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The Flexible Budget

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This excerpt from a new NACUBO book, *College & University Budgeting: An Introduction for Faculty and Academic Administrators, Third Edition*, offers advice on allocating resources and increasing flexibility.

By Larry Goldstein

College and university administrators, especially those with day-to-day responsibility for planning and budget management, frequently ask the question, "How do I deploy the institution's resources to maintain the maximum amount of flexibility?" Flexibility is essential to be able to respond to changing circumstances and conditions. It is inevitable that things will not always play out as projected. One way to provide flexibility is through contingency funding. Some expenses may prove to be larger than expected. Major winter storms may drive snow removal costs beyond anything that might have been considered possible. The contracted Internet service provider may go bankrupt, forcing the institution to rely on a back-up provider with rates originally set only for short-term consumption. A faculty member may need a substantial commitment of institutional matching funds to secure a major research project. Any of these situations could occur. Without adequate contingency funding, they can wreak havoc on resource allocation plans.

Apart from contingency funding, maneuverability is a key element supporting flexibility. For example, funds with the fewest restrictions on their use can be held back and not allocated at the outset so they can be available to address unanticipated issues. State general funds usually cannot be used to finance facilities projects above a certain dollar threshold, whereas unrestricted private resources can be used to cover cost overruns on such projects. Flexibility comes from allocating state general funds to qualified activities and preserving unrestricted gifts and unrestricted endowment income for support of activities that are not eligible for state funding.

Another critical issue is risk tolerance. The greater the institution's aversion to risk, the more important it is to develop a budget that provides maximum flexibility through contingency funding and maneuverability. Flexibility is a way to avoid undue risk. Not allocating all anticipated resources to committed expenses or investments is a way to avoid incurring the risk that resources will be insufficient to meet the commitments. A budget that allocates all anticipated resources runs the risk that some planned expenses or other investments will have to be deferred due to revenue shortfalls or cost overruns.

The best opportunity to influence the budget is at the planning stage. Some of the most important budgetary decisions actually occur during the planning process, an essential activity that should precede the budget process and be linked with it. To wield meaningful influence, a participant should be involved in both the planning process and the budget process. The major decisions that influence resource allocations are both process related and content related. For instance, resource allocations are affected just as much by which institutional representatives participate in the process as they are by the actual amount of resources available for allocation.

Participants generally expect that they can affect the way in which resources are distributed if they analyze the institution's programs and activities in a logical, orderly manner. Still, it is important to recognize that politics cannot be overlooked or underestimated in weighing the budget outcomes. The political environment and the spheres of influence of members of the college or university community vary from campus to campus. Through friendships with trustees or legislators, a department chair may have political connections that give him or her influence far beyond that normally indicated by such a position. An administrator or faculty member who has participated in the budget process over many years may gain knowledge of the institution and accumulate enough political debts to become a powerful figure during budget negotiations. Some participants are more articulate than others and therefore enjoy greater success at garnering resources. In general, the more complex the budget process and the greater the individual interconnections, the more complex the political environment becomes.

Institutional Character: The Environmental Factors

One can argue that the relationship between the budget and institutional character is a "chicken-and-egg" proposition in that they tend to influence each other. Resource allocation decisions are frequently driven by institutional character; similarly, that character is in many ways a function of past resource allocation decisions. An institution can change its character, albeit slowly, by changing the way in which resources are allocated. It is important to recognize that few such decisions will, in and of themselves, bring about major change, although some will provide a stronger push than others. For instance, an institution that is not noted for its research proficiency may make great strides in a relatively short period simply by establishing and staffing a small office of sponsored programs. Moreover, if this step is coupled with the establishment of an internal initiatives fund, used to provide seed money to faculty interested in pursuing sponsored support, the institution can move from a position of little to no external support for research to measurable results within a few short years.

Recently a number of colleges and universities have attempted to change their character through intercollegiate athletics. Several have chosen to change divisions within the NCAA classifications. In most instances, the movement is to a higher, more expensive category. In a few cases, however, institutions have decided to drop a sport or move to a classification requiring less investment. Each action creates an opportunity for the institution to change its character. Sometimes the change can be dramatic.

