Budgeting and Planning Process

Summary

The budget is an important annual planning document for the university and reflects choices, priorities and tactics set forth as the result of intensive planning. Because needs and opportunities change over time, Carnegie Mellon’s budget process allows reasonable flexibility and incentives for academic unit managers to adapt and optimize their activities as events unfold, while still requiring university-wide financial planning and accountability.

The resource allocation process, including the creation of operating and capital budgets as well as space allocation, is directed by the president and provost. The budget plan is reviewed and approved by the Board of Trustees. The President’s Council advises on revenue and expenditure assumptions, budget parameters, university-wide priorities relative to resource allocations, and institutional policies relating to finances. The undergraduate tuition rate is established in consultation with faculty, parents and students, and approved annually by the Board of Trustees.

Carnegie Mellon takes a prudent approach to forecasting revenues given current uncertainties in the external environment. Base increases to the operating budget will be funded only through the reallocation of funds from the existing base budget or by base revenue increases. Savings realized during the course of the fiscal year will result in one-time budget allocations to support qualitative improvements in academic programs and facilities consistent with the established priorities of the university.

The aim of the budgeting strategy is to ensure a solid financial position for the university, to prevent the extension of base operations beyond current revenue capacities, and to maximize the university’s ability to respond to favorable variances throughout the course of the year. The Presidential Advisory Board process has permitted the administration, with significant assistance from the Board of Trustees, to identify priorities and allow the university to capitalize on existing strengths or ameliorate weaknesses in line with the strategic plan.

In fiscal 2004 a multi-year approach to the strategic allocation of all financial resources was put in place. The overall budget provides a more comprehensive breakdown for the budgeted amounts, since all revenues and costs are now in line with the reporting in the annual report. This new approach required many changes in the planning process, including gathering input from participants across the campus. During the last three fiscal years, the university has worked to refine and improve the process for forecasting and budgeting. It has also developed a multi-year plan, which includes all sources and uses of funds.

The budget process begins each year in early fall. Each unit develops or refines its budget for the upcoming fiscal year as well as for the following two future fiscal years. This is a continuous budgeting process that results in a fully integrated three-year budget in accordance with Generally Accepted Accounting Principles (GAAP). The main focus
is on the budget for the upcoming fiscal year, as this is the only budget that is approved by the Board of Trustees in May of each year.

The chief financial officer gives colleges and major administrative units preliminary allocations as a starting point for building their budgets. The deans and vice presidents have great latitude in reallocating funds within their areas of responsibility. In addition to unrestricted operating allocations, many units have other sources of revenue, such as gifts, grants, and sponsored research.

During the fiscal year (which begins on July 1), the vice president and chief financial officer and the provost lead two comprehensive financial reviews (fall and winter) of each unit’s financial performance. While the primary purpose of these reviews is control of the current year’s expenditures, the feedback and discussion at these reviews also assists in planning for the budget for the upcoming year.
Unit-level Budgeting

Budgeting at the unit level is a decentralized process with each unit responsible for building its own budget. Inputs to the process are the central administration’s allocation letter, which includes the assumptions and initial allocation amount, as well as various other data collected at the unit level. The individual unit budgets are aggregated later by the university’s Budget and Financial Planning Office in order to produce the overall university budget that is taken to the Board of Trustees for approval.

For the most part, the college business managers or associate deans are responsible for the unit’s budget. The level of involvement of other staff members varies across the colleges; however, the deans and department heads provide significant input to the budget process.

The budget and planning process itself varies to some extent among the colleges: the Tepper School and the Heinz School are “tubs on their own bottom,” funded by their own resources; at other colleges, such as CFA or H&SS, decision making is coordinated with central administration. SCS is driven to a great degree by external research funding, making its budget-setting approach different from the others.

