Responsibility Center Management

BACKGROUND BRIEFING

Fall 2021

Responsibility Center Management (RCM)

Management & Financial Reporting at Penn

- Internal: RCM is the managerial framework for our internal budgeting and financial reporting on schools and centers
- External: University-level GAAP (Generally Accepted Accounting Principles) reporting is the basis for external financial statements used by rating agencies, resource providers, and others

History of RCM at Penn

- Implemented in the early 70s when the University was in financial distress
- Initially focused on controlling expense
- Evolved to encourage revenue growth as well

Principles of RCM

- Majority of direct revenue and expense is at the school/center level
- Alignment of authority and accountability at the school/center level
- Transparency regarding sources and uses of institutional funds
- Academic leaders have responsibility to advance the mission of the University within the RCM framework

RCM at Penn

Promotes the broadest possible stewardship of financial resources

- Tuition revenue is distributed largely based on course units taught
- Space charges are directly tied to occupancy and building costs
- Administrative units are funded via transparent algorithms
- Schools recognize the full costs of their programs

Encourages and rewards innovation and efficiency

- Schools and resource centers retain the majority of revenue they generate and reinvest in their highest priorities

Key Peers: RCM & Other

Decentralized

- PENN
- DUKE
- CORNELL
- HARVARD
- COLUMBIA
- CHICAGO
- JOHNS HOPKINS
- STANFORD
- MIT

Centralized

- PRINCETON
- YALE
- BROWN
- DARTMOUTH

Responsibility Centers at Penn

Revenue Generating

Schools, Resource Centers, & Business Services

Expectations

- Fund the direct cost of their own operations
- Cover their share of services provided by the administrative service centers (via allocated costs and space charges)
- Maintain internal budget balance and build appropriate levels of reserve

Non-Revenue Generating

Administrative Service Centers

Expectations

- Fund most of operations through allocated cost and space charges
- Maintain internal budget balance and build appropriate levels of reserve

Schools/Centers Incentives within RCM

- Keep the majority of their revenue and all net income
- Expected to build reserves to handle fluctuations in revenues
- Cut programs that are not critical to mission
- Make decisions relative to their individual markets
- Hold central units accountable

RCM: Pros and Cons

To Be Successful in RCM

Requires ongoing engagement at the school/center level and at the departmental level

Leadership (Deans, VPs, Directors) need to be fiscally aware, empowered to manage, and entrepreneurial

Governance and oversight are essential

What Can Happen if not Well Managed?

Financial considerations supersede academic ones

Interdisciplinary teaching and research hindered

Competition, rather than collaboration, among academic units

Investment in unit-level plans and goals at the expense of the institution's goals

Communication and Transparency Required

Maintaining open communication ensures schools and centers do not take action that impacts another responsibility center without full discussion

Stability and Long-Term Horizon

Essential to planning in an RCM environment

Stability in the parameters

Cap and floor on most allocated cost distribution methodologies smooths growth in charges

