

Slack as a Campus Resource:  
How Three Public Universities Manage Fund Balances to Facilitate Strategic  
Behavior and Absorb Environmental Variation

by

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(Under the Direction of Major Professor James C. Hearn)

ABSTRACT

The purpose of this study was to explore the policy settings, environmental factors, and various roles of budgetary slack within the context of three public universities. As a consistent unit of analysis, unreserved fund balances were used as a measure of budgetary slack.

The universities examined in this study operate under a diverse set of budgetary policies and procedures governing the use of fund balances. Despite these varied approaches, two prevailing philosophies existed in terms of how fund balances are managed – “use it or lose it” or “save it to use later”. The research analysis suggests that the ‘use it or lose it’ philosophy fosters a culture under which individuals may be forced to satisfice in their decision making in

order to “spend down” state funds before the fiscal year end. However, the actions of administrators to spend down funds were not accomplished solely through accelerated purchasing in June. Instead, administrators often reassign costs or revise their budgets mid-year to either maintain control of these funds or to ensure that state dollars are exhausted before other institutional funds with greater flexibility.

In contrast, the “save it to use later” philosophy exists when administrators have the flexibility to carry forward funds across fiscal periods. While this policy environment reduces the incentive to spend down state funds, this philosophy still has limitations as decentralized decisions to allocate fund balances within the loosely coupled university are often challenged with issues related to the dominant coalition, goal congruency, and principal-agent conflict.

The study's findings suggest that while slack resources were identified to be effective means to leverage as a buffer to environmental variation, resource for conflict resolution, catalyst for strategic behavior and as a plug for ongoing operating needs, public universities may still operate in an environment that limits the effective use of budgetary slack as a campus resource. In particular, the study identified constraints related to governance and policy restrictions, political activity within the internal management structure, and public perception risk as primary factors influencing the use of slack.

**INDEX WORDS:** Budgetary Slack, Organizational Decision Making, Public Higher Education, Carry-Forward Funds, Domain Coalition, Bounded Rationality, Resource Allocation Decisions

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## DEDICATION

This research study is dedicated to my wife and kids without whom I never would have been able to pursue this project and whose unwavering love, patience and support have given me strength. To my mom and dad, whose love, wisdom, support, and encouragement have been a constant guide and source of motivation throughout the years. Finally, to my mentors and heroes in higher education, such as Doug Toma, Robert Khayat, Tom Meredith, Gloria Kellum, Morris Stocks, Carolyn Staton, and Andy Mullins, whose selfless leadership and commitment to excellence in education provide a lifelong source of inspiration and encouragement.

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## CHAPTER 1

### INTRODUCTION

Colleges and universities have historically shown resilience during periods of economic decline. As such, the traditional university model has remained relatively unchanged over the years as the cycle of competitive pressures have rarely overcome a university's ability to identify new or underutilized resources to mitigate the need for major organizational change (Breneman, 2002).

Consider, for example, the economic recession that began in 2008 which led to dramatic shortfalls in state revenues and drastic budget cuts for public universities. In 2009, the federal government responded to the looming recession by issuing \$53.6 billion in stabilization funds to minimize the economic fallout and state budget cuts, which in turn, served as an economic buffer for public universities (Keller, 2009). While a majority of the public universities received significant state budget cuts, the federal stimulus dollars along with other forms of new and underutilized resources have allowed most universities to react to the financial adversity with short-term cost saving solutions (Breneman, 2002) rather than strategic organizational change decisions that might invoke conversations on consolidation, program elimination, or mission realignment (Keller 2009; Blumenstyk, 2009).

Despite this longstanding resiliency, a university's dependence on new or underutilized resources as a buffer to economic volatility has long been a

concern for industry experts (Cameron, 1983). For decades, industry experts have suggested that the characteristics of the environment in which universities exist - enrollment trends, tuition elasticity, shrinking state appropriations, federal policy changes, unexpected disaster, and so on - are creating conditions of decline that will require a new set of administrative and organizational responses (Cameron, 1983).

Following the economic recession of 1980, Cameron (1983) suggested that “some institutions may respond by becoming smaller, some by going out of business, or some by consolidating or merging. Others may get bigger, change emphasis, or become entrepreneurial.” Today we know that Cameron’s assertion was partially correct as major research universities continued to grow and become more entrepreneurial following the 1980 recession. However, few institutions were forced to close or merge as a result of the recession. Instead, the traditional higher education model prospered in the 1980’s due to abundant levels of new or underutilized resources.

During the recession of the early 1990’s, an article published in *The Chronicle of Higher Education* surveyed academic leaders on whether they predicted any major changes for higher education in the wake of the recession (Breneman, 2002). In this article, several educational leaders predicted transformation in the industry -- one in which higher education would have to focus on efficiency and increased productivity, with heavier teaching loads, reduced student services, larger classes, fewer tenured faculty members, and leaner administrations. Interestingly, several of the leaders that were interviewed

for this study acknowledged that one of the primary challenges preventing organizational change was the internal lack of urgency and the general belief among faculty and staff that "this too shall pass".

