

BEST PRACTICES IN COMMUNITY COLLEGE BUDGETING

PREPARE & DEVELOP INPUTS TO THE BUDGET PROCESS *1A – Adopt/Re-Affirm Budgeting Principles & Policies to Guide the Budget Process*

SUMMARY

Key Points:

- Budget principles are general guidelines that a college intends to honor through its budget process. Principles are not technical and can be understood and appreciated by all members of the organization and the public. By adopting budget principles, a college's decision makers can create overarching values to help frame and guide budget deliberations. A college should collaboratively develop budgeting principles and policies with those who have executive authority to propose a budget and those who have legislative authority to approve it, as well as the strategic planning and the finance departments.
- Budget principles create overarching values for prioritization and resource allocation. Key principles to consider include defining goals for student achievement, using data to drive decision making, allocating dollars optimally to create the most benefit given the cost, reviewing past spending decisions, developing and adhering to a multi-year funding plan, and accounting for and reporting the true cost of serving students and the resulting outcome.
- Budget policies help a college to identify its financial action and provide a standard against which its fiscal performance can be judged. These policies could address establishing a general fund reserve, long-term forecasting, capital asset maintenance and replacement, monitoring of revenues and expenditures, diversification of revenue, pension and other post-employment benefits, and grant funding.

Related Award Program Criteria:

- Criterion 1.A.1: Budget Principles. The Applicant should formally adopt a set of principles and submit them as Supplementary Materials. The principles should address, at a minimum, the concepts outlined in Best Practice in Community College Budgeting, 1A – Adopt/Re-Affirm Budgeting Principles & Policies to Guide the Budget Process.
- Criterion 1.A.2: Budget Policies (Mandatory). The Applicant should formally adopt a set of budget policies and submit them as Supplementary Materials. At a minimum, the policies should address the policy topics recommended by Best Practice in Community College Budgeting, 1A – Adopt/Re-Affirm Budgeting Principles & Policies to Guide the Budget Process.

INTRODUCTION

Developing a budget that optimally aligns resources with goal achievement may, for many community colleges ("colleges"), entail making changes in how resources are spent. Many long-standing assumptions about how best to develop a budget may need adjustment. A set of budgeting principles and policies, agreed to by those with executive authority to propose a budget and those with legislative authority to approve it before the budgeting process begins, can provide a touchstone for what matters most in the budgeting process – creating the best outcomes for students and the community with the money available, while also maintaining financial sustainability.

Budgeting principles and policies should be developed collaboratively between those with executive authority to propose a budget and those with legislative authority to approve it, with the support of strategic planning and the finance department. A college should develop a process that allows governing board members and strategic planning and financial staff to collaboratively participate so that they understand and support the principles and policies.

This Best Practice addresses:

- I. Principles to consider.
- II. Policies to consider.

I. PRINCIPLES TO CONSIDER

Background. Budgeting principles set forth the ideals that the college’s decision makers will adhere to as they develop the budget. Principles are important for creating a shared understanding of the overarching values that underpin budget development.

Recommendation. The GFOA recommends that colleges consider adopting, in some form, the principles below to help frame and guide budget deliberations. Colleges also may consider other principles that support the goal of optimizing student achievement.

- **Use goals to drive the budget process.** A community college’s explicit goals drive how resources are allocated or re-allocated and should be used to guide how potential new investments are evaluated in light of their alignment with the college’s strategic direction.
- **Use data to make decisions.** Collecting and tracking performance measures and other data can help a college recognize where changes in its environment or services are occurring that require reallocation of funds or an infusion of new resources. For example, colleges might adopt a policy stating that budget requests should be supported by hard data (e.g., longitudinal studies, labor market data) that illustrate a real need and/or the proven effectiveness of the proposed change. Such requests will be looked upon more favorably than those without supporting documentation.
- **Consider both the inputs and outcomes of proposed budget decisions.** The budget process should seek to allocate available dollars optimally, in a way that will achieve the best value. This means that colleges should consider both the cost of programs along with the benefits they provide.
- **Regularly re-examine patterns of spending and change them when they no longer make sense.** Community college budget processes are often “incremental,” where last year’s spending becomes the basis for the next year’s budget, with incremental changes made around the margin. However, past patterns of spending may no longer be the best use of scarce resources given changing needs of students and the community. Consequently, the budget process should undertake a critical review of past spending decisions and be willing to discontinue programs that are not achieving their objectives. To support these deliberations, a college should regularly review its programs and evaluate their impact relative to its strategic goals.
- **Take a long-term perspective.** Many community colleges will not be able to make large changes to their educational strategy and resource allocation patterns within a single year. Further, a consistent application of proven strategies over a multi-year period will deliver better results. Therefore, to the degree possible, a college should provide a multi-year funding plan for its strategies to improve student achievement, with the goal of full funding and realigning resources where necessary to fund high priority elements of the plan.
- **Be transparent.** Effective budgeting requires valid information about the true costs of serving students and the outcomes produced for students. Examples of more specific principles or policies to consider include:
 - *Make performance data readily available.* The budget process should be informed by valid and reliable data on fiscal and academic performance.
 - *Consider all costs in evaluating the cost of educating students.* A full cost accounting approach is necessary to evaluate the classroom and non-classroom costs of educating students. In setting, reallocating, or reducing budgets, the full cost of educating students should be considered.