Space and Facilities Allocation

The university gives the provost the authority to allocate or reallocate all space in the university’s physical inventory. Space allocation decision making is embedded in the university’s annual capital plan. This plan includes new construction projects, renovations to existing buildings, deferred maintenance and repairs, real estate leasing, and strategic property purchases. The capital plan is detailed in the Budget Book and includes projections for the next three to five years. The provost’s office and the finance division work with each of the seven colleges to determine the college’s capital budget and priorities for capital improvements and/or space expansion. This is done as part of the cycle of financial review meetings held with the provost, the finance division, and the deans of each of the colleges. Each college presents a list of anticipated capital projects, the rationale for each project, and the ways in which each project supports the college’s and the university’s strategic priorities. In between the financial review meeting periods, several of the central administrative offices (including Campus Design, the Budget and Financial Planning Office, and University Planning) are in frequent communication with each other about capital projects and capital planning, working with the provost, CFO, the deans, and relevant department heads to develop information, cost estimates, and decision-making alternatives for these projects. All capital projects of $2 million or more are presented to the Board of Trustees Property and Facilities Committee for final authorization.

In 2000, Carnegie Mellon developed a new Campus Master Plan, which was formally approved by the City of Pittsburgh in May 2002. The Master Plan, the university’s sixth since 1911, identified remaining building sites on the core campus and outlined a plan for building out the campus over the next 20 years.
Financial Review

Two formal financial reviews are conducted each fiscal year to assess progress toward building the university budget for the upcoming fiscal year plus two future fiscal years. Current fiscal year activity is also reviewed so that any major issues may be resolved and year-end forecasts may be updated to reflect anticipated year-end results. These reviews, conducted in October and January, are attended by the vice president for finance and CFO, the provost, the assistant vice president for budget and financial planning, the controller, the dean or vice president responsible for the unit, and the associate dean or business manager. Including these participants ensures that the appropriate decision-maker is in the room to immediately resolve any issues that arise during the review.

Both the central administration and the units put significant effort into preparing for financial review. These reviews are critical for the successful development of the comprehensive university budget.

The Budget and Financial Planning office reviews the latest quarterly reports for each unit and does a thorough analysis of all of the components of the budget. This analysis is assisted by supporting documents provided by the respective units. As necessary, the Budget and Financial Planning office staff work with the business managers of the units to resolve any issues. The operating budgets for each unit are reviewed in depth to ensure that the allocation amounts agree and that only approved commitments for funding have been included. The other elements of the budget are analyzed to determine if the unit appropriately applied the assumptions that were provided earlier in the process, and to explain any variances. As an overall check, the Budget and Financial Planning office looks at the current year forecast and trends to determine the reasonableness of the budget for the upcoming fiscal year and the forecasts for two additional years.

The Budget and Financial Planning office then prepares discussion points relative to each unit which function as the agenda for the financial review. In developing the discussion points, the results of all analyses are considered. Minutes are taken at the financial review and action items are assigned to the unit or the central staff for follow up before the next financial review. In the case of the Winter Financial Review, which occurs in January, all action items must be resolved immediately to allow for the final submission of the unit’s budget to be included in the comprehensive university budget. If needed, an informal financial review may take place to address any remaining issues before finalizing the budget.

Budget Book

Preparation of the Budget Book is the culmination of the efforts to produce the university’s operating budget. The Budget and Financial Planning office compiles the unit budgets and completes the budget process for the central administrative areas in order to produce the overall operating budget. The Budget Book contains the operating budget for the upcoming fiscal year, along with forecast information for two additional fiscal years. In addition to pro forma financial statements for the budget year, the Budget Book includes a full complement of supporting details and schedules for each of the
major areas of the budget (tuition and financial aid, sponsored projects, fundraising, endowment and investment, compensation, international operations, information technology, debt, and capital plan). Within the supporting detail is a full analysis of each major income and expense area, explaining significant or unusual variances. The Budget Book also contains a financial ratio analysis wherein key financial metrics are presented for historical years, the current year forecast, the upcoming budget year, and the two additional future fiscal years.