There are times in an institution's evolution when it is primed for major change or transformation. This type of change can be thrust upon the institution by external forces, or the impetus for change can come from within the institution. In either case, astute observers will recognize the presence of these opportunities and use the budget process to achieve specific objectives.

A number of factors may create an opportunity for dramatic changes in institutional character. The institution may experience a significant shift in enrollment patterns or greater demand for some programs than for others. For instance, current social and political events may influence students to pursue some disciplines in numbers far exceeding typical patterns. When it becomes clear that the shifts are more than a short-term phenomenon, the institution will use the budget to realign resources to meet the demand.

Changes in employment demographics may also alter an institution's character. The country is about to experience a dramatic increase in employee turnover as the baby boom generation approaches traditional retirement age. In addition, the tenure of presidents and other senior administrative officers has shortened substantially in recent years. The combination of increased retirements and more frequent leadership transitions results in significant opportunities for changed institutional character.

Economic changes may also signal an opportunity for major change. The 1990s was a period of tremendous endowment growth for many colleges and universities. Although relatively wealthy institutions with large endowments did not necessarily experience changes in institutional character, others seized the opportunity to reshape themselves in dramatic ways. Many with modest endowments were able to increase the endowments to a level at which they could provide significantly greater financial resources than ever before. In some cases, this situation was used to change the overall character of the institution.

Significant changes can lead to broad readjustments of resource allocation patterns. Therefore, it is essential to understand the institution's character and seek to recognize shifts as they occur. It is important to note that shifts may not always be obvious, so it is wise to pay close attention to factors that are more easily monitored. Such tangible factors as academic plans, administrative priorities, and revenue fluctuations can be tracked easily from year to year and adjusted when necessary. Over time, changes in these factors also will influence institutional character, but typically in a more manageable way.

Budget Flexibility

Planning is the key factor in any budget. Unfortunately, the activities and programs offered in higher education do not lend themselves to detailed,

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Since publication of the last edition of this primer, budgeting accurate plans. In addition, it is unlikely that the variances will allow unmet revenue targets to be offset by better-than-expected expense results. To accommodate this reality, effective budgeters build flexibility into their plans in anticipation of significant changes in revenue or expenses. One mark of a well-regarded institution is its ability to take advantage of unforeseen opportunities and respond to unanticipated problems. Budgets must be as flexible as possible if they are to respond to unanticipated situations. An unanticipated windfall of funds is rare, but a wise budgeter will know in advance how to deploy such resources as soon as they are identified. In fact, at the institutional level, the plans should include a list of priorities to be addressed if resources become available—either through unanticipated savings or through a windfall.

At each level of the budget process, participants have the opportunity to budget every potential resource to its fullest or to reserve a cushion that can be used to respond to expense overruns or revenue shortfalls. The cushion built in at the department level is modest but will allow the unit to respond to issues that might arise. More cushion is needed at the highest levels because of the magnitude of potential issues. An increase in the cost of a special laboratory supply may affect only one or two units and probably will be accommodated with even a modest amount of cushion. On the other hand, a major spike in energy cost, such as that experienced in California in the early part of the decade, can absorb the entire contingency reserve.

Flexibility usually is structured according to the portion of the budget to which it pertains. Compensation costs account for as much as 60 to 70 percent of most college or university budgets; fixed expenses such as utilities and physical plant maintenance represent approximately 10 to 15 percent. The balance usually is spent for operating expenses such as service contracts, technology, supplies, communication, noncapital equipment, and travel. Typically, constraints on the use of funds differ from one expense category to another. For example, in many institutions, amounts budgeted for compensation may not be spent for other operating expenses. Instead, amounts not spent are captured centrally for reallocation or, in some public institutions, must revert to the state. Strategies for creating flexibility tend to be tailored to the activity, the expense constraints affecting the institution, and the level of operation within the institution.

To some, the concept of flexible resources has a negative connotation of inefficiency and poor administration. Contingency funding in an institutional budget is sometimes considered "fat." One extension of this philosophy is the notion that a leaner budget translates into greater accountability or improved efficiency. In fact, the most effective organizations are those in which resources can be marshaled as necessary to respond to challenges or take advantage of opportunities. Most budgeters recognize the importance of flexibility and will seek to protect the budget contingencies from those above and below in the hierarchy. They must take care, however, not to go to extremes by forgetting that the contingency funds are there to be used when needed. They should not be spent unwisely, but neither should opportunities be missed because of a misguided desire to build reserves at all costs.