- *Use a consolidated “all funds” budget.* The budgeting process should consider all available funds in order to make the greatest impact with available dollars, while also acknowledging constraints on spending.
- *Budget for programs.* The budget should identify discrete programs (as defined by NACUBO) and as individually defined certificate or degree programs. Programs are a set of activities designed to produce a defined result for a defined set of constituents.
- *Communicate the principles.* Make the budgeting principles available to stakeholders. One method is to post them on the college’s website.

II. POLICIES TO CONSIDER

Background. Budget policies clarify and crystalize the intent behind how the college will manage its financial resources. Policies identify acceptable and unacceptable courses of financial action, establish parameters in which the college can operate, and provide a standard against which the college’s fiscal performance can be judged.

Recommendation. The GFOA recommends that colleges develop and adopt policies in the following areas. Additional detailed guidance on each of these policy topics is available in Appendix 1.

General Fund Reserve

Colleges should adopt a policy to establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund as a reserve to hedge against risk. The policy should address, at a minimum: the target level of fund balance to maintain; the conditions under which fund balances may be spent; who can authorize the use of fund balance; and guidance on how fund balance will be replenished to target levels after it has been used.

Long-term Forecasting

A policy should direct staff to develop long-term revenue and expenditure forecasts (typically covering three to five years) as part of the budget process and to consider these forecasts during budget development in order to address the future financial position of the college. The policy should also direct the development of long-term enrollment forecasts in order to support financial decision making, including, where practical, trend analysis for students in categories that cost more to educate, such as health care and technical career programs.

Funding New Programs

As colleges look for new ways to improve student learning, they will need to fund new programs and initiatives. Given that new programs are often at a natural disadvantage when competing with existing programs for funding, colleges should develop policies that describe how the college will fund and manage new programs. These policies should encourage practices that support budgeting decisions that best align resource allocation with improving student achievement, such as establishing a preference for “pilot” or “experimental” periods for new programs and up-front estimation of cost and benefits, followed by rigorous evaluation of actual results after a defined period.

Asset Maintenance & Replacement

Colleges should adopt policies that govern maintenance and replacement for its facilities as well as its shorter-lived assets such as technology. As a basic rule, the policy should direct that all assets will be maintained at a level that protects capital investment and minimizes future maintenance and replacement costs. The policy should commit the college to maintaining an inventory of its maintenance/replacement needs and define the funding mechanisms for staying current with those needs.

Estimating the Operating and Maintenance Costs of Capital Assets

Capital assets, especially facilities, are a large part of a college’s total spending and the impact on the operating budget is significant because facilities must be operated and maintained. A policy should, foremost, direct that the estimated operating and maintenance costs of a potential new asset be taken into account when assessing the feasibility of acquiring the asset, including the affordability of those costs within the operating budget.

Monthly Monitoring of Key Revenues and Expenditures

Community colleges should develop a policy that establishes monthly monitoring of key revenues and expenditures. The policy should describe which specific revenues and expenditures are to be monitored, identify who is responsible for monitoring, and specify the frequency of reports.

Revenue Diversification and Stabilization

A community college should adopt a policy to encourage diversification and stabilization of the revenue base in order to prevent fluctuations in revenue yield. It is possible to elaborate on this basic goal in several ways. A policy could direct the college to develop sources of revenue that are under its own control in order to make the college less vulnerable to changes in state funding. A policy could also encourage the college to actively seek out new sources of revenue to diversify its revenue base, including offering guidance how fees and charges should be used, the level of cost recovery expected for fees (including for college enterprises), and parameters for pursuing grants, partnerships, gifts, and endowments. Finally, because tuition and fees are where colleges generally have the most local control over their revenues (at least for colleges that have the legal ability to set their own tuition and fees), a policy should direct that tuition and fees be regularly reviewed and updated in order to ensure that they are appropriate.