In 2009, another article published in *The Chronicle of Higher Education* examining the effects of the most recent recession on higher education noted, "the absence of radical change is probably a measure of the resiliency of the higher education sector, the cushion provided by federal stimulus funds, and the political difficulty of instituting swift changes at such complex and decentralized organizations" (Blumenstyk, 2009).

While it is unclear whether universities have experienced the full effect of the recent economic fallout, the resilience of colleges and universities during periods of economic decline is not a new phenomenon. In fact, American colleges and universities have shown resilience over the centuries, especially with their ability to add and absorb new constituencies, new programs, and changing fields in research and academia (Slaughter & Rhoades, 2004).

Macro-organization theory often attributes this resiliency to an organization's ability to absorb environmental uncertainty using a buffer of resources that organizational theorists refer to as organizational slack (Cyert and March, 1963; Thompson, 1967). Researchers define slack as excess resources above and beyond what is required to operate that allow organizations to adapt to competitive demands and to buffer themselves from unforeseen circumstances (Bourgeois, 1981; Cheng & Kesner, 1997; Cyert & March, 1963).

Depending on ease of recovery or redeployment, researchers have identified three different types of slack: available, recoverable, and potential (Bourgeois & Singh, 1983; Cheng and Kesner, 1997; Sharfman et al, 1988). Applying these forms of slack in the context of a university, available slack refers to the resources that are not yet committed within the organization such as departmental funds allocated for an unfilled faculty position or unspent marketing funds within a department. Recoverable slack is identified as resources that are generally dedicated to covering fixed operational costs that can be recovered by improving the efficiency such as utility savings or debt restructuring. Recoverable slack can also be identified as “resources that have been absorbed into the system as excess costs that can be recovered through organizational redesign” (Cheng & Kesner, 1997). For example, a university may choose to consolidate two departments with similar functions in order to reduce the associated overhead expenses and to reallocate these funds for other purposes. The third form of slack, potential slack, is identified as the future resources or revenue streams that can be generated by the firm through external sources (Cheng & Kesner, 1997). In higher education, if a university’s borrowing power increases, senior administration can potentially access larger amount of resources. An organization’s total slack is determined as the specific sum of the level of available, recoverable, and potential slack (Sharfman et al, 1988).

For decades, there has been an ongoing debate between organizational theorists on the role of slack in supporting organizational adaptation (Nohria and Gulati, 1997). Some argue that slack “will either solve many organizational

problems or facilitate the pursuit of goals outside the realm of those dictated by the pursuit of optimization principles (Bourgeois, 1981).” For others, organizational slack is perceived as a negative term that exudes inefficiency or underperformance (Leibenstein, 1969; Nohria and Gulati, 1997). Recent efforts have attempted to reconcile this debate between slack as an asset or as an analog for inefficiency by identifying the optimal amount of slack for a firm (George, 2005; Peng and Tan, 2003).

Beyond the role of slack with organizational adaptation, researchers have identified numerous other roles that slack serves within an organization such as an inducement, resource for conflict resolution, environmental buffer, and as a facilitator of strategic behavior (Bourgeois, 1981). Regardless of the organizational setting, these roles of slack are appealing as it conveys the notion of a cushion of excess resources available in an organization that will either address organizational problems or facilitate the pursuit of strategic goals.

As it relates specifically to higher education, researchers have referenced several roles of slack in organizational decision making (Cohen, March, & Olsen, 1972), strategic choices (Cameron, 1983), and in relation to the university's governance structure (Hearn and McLendon 2011; Weick, 1982); however, beyond a few secondary references, there has been limited research conducted on the role of organizational slack within the university organization.

As such, this study contributes to the research literature in this area by specifically examining the policy settings and environmental factors that influence the various roles of slack in the context of three public universities. As a



consistent unit of analysis, unreserved fund balances were used as a measure of budgetary slack, a specific type of slack resource that is recoverable and easily reapplied within the university organization (Sharfman et al, 1988; Nohria and Gulati, 1997).

Fund balances represent the net amount of revenues (assets) and expenses (liabilities) available for an organizational unit or even the university's central operating budget. More generally, a fund balance represents the unencumbered funds at the end of the fiscal year after all spending commitments are made. Unreserved fund balances is that portion of the total fund balance that is not restricted for future payments to satisfy outstanding or future liabilities (Hendrick, 2006). For example, if an academic department budgets \$20M in salary expenses for a fiscal year and this particular department has ten full-time staff members leave the university, an unreserved fund balance would become available for the lapsed salary expenses that were not used during the period of time these ten positions were left unfilled.

It is important to recognize that fund balances are a product of budgetary slack when these excess, discretionary funds are generated as a result of normal employee attrition, an increase in operational efficiency, or as a result of budget manager imbedding a buffer of funds in his or her budget to prepare for unexpected circumstances. For instance, tuition revenue associated with enrollment growth is not a source of slack. Instead, slack would be the university's excess capacity that is available to absorb an increase in enrollment without investing in new classroom space or other marginal costs associated with

new students. A common example in higher education would be an academic dean increasing the number of seats available in a summer school class from 15 to 20 students without increasing any other costs associated with that class. The slack capacity in the classroom would yield new discretionary revenue assuming the dean had not included this enrollment increase in their budget projections.