Managers typically seek to shift uncertainty to others. Department heads routinely turn to deans or central office personnel for resources needed to respond to emergencies or opportunities. For instance, a department that encounters unanticipated price increases for needed supplies or higher-than-expected salary demands for an adjunct needed to replace a faculty member who becomes ill may expect the provost to provide supplemental funding to address the situation. Conversely, deans and central administrators may take on the burden of monitoring departmental spending closely to anticipate problems, or they may use their contingency funds to address problems within departments rather than use them for opportunities at the college level. State officials often shift uncertainty to public higher education systems or to individual campuses by establishing regulations that prohibit operating deficits.

Planning for the Unknown

The notion of flexibility changes from one budget cycle to another as circumstances change. New resources must be found to adapt to different conditions, and new strategies must be utilized to create contingency funding in the budget. Although budgeters at all levels seek to include cushion in their portions of the budget, they are reluctant to label it as such for fear that others may seek to claim the amounts.

Changes in revenues or expenses arise from five primary sources:

- Enrollment fluctuations
- Revenue fluctuations
- Expense fluctuations
- Emergencies
- Unforeseen opportunities

The uncertainty surrounding enrollment projections is a major reason for building cushion into the budget. If enrollments fall below expected levels, institutions will lose tuition and, in the case of public institutions, may lose state appropriations as well. Unless the expense budget contains a cushion, the institution will face a deficit for that year. Similarly, excess enrollment can create budget problems. Additional class sections may be required to accommodate the unanticipated increase in enrollment, but the revenue generated from the enrollment may not be sufficient to cover all additional costs. Unanticipated enrollment increases may also affect auxiliary units. It usually is not a problem for dining operations, but bookstores may not have adequate textbook inventories to meet demand, or there may not be sufficient campus housing for the additional students, who will be crowded into existing space.

A different problem occurs when enrollment patterns do not follow historical trends. For instance, enrollment may shift dramatically among majors in such a way that it is not possible to reallocate resources. It may become necessary to engage adjunct faculty to meet the increased demand even though no savings can be realized in the programs that experience enrollment drop-off.

Revenue shortfalls in sources other than tuition and fees can cause budget problems. Investment income may not meet targets due to unanticipated market conditions. Adverse publicity may cause donations to decline. Similarly, economic problems within the state might affect state revenues, thereby causing the state to reduce appropriations to public institutions. If the problem develops late in the fiscal year, it may require the institution to return funds already received.

Expense fluctuations also can have significant impacts— even when they do not rise to the level of an emergency. An unanticipated postage hike, increased insurance costs due to a spate of natural disasters, and price increases for repair materials used in the physical plant are examples of expense increases that, if experienced simultaneously, could create a significant deficit requiring attention. Campuses are like small- or medium-sized cities. Price increases in almost any commodity will affect them. If the increase relates to a widely used commodity, the impact can be significant.

The types of emergencies that can adversely affect a college or university vary widely. Several years ago when the federal government reacted to an indirect cost issue, many campuses were forced to repay amounts that had been collected as part of the normal overhead recovery process related to sponsored agreements. In some cases, the amounts were significant and were required to be remitted on relatively short notice. The California energy crisis resulted in major budgetary disruptions for colleges. Although most campuses have several types of insurance, a natural disaster can strike at any time and cause an institution to incur significant unplanned expenses to meet policy deductibles. Many would argue that the dramatic price increases in health insurance constitute an emergency. Typically, these events cannot be anticipated when the budget is planned 6 to 18 or more months prior to its implementation. The best that budgeters can hope for is to have sufficient reserves, provide adequate contingency funding, or have the freedom to alter other budget plans to accommodate these situations when they arise.

Ultimately, flexibility comes from having adequate revenues to conduct activities and programs. Unrestricted revenues such as tuition and fees, unrestricted gifts and endowment income, some state appropriations, and surpluses in auxiliary or other self-supporting activities provide the resources that cushion an institution against unforeseen events. The critical task is identifying the cushion and preserving it despite the demands of daily operations.

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