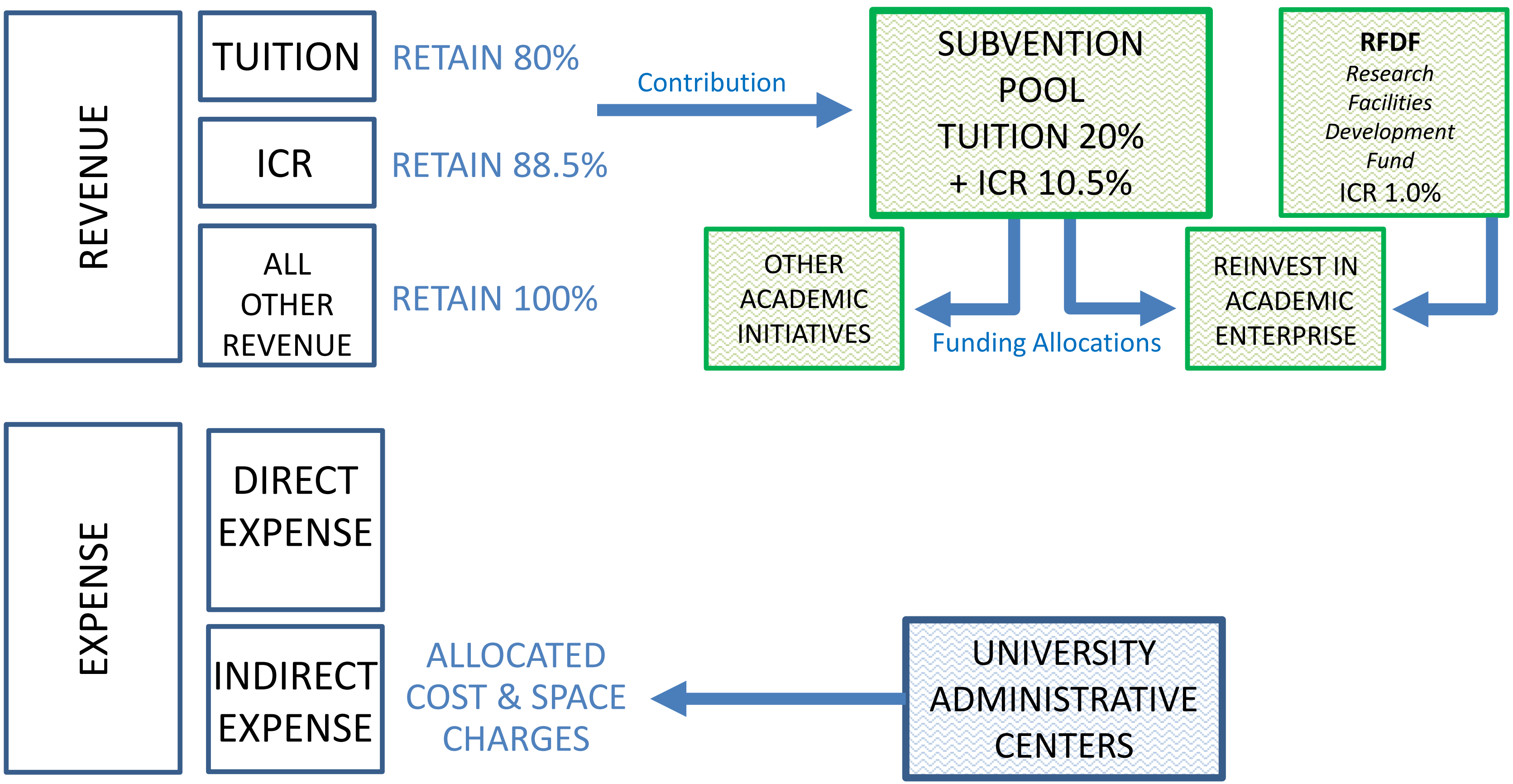
Periodic review of distribution methodologies, with changes implemented only if they are needed to realign behaviors

Tight ranges on multi-year growth parameters

Multi-year planning horizon

Long-term implications of initiatives considered

RCM Funding Dynamics
SCHOOLS + RESOURCE CENTERS



Note: PhD tuition is not subject to Subvention Pool share.

Who Determines Tuition & Fees, Student Aid, and Admissions?

University Determines

- UG Tuition Rate, Total Charges, and Cost of Attendance
- UG Aid Policy
- UG Admissions
- General Fee Rates for All Students
- PhD Tuition Rate

Schools Determine

- Professional Tuition Rates, Aid, and Admissions
- Non-Traditional UG Tuition Rates, Aid, and Admissions

Tuition Distribution

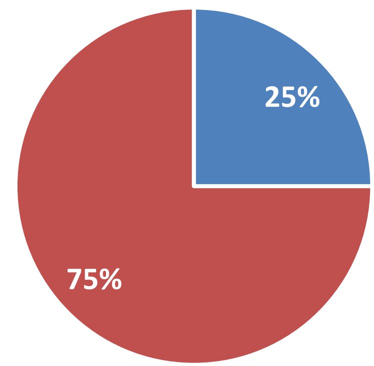
Primarily based on teaching

Undergraduate Tuition

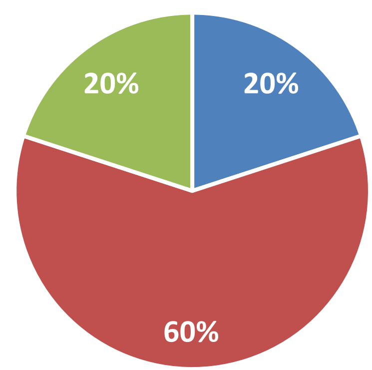
- **Tuition Block**
  - Applies to the four UG schools + two schools that administer UG majors (Annenberg & Weitzman)
  - Established base tuition level for FY19
  - Grows each year by parameter
  - Provides stability for planning
  - Recalibrated every 4 years (will be new base tuition level for FY23)
- **Non-Block**
  - Law, GSE, SSPP, DENT, VET, PSOM
  - Based on teaching only