When fund balances become available, an institution's financial policies dictate how these funds are managed internally. For public universities, financial policies are often governed at a higher level by state law or by policies of the university's board of trustees. In fact, state-level policies have historically treated public universities like other state agencies and required unexpended state funds to be returned to the state treasury at the end the fiscal year. Public universities that operate in this type of policy environment often foster a "use it or lose it" culture which may encourage administrators to spend down budgetary funds rather than return these funds back to the state at the end of the fiscal year.

In contrast, some public universities have negotiated increased levels of operational autonomy from the state, including greater flexibility to carry-forward unspent state funds across fiscal periods. In this situation, universities typically have a carry-forward allowance policy which allows the organization to keep unspent state funds as carry-forward balances in the form of a one-time budget increase for the ensuing fiscal year. Senior administrators who oversee schools and departments often have full discretion as to how these carry-forward funds are reallocated. This type of policy environment encourages a "save it to use later" culture; however, a decentralized approach to managing fund balances at

the school and department level may limit goal congruency throughout the university.

Before delving into the research literature, the subsequent sections in this introductory chapter further explore two particular roles that slack serves in the university organization as a buffer to environmental uncertainty and as a facilitator of strategic management. The final section in this chapter highlights the overall purpose and relevance of this study on budgetary slack in higher education.

### The Resiliency of the American University

Historically, organizational slack has served as an important buffer of resources for organizations through periods of unexpected environmental demands and economic volatility (Bradley et al, 2011; Cyert and March, 1963). While this role of slack can be applied to higher education anecdotally, there is limited research that has scientifically applied these findings in the context of the university organization. Nonetheless, I would argue there is substantial evidence of universities absorbing the financial effects of economic volatility through access to new or underutilized resources within the internal and external environment of the university. As such, consider the following historical uses of new and underutilized resources in the American higher education system during the major economic recessions that have opened each decade since the 1970's:

### *Early 1970's Recession*

Universities benefited during the 1970's recession from an enrollment boom that was driven by the G.I Bill and the post-war baby boom (Breneman, 2002). As the boomer generation began to fade, the Higher Education Act of 1972 established the role of the federal government in financial aid programs, including Pell Grants, which led in the shift of educational loan funding from institutions to students and ultimately reclassified students as consumers of higher education (Breneman, 2002). Moreover, the newly established federal system of competitive research grants led to a new source of funding for universities in the 1960's and 1970's (Thelin, 2004).

### *Early 1980's Recession*

The recession of the 1980's threatened the higher education industry with double-digit inflation, declining state appropriations, and a flattening population of high school graduates, yet public universities were able to offset their losses and avoid radical organizational change through a sharp increase in tuition rates and private fundraising (Breneman, 2002). This entrepreneurial response began a shift from the perspective of higher education as a social-good to a neo-liberal state where universities were increasingly focused on their role as economic actors (Toma, 2010). Moreover, the Bayh-Dole Act was passed in 1980 to commercialize and privatized federal research, allowing universities and corporations to claim ownership of patents taken out on products and processes discovered during the course of federally funded research (Slaughter & Rhoades, 2004; Toma, 2010).

### *Early 1990's Recession*

The U.S recession of the early 1990s was driven primarily by global competition and from a dramatic decline in federal spending in the area of national defense (Breneman, 2002). Fortunately, for universities, advancements in technology opened a new economy in the global markets, higher education benefited greatly from the privatization, commercialization, and deregulation efforts that enabled the entrepreneurial university to seek resources in new markets and to sell knowledge as a commodity (Slaughter & Rhoades, 2004; Toma, 2010). As such, universities were again able to avoid significant disruption by responding to economic adversity with sharp increases in tuition, a more active pursuit of private support, and a continued focus on diversifying and expanding revenue sources (Breneman, 2002).

### *Early 2000's Recession*

The mid to late 1990s marked one of the longest periods of economic growth in our nation's history before the infamous 'pop' of the dot-com bubble, which ultimately led to another economic recession in the early 2000's (Breneman, 2002). Again, the business model of the higher education sector remained strong as colleges and universities benefited from significant increases in endowment growth and tuition increases (Breneman, 2002).