Funding Pensions and Other Post-Employment Benefits (OPEB)

A pension and OPEB policy establishes the strategic intent to remain current on funding pension and OPEB liabilities. Colleges should adopt a policy that calls for the college to contribute the full amount of their actuarially determined annual required contribution (ARC) each year and to target a 100 percent or more funded ratio (full funding). A policy should also address other post-employment benefits (OPEB), such as health-care coverage provided to retirees. The GFOA recommends that colleges finance these benefits as they are earned (i.e., prefund), rather than pay for benefits only as they become due. Unlike pensions, however, the GFOA recognizes that in some cases, less than full actuarial funding is appropriate, perhaps because benefit levels will be adjusted over time to compensate for the effects of health-care inflation.

Grant

Grant funding provides support of college programs, activities, and student scholarships. Some grants have special requirements in terms of how funds are spent, monitored, and reported or may require ongoing funding to maintain a program or asset beyond a grant's life. A college should adopt a policy that establishes how it will identify grants and the party responsible for ensuring that grants identified are aligned with the college's mission, vision, and strategic goals. A policy should also establish a review process for grant proposals to ensure that necessary infrastructure required to support the grant's requirements is sufficient. Before submission of the grant proposal, the college's chief financial officer or designee should determine the financial impact the grant may have on the college's budget. The policy should also establish an evaluation component so that the college can identify a grant's outcome measures, total direct and indirect costs, and operational and administrative needs, providing a formal evaluation to the college's administration at the conclusion of the grant period.

APPENDIX 1

This Appendix provides detailed guidance on the financial policies described in the main body of this Best Practice.

GENERAL FUND RESERVE

Community colleges should adopt a policy to establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund as reserve to hedge against risk. Such a policy should be set by the appropriate policy-making body. The policy should address, at a minimum:

The target level of fund balance to maintain. The adequacy of unrestricted fund balance in the general fund should be assessed based upon a college's own specific circumstances. Nevertheless, the GFOA recommends for general purpose governments that, at a minimum, the unrestricted fund balance in their general fund is no less than two months of regular general fund operating revenues or regular general fund operating expenditures and operating transfers out. The choice of revenues or expenditures as a basis for the reserve amount may be dictated by what is more predictable in a college's particular circumstances. In determining the right level of unrestricted fund balance for its precise circumstances, a college should analyze the risks that it faces and establish reserve levels commensurate with those risks, using the two month benchmark described above as a baseline minimum. Risk factors that colleges should consider are described below:

Critical:

- **Revenue source stability.** Volatile revenue sources call for a higher level of reserves to avoid the need for sudden service cutbacks.
- **Expenditure volatility.** This risk factor refers to potential spikes in expenditure, especially those arising from a special, non-recurring circumstance – for example, a settlement from a lawsuit could cause an unexpected expenditure spike.
- **Liquidity.** A larger amount of unreserved fund balance may be needed to avoid cash flow problems if the average maturity of receivables significantly exceeds the average maturity of payables. For example, colleges that are heavily reliant on property taxes may receive the bulk of taxes one or two times during the year, requiring reserves capable of bridging the months with lower receipts.
- **Fluctuation in student population.** Rapid change in the total student population might call for higher levels of reserves, in case the college does not have a flexible enough revenue or expenditure structure to quickly adapt to these changes.

Also Consider:

- **Vulnerability to extreme events.** This factor concerns the extreme events (e.g., natural disasters) and the unexpected expenditures that might be required to respond to them (e.g., repair to facilities).
- **Leverage.** A highly leveraged organization has less flexibility. Examples of leverage include unfunded asset maintenance or replacement needs, long-term debt, and pension obligations. Reserves are a critical source of financial flexibility, so high leverage may call for higher reserves.
- **Other funds' dependency.** If the general fund is used as a "backstop" for other funds, higher levels of reserves may be necessary.
- **Capital projects.** Do critical capital projects have a funding source? If not, might some stakeholders view general fund reserves as a possible source? Reserves are not always an ideal source for funding capital projects, but it is important to understand the relationship between capital projects and fund balances.

Conditions for use of fund balance. The policy should describe the conditions under which fund balances can be used. It is highly recommended that a policy should prohibit the use of fund balances for recurring operating expenditures, except as temporary resources in the event of a revenue downturn while expenditure reductions are implemented.

Authority over reserves. The policy should describe who can authorize use of reserves. A policy might reserve this authority for the chief executive officer, policy-making board, or other position appropriate given local conditions and statutes.

