expenditures. Taxes flow back to the Office of the Provost and are added to the funds used for allocations. There are three types of taxes: General Taxes, Research Taxes, and University Participation Taxes. Taxes are charged with a two-year lag to facilitate unit planning.
Total Funds budget	Refers to Total Sources for the purposes of this report. It includes units' total sources of revenue, including General Fund budget, other operating revenues, and non-operating revenues. See <i>Sources and Uses</i> . We use the 2003-2004 figures in our analysis.
Transparency	Used in the context of the study as a measure of openness and clarity of process, attribute, or decisions. Care should be taken to place the term in context. For example, while an attribution formula may be clear and transparent, the reason for the use of that formula may not be.
Unit Type	<p><i>Academic</i>: Units whose primary mission contributes to the accomplishment of the University's missions in teaching and research. Academic units may be budgeted using an activity or a non-activity approach. Examples of academic units that are budgeted using a non-activity approach are museums, libraries, and the Horace H. Rackham School of Graduate Studies.</p> <p><i>Non-Academic</i>: Units that support University's academic mission, such as housing, security, facilities. Examples include Division of Student Affairs, auxiliary units, and Facilities and Operations.</p>
University Budget (UB) Model and System	Implemented in 1999 as a version of RCM, succeeding a prior system known as VCM, Value Centered Management system. See <i>Activity-based budgeting</i> .