### *2008-2010 Recession*

The economic recession that began in 2008 led to dramatic shortfalls in state revenues. The National Association of State Budget Officers projected that

total state deficits would approach nearly \$230 billion between fiscal year 2009 and 2011 (Prah, 2010). In September 2009, the Association of Public and Land-grant University (APLU) surveyed its 188 member university and found that more than 55 percent reported cuts in state appropriations with nearly one-half of the institutions experiencing cuts of 10 percent or greater (Keller, 2009). While the public higher education has clearly not been immune to the economic fallout and state budget cuts, public universities have, with a few exceptions, minimized the negative financial impact through the federal stimulus dollars along with other forms of available and potential slack resources. In 2009, the *Chronicle of Higher Education* conducted a survey with chief financial officers at four-year colleges and universities to determine how institutions were coping with the dramatic state budget cuts that have resulted from the recent economic downturn (Blumenstyk, 2009). The results from the survey showed that the coping strategies for most universities during the 2009 recession focused primarily on short-term cost cutting solutions. More specifically, universities were focused on absorbing the budget cuts by reducing organizational slack by eliminating non-essential permanent, temporary, and part-time staff positions; collapsing course sections into fewer, larger sections; deferring maintenance expenditures; mandating staff furloughs; and by reducing purchasing.

This historical perspective on the role of slack resources as an environmental buffer illustrates how universities have successfully absorbed a steady increase in enrollment using slack capacity and other underutilized

resources in order to minimize organizational disruption and to maintain a positive growth trend despite shifting economic trends.

### A University's Strategic Use of Slack

In higher education, one source of revenue that may be undervalued in strategic management is budgetary slack. Consider, for example, an article published in *The Chronicle of Higher Education* which explained how, in the midst of the 2008 recession, the president of Pepperdine University asked his deans to forfeit a tenth of their budgets to redirect for more tenure-track faculty and to increase the prestige of the law school, among other strategic priorities for the university. This reallocation represented \$25-million or 10 percent of the university's operating budget. In the article, Jane V. Wellman, executive director of the Delta Project on Postsecondary Education Costs, Productivity, and Accountability was quoted saying: "for public and private colleges, the biggest source of new money to do new things is going to come from money you've already got" (Stripling, 2011).

While the redirection of a portion of a university's operating budget is an innovative way to fund strategic priorities using budgetary slack, university leaders often struggle to cut some programs for the sake of others as they feel locked in by tradition and a tenure system that makes phasing out programs difficult (Stripling, 2011). As such, the role of fund balances, as a discretionary form of budgetary slack, becomes an intriguing resource for universities to utilize for strategic efforts.

The challenge, however, is that universities, as loosely coupled organizations, “exhibit an abundance of slack resources, minimal coordination between and among units, high levels of decentralization and delegation, tendencies toward equifinality, and causal independence (Hearn and McLendon, 2011).” Therefore, universities are often challenged to institutionalize a process for facilitating strategic behavior or promoting innovation (Cameron, 1984). Furthermore, there is also likely an unspoken reluctance by senior administrators (i.e. domain coalition) to relinquish control of these discretionary fund balances as institutional leaders are ultimately responsible for managing and responding to organizational risks and pursuing strategic opportunities.

Cameron (1983) suggests that “when faced with condition of decline, administrators define these conditions exclusively as resource allocation problems or problems of efficiency, and they respond conservatively rather than innovatively.” Consequently, this risk adverse behavior, in turn, relegates the role of slack as facilitator of strategic behavior and instead, shifts an administrator’s focus on maintaining the status quo or on short-term solutions that will preserve the current condition of the institution (Breneman, 2002; Blumenstyk, 2009; Cameron, 1983).

For public universities, the lack of an institutionalized process for reallocating for strategic purposes may also be influenced by state policies and the bounded rationality of university leadership. The bounded-rationality paradigm asserts that our cognitive limitations forces university leaders and policymakers to satisfice our decision behavior due to time constraints,



incomplete information, and the competing demands of organized interests (Cyert and March, 1963; Lindblom, 1968; March and Simon, 1958).

While the role of slack as a facilitator for strategic behavior may be less discernible than its role as an environmental buffer, I would posit that the strategic role of slack is challenged with numerous environmental constraints within the university setting, particularly within the public domain and its state policy restrictions. Additional research is necessary to better understand the effects of these constraints on colleges and universities, particularly in terms of how they might inhibit strategic behavior.

#### The Purpose of the Study and Relevant Audience

The impetus for this study was inspired by a simple question that a colleague once asked, “how can a university be strategic when there are no new dollars?” Recognizing that a significant amount of unspent funds are reallocated within the university organization throughout the year, I became interested in understanding the effect these discretionary fund balances have on a university’s strategic behavior? After exploring the issue further, it became evident that these excess slack resources serve numerous roles with an organization; however, it was unclear how effective the strategic role was being utilized.

As such, the purpose of this study was to contribute to the literature in the area of organizational slack within the context of the university organization. The scope of this particular study was more narrowly defined to specifically examine the policy settings, the influence of environmental factors, and the broad

scope of roles that budgetary slack serves within the context of three public universities. The public domain of higher education was selected in order to explore the effect that state policies and other external governance factors have on a public university's ability to leverage the various uses of slack.

Although this study focuses on the use of budgetary slack in American public universities, the research, recommendations and principles outlined should be scalable and applicable to other types of higher education institutions in some form. Thus, this research is relevant to higher education professionals, scholars, and policy makers, particularly those who are involved in budgeting, financial management, and strategic planning.