Graduate and Professional Tuition

- **PhD**



- **Professional**



■ Home School ■ Teaching School ■ Subvention Pool

Student Aid

Market-specific approaches

Undergraduate Aid

- **Traditional UG**
  - Grant-based aid to meet 100% of demonstrated need
  - Financial aid discount rate
    - 38% of UG tuition net of Subvention Pool share
    - Assessment goes to UG aid pool which is administered centrally by SFS
    - Tuition is distributed to schools net of financial aid
- **Non-Traditional UG**
  - Primarily merit based
  - Centrally-incurred aid is distributed to teaching and home school

Graduate and Professional Aid

- **PhD**
  - Primarily fully funded
  - Stipends are market competitive
- **Professional**
  - Home school determines and funds aid
  - Primarily merit-based
  - Gross tuition (after subvention) flows to teaching and home school

Indirect Cost Recovery (ICR)-- Research

For each $1 of eligible* direct expenditures under federal grants, Penn currently receives an additional 62.5¢ to cover its research overhead, including space, administrative, and compliance costs

Many non-federal grants do not provide full ICR

Research ICR income is allocated at Penn as follows:

88.5% Dean's office of school receiving the grant

10.5% Subvention Pool

1.0% Research Facilities Development Fund (RFDF)

* Excludes equipment, student aid, and subcontracts in excess of $25,000

Other Revenue

- All revenue other than tuition and indirect cost recovery remains entirely in the school or center that generated the revenue
- ***Sales and Service Revenue*** and ***Other Income*** (e.g., clinical revenue) cover the cost of the goods or services provided; any net income can be used to support other school/center operating expenses
- ***Spendable Income*** from restricted endowment and ***Operating Gifts*** are typically subject to an indirect cost recovery policy
  - Up to 20% of an operating gift or spendable income from an endowment can be used *by a school or center* to support indirect expenses
  - While we strongly encourage full deployment of this policy, a school dean or resource center director has the discretion to exempt an endowment or gift from overhead