The budget is officially presented to the Board of Trustees for approval in May, however preliminary versions are reviewed with the Finance Committee earlier in the spring. The budget is approved through a formal resolution of the Board.

Assessment of Financial Strength and Performance

The finance division constantly monitors and assesses financial performance through a number of standard practices that occur monthly, quarterly or annually.

At the end of each fiscal quarter, the finance staff does a complete review of the budgeted and actual financial results. The numerous analyses that are prepared to support this review are compiled into the “Quarterly Book,” which is then distributed to members of the management group for reference. Similar to the composition of the Budget Book, the Quarterly Book contains the actual quarterly financial statements and the budget and forecast data at both the aggregate level and at the department/unit level. Following the statements are chapters containing detail and analysis related to tuition and fees, gifts, sponsored projects, accounts receivable, salaries and benefits, operating expenses, international and satellite operations, treasury activity, subsidiaries, capital projects, ratio analysis and the debt issue. As part of the quarterly analysis, significant variances from budget to forecast to actual are researched so that any necessary corrective action may be taken in the following quarter. If variances result from planned deviations from budget, these explanations are noted and forecasts are adjusted accordingly.

Preparing the Quarterly Book for the fourth quarter is a significant part of the year end procedures. As at the end of the previous three quarters, analysis of year end balances is performed in each of the major areas noted above, but the level of scrutiny at year-end is more intense. Significant variances are researched and explained and accounts are reconciled in preparation for the independent audit. In addition to the standard contents of the Quarterly Book, additional supporting schedules may be prepared at the request of the auditors. As adjusting entries are made, the impacts are reviewed to ensure that all impacted analyses and statements are updated accordingly. The year-end process culminates with sign-off of the independent auditors, issuance of the annual report, and other required filings. While that completes the statutory requirements for closing the year, the fiscal results of operations continue to be reviewed and analyzed to provide input into the next budget and planning cycle, which is already underway.

Ratio analysis is an assessment tool that has been used by the finance division for many years. However, in the last two years it has gained more visibility because of encouragement from the Board of Trustees. The Board requested that a set of metrics be
developed that will give them a snapshot of the university’s financial health and that can be updated frequently to ensure that they have access to the most current information. In November 2006, the first strategic metrics dashboard was presented at the Board meeting. This dashboard contains key financial metrics that administration uses to evaluate the university’s financial health. The main section contains the ratios used by bond rating agencies to evaluate risk along with other metrics related to finance. In addition, the dashboard contains metrics to assess the process of enrollment, education, financial research, and university advancement from a finance perspective. The dashboard data are updated quarterly, and various components are included in financial presentations to management and the Board throughout the year. As mentioned previously, ratio analysis (highlighting key financial metrics) is included in the Quarterly Book for additional visibility and to reinforce its usefulness as an assessment tool. This same ratio analysis is also shown in the Budget Book with projections for the budgeted year and the two additional fiscal years that are forecasted. Presenting this analysis in the Budget Book provides management with an assessment of how current budget decisions and assumptions will impact the university’s future financial ratios, which are a major factor influencing its ability to borrow for strategic initiatives.

In conjunction with the Provost, the finance division has recently introduced a cost accounting model called the tubs analysis to be used as another assessment tool and to provide a different type of financial input into the planning and decision-making process. Under current business practices, we allocate resources based on our goals. However, the financial information required for external reporting does not provide the information needed to optimize decision-making. The purpose of the tubs analysis is to examine the effectiveness and efficiency of the use of the university’s resources in supporting our desired initiatives. The tubs analysis attempts to address the need for more detailed cost analysis at an aggregate level in a university environment. Other goals of the tubs model are to support efforts to ensure that the university remains financially healthy; to support long-term strategic planning by bringing visibility to the net operating results of each academic unit; and to enhance the awareness of costs and opportunities for generating revenue.