## CHAPTER 2

### LITERATURE REVIEW

The existing literature closely examines the roles and influence of organizational slack within industry and to a lesser degree within government finance areas, but there is a scarcity of research on slack within the university organization. To address this gap in the literature, this study explored the policy settings, environmental factors, and the various roles of organizational slack with a particular focus on the role of budgetary slack within the public university setting.

There is no standard conceptual framework to apply directly to this study, so it will be appropriate to construct one from a variety of domains. Thus the applied framework will rely on multiple dimensions to explore varying levels of this topic. To that end, the review of the literature will explore three theoretical domains. First, this chapter begins by looking broadly at the existing research on organizational slack. The second section provides an overview of the literature on budgetary slack and its contributing factors including: information asymmetry, budget emphasis, and budget participation. The third section will summarize the literature on bounded rationality and domain coalition in the context of higher education.

## The Literature on Organization Slack

Research on organizational slack has attracted the attention of organizational theorists since the early 1960's when Herbert Simon, James March, and Richard Cyert at Carnegie Mellon University advanced early research on organizational behavior and the application of decision analysis and management science. These renowned organizational theorists, often recognized as the "Carnegie School", began a continued exploration on the role of organizational slack and the effect of these excess resources on organizational learning, adaptation, and managerial decision-making (Augier and March, 2008).

Building upon the early work from the "Carnegie School", Bourgeois (1981) defined organizational slack as "a cushion of actual or potential resources which allow an organization to adapt successfully to internal pressures for adjustment or to external pressures for change in policy, as well as to initiate changes in strategy with respect to the external environment." Bourgeois' description was based on one of the original definitions by Cyert and March (1963), which defined slack simply as the excess of resources allocated over the minimum necessary to accomplish the tasks assigned.

Using this basic definition as a guide, researchers continued to advance the literature on slack. Waller (1988) described slack as the excess of resources over and above those needed to finish an assignment. In essence these are resources which can be used in a discretionary manner. It signifies various ways in which resources that may have been devoted to pursuing organizational goals

can be redirected for other purposes. In terms of the ease of recovery or redeployment of these resources, researchers have identified three different types of slack: available, recoverable, and potential (Bourgeois & Singh, 1983; Cheng and Kesner, 1997; Sharfman et al, 1988). Moreover, Sharfman et al (1988) conceptualized slack in two dimensions: 1) absorbed slack as those excess resources that are not easily to redeploy; and 2) unabsorbed slack as those unreserved resources that are discretionary and more easily redeployed. Gresham (1999) focused on the importance of different types of slack resources (capital, human, time, organizational, etc.). George (2005) introduced the term transient slack, defining it as excess resources available after resource demand for operations have been met. Greenley and Oktemgil (1998) distinguished between generating slack, generated (investing) slack and invested slack, and further divided the absorbed slack into combined slack and dispersed slack according to the different right of control.

Time frame for recoverability is also important characterization of slack. Recognizing that budgets and performance reviews typically follow annual cycles, short-term slack becomes the excess resources that can be recovered within one year. Otherwise, it becomes long-term slack. Thus, potential (or unabsorbed) slack can be viewed as short-term slack, while committed (absorbed) slack can be viewed as long-term slack (Sharfman et al, 1988).

Some organizational theorists recognize slack, despite its costs, as excess resources that help facilitate innovation and change, and thus allow organizations to adapt to competitive demands and to buffer themselves from

unforeseen circumstances (Cyert & March, 1963; Cheng & Kesner, 1997).

Organizational slack essentially serves as a buffer to environmental variation by functioning as a reserve of resources that are available for an organization to utilize during a period of adversity. Along this same line, Thompson (1967) identified slack as resources that protect an organization from the uncertain success of projects while also serving as a facilitator of strategic behavior, which enables organizations to experiment with new strategies such as introducing innovative products and entering new markets. In recent years, researchers have examined the effect of slack on a firm's entrepreneurial management and growth (Bradley et al., 2010; Mosakowski, 2002) and strategic choices (Mishina et al., 2004).

In contrast, some theorists have argued that slack is an analog for inefficiency, a buffer which shields the firm from the changes that are needed to meet external demands (Nohria and Gulati, 1997). Scholars that view slack as a liability believe that excess resources results from an organization's failure to use resources optimally. Additionally, some theorists argue that slack leads to principal-agent problems, which suggests that senior management and unit-level managers will not always be motivated with the same goals and incentives (Tan and Peng, 2003). In other words, unit-level managers are likely to prioritize the optimization of their own unit before the needs of the organization.

This debate between organizational theorists on the role slack plays in organizational adaptation continued for several decades (Bourgeois, 1981). Proponents argued that slack was essential for innovation, while organizations

confronting increased competition and financial challenges felt pressured to eliminate all forms of slack. This paradox demonstrates an interesting dynamic between innovation and slack: if slack is both a form of inefficiency and also an important driver of innovation, then organizations that cut slack from their departments may find that their capacity to innovate is hindered (Nohria and Gulati, 1997).

