

Financial Policies and Governance UM

The University of Missouri System was built upon the assumption that state and taxpayer resources would be the primary source of funding for Missouri's public research universities. The President's role, with oversight from the Board, was to help distribute these taxpayer funded resources in the most efficient manner possible, taking into account the needs of individual campuses and the needs of the State. The funding model for public higher education has shifted to one where students pay the majority of the cost of their education instead of the taxpayer.

Along with the consolidation of the role of the UM System President and the Chancellor of the University of Missouri, the Curators also established the Council of Chancellors (CoC). Each chancellor will be provided more autonomy over their campus and expanded participation in decision-making on UM System matters. Greater autonomy and responsibility will also result in greater accountability of the chancellors to meet their mission and to achieve expected financial performance. Over the next 2 months (by the November, 2020 Board of Curators meeting), the chancellors will develop a plan for governance as stipulated in the Board of Curators resolution of July 28, 2020. In the next sections, draft concepts are provided in response to the queries from members of the Board. The draft concepts are purposefully open-ended to encourage Board discussion and allow for further direction and definition.

The shift in the role of the President and the UM system will also result in changes in the model and expectation of financial performance for each university. Under the prior model UM System Administration, as a separate financial entity, could provide a backstop to the individual universities if one ran into significant hardship. UM carried large reserve balances to potentially backstop a struggling campus outside of MU, although in recent years the Health System became large enough in relation to reserves where this backstop would not be effective. The financial management focus remained upon a President being accountable for overall financial performance and holding individual campuses and chancellors accountable for their contributions to that performance.

At the September Board Meeting, Vice President Rapp will lead a discussion with the Finance Committee on the desired policy updates necessary to reflect this reality. Areas of discussion with questions and draft responses are provided below:

Tuition

- *Should campuses have freedom on rate setting (within the bounds of statute)?*
- *How should the market play into tuition rates?*

With greater autonomy and responsibility comes greater accountability. Each chancellor will have the ability to set tuition rates at levels deemed market competitive for their students, within the bounds of the Missouri Higher Education Student Funding Act (HESFA). This would include allowing each University the ability to seek a tuition

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increase waiver from Missouri Department of Higher Education. Tuition and fee approval remain an approval right of the Board and will follow the standard calendar with approval in the spring of each year. Each chancellor will have freedom to design their relevant tuition strategy under applicable state statute with final approval by the Board of Curators.

Resource Allocation from the System

- *How will UM set state advocacy priorities in the new model?*
- *How will strategic resource generation from investments (“central bank dividend”) fund mission enhancement?*
- *Will core state appropriations continue to be maintained for each University in a pro-rata manner?*

Instead of flowing through the Missouri Compacts Program, each chancellor will receive pro-rata share of investment earnings from the University’s general pool investments. To utilize the dividend, each chancellor must first meet their financial performance targets. Each chancellor must submit a plan to the Board for approval for the strategic use of the dividend, and this will be the source of future strategic funding for each campus.

The historical role of the President was to allocate (with Board approval) state appropriations to best serve the mission and to achieve excellence at the 4 universities of the UM System. This role is well served when core appropriations grow faster than inflation, as they largely did in the period from 1965-2000. However, since 2000, the paradigm has shifted in public higher education and the state continues to fund a smaller share of each university’s budget. The role of System as an allocator must shift to reflect this reality. Excluding line-items approved by the legislature and increases based on performance against criteria defined by the legislature, the System has not received a core increase since 2009. Over this time, cuts have been distributed as their pro-rata share across the campuses. The President distributed performance funding differentially through a strategic funding process in 2014 and 2015. On a forward basis, the System will maintain the pro-rata share of appropriations with any change to the relative share requiring Board approval. The annual request for appropriations will be reviewed by the Council of Chancellors prior to presentation to the Board for vote as a part of the appropriations request process. The institutions will still agree to a strategy on priorities and advocate as a single group for the appropriation priorities approved by the board.

Financial Accountability and Performance

- *How will financial accountability become a larger responsibility for chancellors?*
- *What levers should be utilized to help future boards manage financial performance?*
- *How will the credit worthiness of each campus and capital projects be evaluated?*

The UM System will still provide many of the services necessary in managing a balance sheet (banking, debt issuance, investment management, etc.), but each chancellor will be responsible for achieving the mission and delivering the financial performance to ensure

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continued operation. It is expected each University will meet a set of established financial performance metrics. The financial performance metrics would be approved by the Board. The financial performance metrics will also define red-line thresholds that cannot be crossed. The Chancellor will be responsible for financial performance of their University. Should one university's under-performance require transfer of assets or other support from the universities that have met their performance expectations such collateralization/capitalization will occur only with the approval of the Board of Curators and within the context of the financial performance metrics and thresholds established in policy.

Examination of the performance across all universities and the related impact on borrowing costs and investment earnings will be required to implement this policy well and a period of transition will be necessary. New models of allocation of dividends, debt capacity, and capital among universities must increase transparency. The UM System Finance team will also explore implementing revised financing policies, potentially adjusting both the rates of interest and returns on invested capital. This will be important in capital investment decisions requested by the chancellors and approved by the Board of Curators. The rate and allocation differentials will serve to ensure that one university does not overconsume resources and assets of the other universities. Interest rates and other funding mechanisms will seek to reflect market differentials, and any savings from the collective financial strength of the enterprise will be shared amongst those entities considered additive to the enterprise's creditworthiness. The financial health of the system will only be maintained so long as the sum of the institutions remains greater than the sum of the parts and the financial policies of the System will be revised to reflect the same.

The Board retains approval rights of key financial decisions, including:

- Capital projects
- Debt issuance
- Operating Budgets

These processes should be enhanced with the establishment of financial performance thresholds that must be met prior to Board approval. The Board should consider codifying the formal establishment of financial performance targets for each university in a board approved policy. The financial performance expectations should serve as a gate to prevent projects or the issuance of debt from proceeding without performance against policy expectations.

Based on the discussion and feedback from the Finance Committee and full board at the September meeting, the University's leadership team will take the Board's feedback and draft updates to current governing policies to reflect the desired changes.

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