Subvention Pool

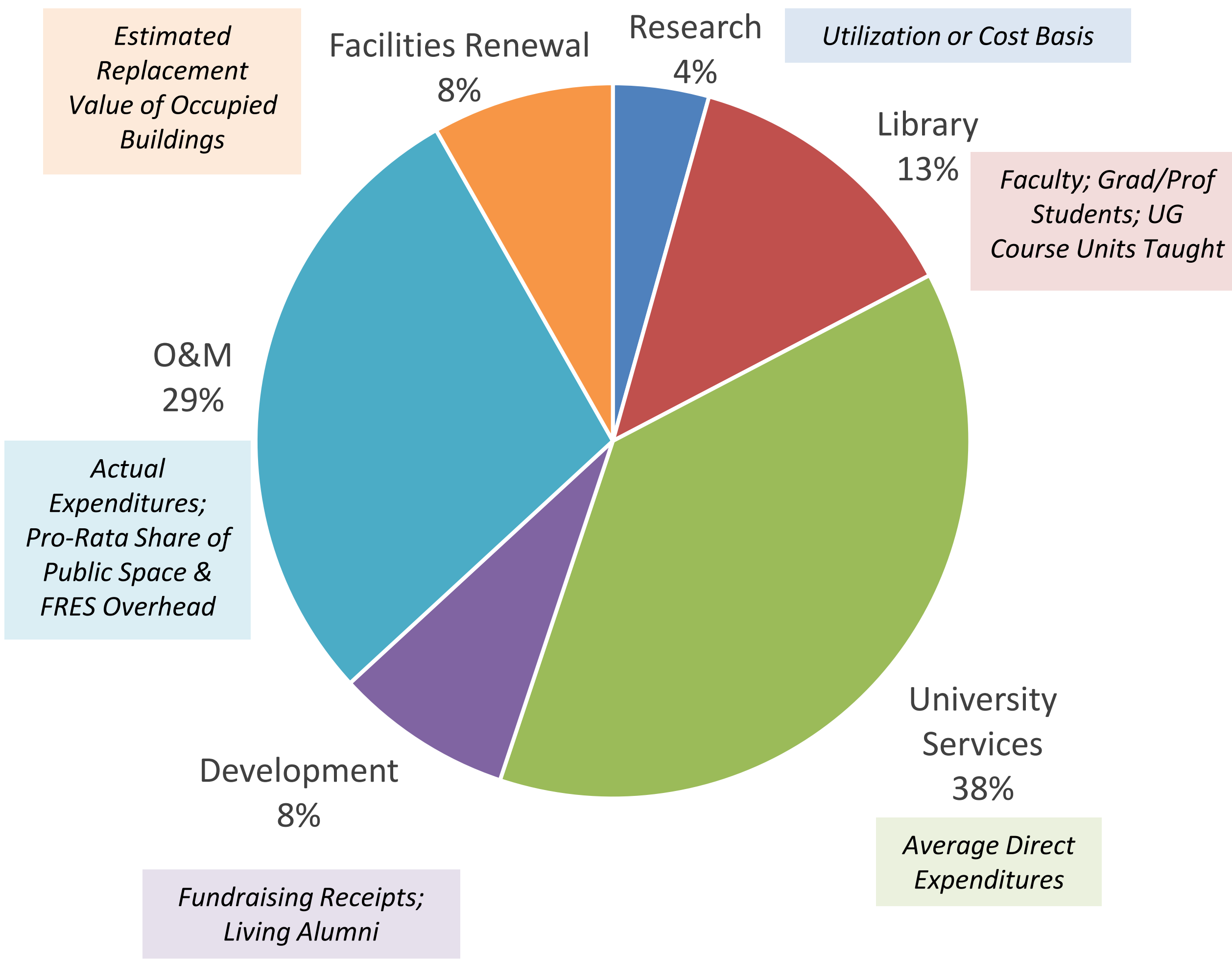
- Funded primarily through 20% of tuition and 10.5% of grant overhead
  - Subvention revenues represent only 6% of University total
  - Doctoral tuition is not assessed
- Allocated back to schools, resource centers, and cross-school academic initiatives as directed by President's Office and Provost's Office
  - 88% of pool is committed as subvention to schools and resource centers and graduate student support to schools, with the remainder supporting other key University-wide academic initiatives
- Gives Provost and President the ability to influence development and implementation of academic priorities at Penn

Funding of Administrative Centers

(includes President's Office, Provost Office, EVP Office, Finance, ISC, HR…)

- In order to maximize efficiency and reduce administrative costs, Penn provides a number of services centrally
- Those services are paid for through direct internal charges or via allocated cost and space charges
  - Internal Charges: Direct charge for services for which the cost and quantity are measurable and the purchasing unit can decide how much they want to consume (e.g., building security guards).
  - Allocated Costs: Funds the cost of administrative services for which the cost and quantity of services provided is difficult to measure. Most of these costs are distributed based on the proportionate share of University expense, but there are separate formulas for the Library and Development.
  - Space Charges: Includes both O&M and Facilities Renewal charges, which fund the Division of Facilities & Real Estate Services. These charges are allocated based on occupancy and historical building costs.

Allocated Costs & Space Charges



allocation basis in shaded boxes

RCM at Penn

Continues to evolve

Shifted central research compliance funding from ICR to allocated costs

- Too much variability in ICR revenue relative to increasing compliance costs
- Create stability in planning

Shifted a portion of IT funding from direct bill to allocated costs

- Replaced granular, time-consuming billing process with allocated charges for essential services (including network and email/calendaring)
- Little benefit to having choice for these essential areas

Changed UG tuition allocation methodology

- Gradually increased home school portion relative to teaching school portion over two decades
- Block approach for UG to eliminate barriers (real or perceived) and create stability in primary revenue source

Review allocated cost methodology periodically

- Ensure cost allocation is fair and in alignment with consumption
- Make changes where needed
- Involve schools/centers in these reviews