Over the past decade, researchers have increasingly recognized that the important question is not whether slack is good or bad for performance, but rather, what range of slack resources is optimal for performance. Tan (2003) suggests that at low levels, slack has a positive effect on firm performance, but this gradually diminishes with increasing slack and then becomes negative producing an inverse U-shape relationship between slack and performance. As it relates to higher education, researchers should carefully consider whether this finding on the optimal level of slack holds true given the unique characteristics and complexities of the loosely coupled university organization.

In terms of the roles of organizational slack, Bourgeois (1981) examined the administrative theory literature since the 1960's and identified four primary ways that slack is utilized. More specifically, Bourgeois (1981) noted that slack functions as an inducement for employee retention (Cyert & March, 1963), serves as a resource for conflict resolution and political activity within organizations (Cyert & March, 1963; Moch and Pondy, 1977; Pondy 1967; Galbraith, 1973), acts as an environmental buffer (Cyert & March, 1963;

Thompson, 1967), and facilitates strategic behavior and innovation (Cyert & March, 1963; Thompson, 1967).

Although the scope of this study focused specifically on the role of slack in higher education, the next four sections briefly summarize the literature on the primary roles identified by Bourgeois (1981) in industry.

### *Slack as an Inducement*

Cyert and March (1963) define organizational slack as the condition that occurs when the level of inducements – such as income and prestige – exceeds the amount required to retain these employees within the organization. American colleges and universities provided an example of slack in this role as universities responded to state budget cuts following the 2009 economic recession using short-term cost reduction strategies such as employee furloughs (Keller, 2009). The amount of salary an employee is willing to give up before searching for another job represents the cushion of slack resources that an organization is able to utilize in response to an environmental demand.

### *Slack as a Resource for Conflict Resolution and Political Activity*

Some researchers have portrayed organizational slack as a resource for conflict resolution (Cyert & March, 1963; Pondy 1967). More specifically, Pondy (1967) identified three perspectives to which slack resources can help mitigate conflict. First, viewed from a bureaucratic lens, slack can help address conflict that results from tensions between supervisors and managers. Second, from a systems perspective, slack can help mitigate conflict that results from a lack of



buffers between interdependent parts of an organization. Third, from the perspective of the goal model, slack can address conflict that results from a lack of goal congruency among key organizational personnel within separate subunits of an organization.

Moreover, Cyert and March (1963) and later Moch and Pondy (1977) also identified slack as a resource that can help mitigate conflict associated with political activity within the organization. Cyert and March (1963) maintain that slack resources reduce political activity as more resources minimize the conflict between interdependent units that compete in the internal resource allocation process. Said differently, slack provides opportunities to distribute resources generally to all participants (Moch & Pondy, 1977).

#### *Slack as an Environmental Buffer*

As highlighted in the study's introduction, perhaps the most significant role that organizational slack has played in the university organization is that of a buffer of resources that cushions the university from unexpected environmental demands (e.g. economic recession, increasing inflation, drop in enrollment, etc.). James Thompson (1967) was among the first scholars to recognize slack in this role as a "buffer to the technical core". In the case of a highly differentiated organization such as a university, slack not only helps absorb the external environmental demands but also serves as a resource to buffer between various parts (i.e. sub-units) of the organization that may not generate resources equally in order to maintain value homogeneity (Cohen, March, & Olsen, 1972).

Moreover, Thompson (1967) saw this role as an economic efficiency problem in which environmental uncertainty is absorbed or reduced by non-core functions within the organization. Researchers such as Pondy (1967) and Galbraith (1973) address the role of slack as a buffer but they focus on the role that these resources have in buffering interdependent organizational units from conflict.

Galbraith (1973) also addressed slack as a solution to workflow problems by recognizing that the creation of slack resources would reduce the workload strain on individuals and thus improve the overall performance of the organization. This perspective of slack runs counter to those scholars who recognize slack as an analog of inefficiency or in more direct terms as people that could do more in their jobs and as resources that can be better utilized within an organization.

#### *Slack as a Facilitator of Strategic Behavior*

Another important role of slack highlighted in the introduction is the role of slack as a facilitator of strategic behavior within an organization. Organizations utilize slack by reallocating these excess resources for new innovative projects or services to advance their organization. The presence of slack allows an organization to be more aggressive with strategic decision-making recognizing that these excess resources are above and beyond what is necessary for the firm to operate (Thompson, 1967). In other words, slack creates funds that can be redirected toward strategic projects with uncertain outcomes, fostering an environment for innovation.

These factors allow the pursuit of strategic projects and initiatives even when they don't appear to be justifiable in terms of internal norms. Furthermore, slack enables firms to expand their products and services in emerging areas (Hambrick & Snow, 1977). Cyert and March's (1963) research explored the hypothesis that organizations that were failing would engage in strategic behavior and innovation in order to reinvent themselves and to identify new alternatives for success. Interestingly, Cyert and March's findings did not support their hypothesis as expected. Instead, this study found that when an organization is performing well then available slack resources tends to be higher. This abundance of slack enables organization with the freedom to experiment with new ideas and to be less risk averse to strategic behavior. Given these various roles of slack, it will be important to consider how and why senior administrators choose to allocate slack resources to serve these various roles.