Replenishing reserves. Colleges should also consider providing broad guidance in their financial policies for how resources will be directed to replenishing reserves. A college should also consider a policy statement that establishes the broad strategic intent of replenishing fund balances as soon as economic conditions allow. This emphasizes fund balance replenishment as a financial management priority. Please consult the GFOA Best Practice, Replenishing General Fund Balance (2011), for additional guidance on this topic.

LONG-TERM FORECASTING

A policy should direct staff to develop long-term revenue and expenditure forecasts (typically covering three to five years) as part of the budget process and to consider these forecasts during budget development in order to address the future financial position of the college. The policy should also direct the development of long-term enrollment forecasts in order to support financial decision making, including, where practical, trend analysis for students in categories that have an important impact on the revenue or expenditure structure of the college.

The policy should direct that the assumptions behind the forecast be made transparent, including:

- Assumed rates of change in explanatory variables that the forecast is based on (e.g., inflation rates, local unemployment rates, etc.).
- Changes in personnel costs, as may be based on collective bargaining agreements or other relevant guidance.
- Operating and maintenance costs of new facilities that are scheduled to be opened during the forecasting period.
- Assumptions made about changes in service levels from the status quo (e.g., adding or eliminating programs or facilities).

FUNDING NEW PROGRAMS

As community colleges look for new ways to improve serving students, the college will need to fund new programs and initiatives. Given that new programs are often at a natural disadvantage when competing with existing programs for funding, colleges should develop policies that describe how the college will fund and manage new programs. These policies should encourage practices that support budgeting decisions that best align resource allocation with improving student achievement. Elements of such a policy could include:

- Testing new programs on a “pilot” or “experimental” basis, wherever practical. The length of the pilot or experimental period can and should vary according to the nature of the program, but there should be a clearly defined beginning and ending point.
- A thorough analysis of expected costs and benefits wherever possible and conducting a “pre-mortem” to examine the strength of the assumptions on which the expected costs and benefits are based.¹ The analysis should result in a clearly defined set of criteria that will be used to define success for the new program. Ideally, the new program’s set up will easily facilitate collection of cost and performance data, thereby allowing the college to determine if a cost-beneficial impact has been made on student achievement.

- A “post-mortem” at the end of the pilot period, including an evaluation of whether or not the expected impact on student achievement has occurred.
- Establishment of an innovation fund, which is a dedicated pool of resources that can be used to fund new programs and initiatives on a limited basis. Annually, the college should determine the innovation fund’s size, what types of projects would be eligible to use it, how long a program can draw from it, and how the fund will be replenished.

ASSET MAINTENANCE & REPLACEMENT

Colleges should adopt policies that govern maintenance and replacement for its facilities as well as its shorter-lived assets such as technology. As a basic rule, the policy should direct that all assets will be maintained at a level that protects capital investment and minimizes future maintenance and replacement costs.

A college should adopt a policy that: directs staff to conduct a complete physical inventory and periodic measurement of the physical condition of its buildings; establishes condition standards appropriate for buildings and other asset classes; calls for appropriate staff to evaluate building conditions and recommend funding priorities; and establishes the requirement to fund asset maintenance and, perhaps, identify specific funding mechanisms to direct resources to maintenance.

As part of such policies, the college should consider policy elements such as prioritizing maintenance of existing facilities over construction of new facilities. The policy should direct that the college use full life-cycle costing to decide whether or not to build a new facility or replace an old facility. With respect to shorter-lived assets, an effective policy should direct staff to prepare and maintain a long-term replacement schedule in order to identify future expenditure requirements. This prerequisite can inform decision makers to help smooth out the required expenditures from year to year, or at least provide notice of sizable upcoming requirements.

With a replacement schedule in place, a policy could prescribe how the future expenditures will be funded. Ideally, a policy will establish an internal service fund, reserves fund or other accounting mechanism that accumulates money for the expenditures identified by the replacement schedule. A policy may address how the requirements will be funded – for instance, through chargebacks to the college’s subunits or through annual appropriations from discretionary revenues. Chargebacks are generally a more consistent funding source, but are more difficult to administer.

ESTIMATING THE OPERATING AND MAINTENANCE COSTS OF CAPITAL ASSETS

Capital assets, especially facilities, are a large part of a college’s total spending and the impact on the operating budget is significant because facilities must be operated and maintained. A policy should, foremost, direct that the estimated operating and maintenance costs of a potential new asset be taken into account when assessing the feasibility of acquiring the asset, including the affordability of those costs within the operating budget.