### Budgetary Slack Defined

Organizations depend on financial budgets for planning and controlling their operations. As such, budgets are an important tool for management in forecasting the future of an organization (Onsi, 1973). There are two main reasons for inaccuracy in a budget. One reason would be by error, the other by design (Young, 1985). This study with its focus on budgetary slack in higher education, explored the budgetary inaccuracy for both reasons as administrators are unable to perfectly predict their annual budget needs and these same

managers will often imbed extra funds in their budgets as a buffer for unknown financial circumstances.

In broad terms, Merchant (1985a) defined budgetary slack as the “excess amount budgeted in area over what was necessary.” Moreover, Lukka (1988) stated that a budget with slack was one in which the “figure has been intentionally made easier to achieve in relation to the forecast.” According to a research study by Mohamed Onsi (1973), 80 percent of managers indicated that they bargained for slack in their budgets. Onsi also observed that central operating budgets likely have slack in them as well. While the amount of slack will vary over time and between companies, Schiff and Lewin (1970) explained that slack might account for as much as 20-25 percent of a division’s budgeted operating expenses.

One particular theory that researchers have identified as a major factor in the creation of budgetary slack is agency theory. The literature connects this behavior of budgetary slack creation to the manager’s (i.e. subordinates) ability to leverage more accurate knowledge (information asymmetry) on unit-level costs and performance capabilities during his or her budgeting setting discussions with a superior (Chow, Cooper, & Waller, 1988). In turn, unit-level managers benefit from the creation of budgetary slack by utilizing this buffer of financial resources to protect themselves from environmental uncertainty as well as to experiment with new ideas and personal projects. In context of the agency theory, researchers have further defined budgetary slack as the incorporation of budget amounts that possess a buffer to make it easier to attain for managers

(Lukka, 1988; Young, 1985; Dunk, 1993). Schiff and Lewin (1970) maintain that managers incorporate slack into their budgets by understating revenues and inflating cost projections.

While a scan of the research literature did not identify studies that specifically explore the role of budgetary slack within the university setting, scholars have identified three primary factors that lead to the creation of budgetary slack that are particularly relevant to the university organization. The first factor relates to information asymmetry, which arises when the manager has more information relevant to the budget decision process than the superior (Baiman and Evans, 1983; Coughlan and Schmidt, 1985; Dunk, 1993).

Research has suggested that the budget allocation process can be improved through better communication between the manager and the supervisor (Magee, 1980; Baiman and Evans, 1983; Chow, Cooper, & Waller, 1988). However, managers may choose to withhold information in the budget setting process if their performance is based on the effective use and attainment of budgeting goals. In other words, if managers perceive performance rewards based on budget attainment then they may incorporate slack into their budgets to create greater flexibility in achieving individual goals (Schiff and Lewin, 1970, Dunk 1993). In contrast, if a manager does not have better information than the supervisor then he or she would likely not have the leverage to incorporate slack into their budget.

Chow, Cooper, and Waller (1988) recognized the purpose of a budget as a motivation for improved manager performance as well as for the facilitation of

planning. These two budget functions create an incentive problem in that a manager benefits by incorporating slack into the budget in order to achieve performance goals. As such, managers are more likely to withhold information from superiors to leverage the opportunity to create a cushion of financial resources (Dunk, 1993). This individual incentive leads to the principal-agency theory, which maintains that managers may prioritize the optimization of their own unit before the needs of the organization. Consequently, managers are prone to include excess resources in their annual budget requests in order to hedge against unforeseen circumstances or to invest in personal projects or initiatives rather than the strategic needs of the overall organization.

The second primary factor leading to budgetary slack relates to budget emphasis, which translates into the importance of budget attainment within an organization's performance goals and expectations (Dunk, 1993). Since managers are pressured to achieve their budgeted goals, there is a likelihood that they will create budgetary slack (Merchant, 1985a). This pressure, applied from supervisors, is budget emphasis (Dunk, 1993). When the achievements of budgeted goals are emphasized, the normal tendency is to incorporate slack into the firm's budgets (Lowe & Shaw, 1968). The main reason for subordinate managers' efforts to build slack in their budgets is to increase their pay-off chances. If managers perceive their rewards as dependent on budget attainment, they will tend to build slack into their budgets through the participation process (Schiff & Lewin, 1970). Researchers maintain that low budget emphasis will

decrease the ability of managers to incorporate budgetary slack regardless of the information asymmetry (Dunk, 1993).

The third primary factor relevant to budgetary slack is the role of participation in the budget setting process. The research literature maintains that participation by managers in the budgeting process may result in the generation of slack budgets (Antle and Eppen 1985). Lowe & Shaw (1968) stated that managers built slack into their budgets as a means of protecting their personal interests, and that it was rational economic behavior for them to do so. Schiff & Lewin (1970) proposed that if subordinates perceive their compensation as being dependent upon budget achievement, they might aim to have slack in their budgets.