The policy should also provide guidance on how operating and maintenance costs should be estimated, particularly by defining what is included in the definition of “operating and maintenance costs.” The policy should direct that the college consider the costs needed to operate the asset on a day-to-day basis (e.g., staffing and utilities), as well as the costs to maintain the asset at an acceptable condition over its lifecycle (e.g., replacement of components with shorter lifecycles).

MONTHLY MONITORING OF KEY REVENUES AND EXPENDITURES

Community colleges should develop a policy that establishes monthly monitoring of key revenues and expenditures. The policy should describe which specific revenues and expenditures are to be monitored. The policy should also describe who is responsible for monitoring and how often reports will be issued. It is recommended that the responsible party provide these reports to the governing board each month or at each board meeting, if the board meets less often than monthly. The policy should provide guidance on important information to be included in these reports, such as:

- Significant events that will impact a fund's total budget by some percentage (e.g., greater than x% and \$y), that are not part of normal operating patterns, and that will likely have a material impact on the college's ending balances. The report should place special emphasis on such events to ensure the audience grasps their significance.
- Reports should include explanations of important anomalies.
- Reports should explain important assumptions or accounting treatments underlying the data presented.

REVENUE DIVERSIFICATION AND STABILIZATION

A community college should adopt a policy to encourage diversification and stabilization of the revenue base in order to prevent fluctuations in revenue yield. It is possible, however, to elaborate on this basic goal in several ways.

Increase local control. State government provides a significant part of the funding for many community colleges. A revenue stabilization policy could direct the college to develop other sources of revenue that are under its own control in order to make the college less vulnerable to changes in state funding.

Encourage new revenue sources. A policy could also encourage the college to actively seek out new sources of revenue to diversify its revenue base.

Fees and charges for use of services. These are the most readily available source of new revenues for many colleges, so a policy should identify conditions under which new fees are appropriate, such as:

- The benefit of the service accrues primarily to the individual consuming the service, as opposed to benefiting the general public.
- The fee serves to govern demand for a service that would otherwise be over-utilized.
- The fee can be administered with minimal additional administrative overhead.

Grants, partnerships, gifts, and endowments. These are another important potential source of new revenue for colleges. A policy can encourage colleges to actively pursue these sources of funding, but should also recognize that where these revenues only last for a limited period of time (e.g., a two-year grant), they should not be relied upon to support the college's ongoing expenditures.

Review of tuition and fees. Because tuition and fees are where colleges generally have the most local control over their revenues (at least for colleges that have the legal ability to set their own tuition and fees), a policy should direct that tuition and fees be regularly reviewed and updated in order to ensure that they are appropriate. The policy should state how often a review would occur. In addition, the policy should specify who will perform the review and to whom the review will be presented for subsequent action.

A review of fees should be informed by the cost-recovery goals of the fees. A policy should provide guidance that illuminates how fees are expected to recover costs, including whether or not differential tuition rates for higher cost programs will be charged.

FUNDING PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS (OPEB)

A pension and OPEB policy establishes the strategic intent to remain current on funding pension and OPEB liabilities. Colleges should adopt a policy that calls for the college to contribute the full amount of their actuarially determined annual required contribution (ARC) each year and to target a 100 percent or more funded ratio (full funding). A policy should also provide for stable amortization periods over time and parameters for making changes to the amortization period.

A policy should also address other post-employment benefits (OPEB), such as health-care coverage provided to retirees. Like pensions, OPEB liabilities are accrued in the current period by current employees, although the required cash outlay will not become due until later. Also, like pensions, the GFOA

recommends that governments finance these benefits as they are earned (i.e., prefund), rather than pay for benefits only as they become due. Unlike pensions, however, the GFOA recognizes that in some cases, less than full actuarial funding is appropriate, perhaps because benefit levels will be adjusted over time to compensate for the effects of health-care inflation. Assuming the college elects to prefund benefits, the policy should clarify several points: which actuarial cost allocation method to use; whether all OPEBs will be prefunded (or whether to exclude implicit rate subsidies for health care, for example); and what level of funding will be targeted.

Endnote

¹ A pre-mortem is a brief meeting of individuals who are knowledgeable about the proposal for a new program and takes place before the college has formally committed itself to the new program. The participants imagine that it is a year in the future and that the program has been a complete failure and they are to write a brief history of the failure. The pre-mortem helps temper uncritical optimism and forces people to consider possibilities for why their initial estimates of the program's potential might be wrong. See Daniel Kahneman, *Thinking Fast and Slow* (New York: Farrar, Straus, and Giroux, 2001).