Moreover, Lukka (1988) argued that increased participation would give managers the opportunity to contribute directly to the creation of slack when information asymmetry is high. Lukka also maintained that low participation in the budget setting process limits a manager's ability to incorporate slack regardless of the level of information asymmetry or budget emphasis (Lukka, 1988). Said another way, if information asymmetry is low and budget emphasis is high, subordinates will have the incentive to create slack, but will not be in a position to incorporate it into the budget (Chow et al. 1988).

In contrast, other scholars provide evidence that participation may lead to a reduction in slack. The idea being that increased communication between the manager and supervisor would provide the supervisor a greater understanding of

the needs of a manager's unit of responsibility thus limiting the ability for slack to be incorporated into the budget (Magee, 1980; Baiman and Evans, 1983).

Alan Dunk (1993) explored this debate further and found that there was little support for the view that increased managerial participation increases slack when information asymmetry and budget emphasis were high. Instead, Dunk (1993) observed that slack reduction may occur with increased budget participation, which runs contrary to the position that slack creation was influenced by participation when a manager had greater information and was incentivized by budget attainment.

In terms of the annual budgeting process, it will be important to examine how the diversity, complexity, and scope of the university organization effects issues related to information asymmetry. Furthermore, it will be useful to further explore the effect of information asymmetry, budget emphasis, and budget participation on budgetary slack in the loosely coupled university organization.

#### Additional Perspectives from the Carnegie School

There are two additional theories identified by the "Carnegie School" within the literature that are important to highlight for the purposes of this study. The first theory is related to bounded-rationality, which relates to our cognitive limits to rationality as humans (March and Simon, 1958). As explained previously, the bounded-rationality theory asserts that our cognitive limitations forces us to satisfice rather than optimize our decision behavior due to time constraints, incomplete information, and the competing demands of organized



interests (Lindblom 1968; March and Simon, 1958). Satisficing means that instead of waiting to explore every opportunity and decision alternative thoroughly, the first feasible alternative is chosen before the optimal solution is identified due to time constraints, incomplete information, which results in suboptimal behavior.

Furthermore, Cyert and March (1963) maintain that the existence of slack allows one to satisfice earlier in the decision process than might otherwise be the case and vice versa. Thus, an increase in slack resources increases our willingness to select an acceptable alternative rather than the optimal solution. This tendency to satisfice when slack is available presents a contradiction to the role of slack as an innovator and facilitator of strategic behavior (Bourgeois, 1981). If slack limits our need to search for a more optimal solution then what are the implications on an organization strategically adapting to environmental demands, particularly a slack-rich organization such as a major research university? It will be important to consider how bounded-rationality and satisficing might influence university leadership to focus on short-term organizational needs rather than innovation when considering the use of available slack resources, particularly public universities which often have state funds that become lapsable at the end of the fiscal year.

A second relevant theory identified by the “Carnegie School” that is important to consider for this study is the dominant coalition theory. A dominant coalition consists of the network of individuals within and around an organization that most influence the mission and goals of the organization (Cyert and March,

1963). This theory explains how the organization can have goals despite the different interests of its participants. In higher education, the goals of the university organization typically flow through information channels of the dominant coalition, including the president, provost, board of trustees, and academic deans. The significance of this theoretical construct is the opportunity that the dominant coalition has in engaging in political behaviors in order to capture available slack in the organization before it is introduced into the technical design of the organization (Dunk, 1993). It will be important to further explore the influence the dominant coalition has in the allocation of discretionary fund balances within the university organization.

## CHAPTER 3

### RESEARCH DESIGN

This study's research questions center around the policy settings, environmental factors, and the various roles associated with budgetary slack within the context of three public universities. As noted previously, unreserved fund balances were used as a measurable and observable form of budgetary slack. To that end, the research presented in this study targets three basic research questions. First, how and for what purposes do public universities allocate unreserved fund balances? Second, what environmental factors influence the use of these discretionary funds? Third, what roles, if any, do fund balances serve in the university organization? Individually these research questions assess relatively minor issues within the field of financial management, but when viewed collectively, they address more comprehensive issues regarding how public universities manage fund balances to facilitate strategic behavior and absorb environmental variation.

To address these questions, the research analysis examined the various mechanisms, practices, and policies that govern the use of fund balances; assessed the university's organizational structure and policy settings; and conducted interviews with senior administrators involved in budgeting and allocation of fund balances. Furthermore, a supplementary data analysis on multi-year unreserved fund balance trends was examined at one university in the

study. This information was considered additional context when considering how the various policy settings and environmental factors might influence the use of discretionary fund balances.

### Setting and Research Design Choice

The study's research design was a comparative case study that examined three public research universities using a qualitative methods approach. The qualitative design was chosen because this approach is best suited for exploratory research aimed at capturing and understanding people's perspectives, understanding an organizational phenomenon, studying a particular context or setting, and interpreting processes (Creswell, 2003; Merriam, 1998).

The case study design is suitable for this study in order to present a careful examination of the strategic phenomenon of budgetary slack in the public university setting. As described by Merriam (1998), the case study "is employed to gain an in-depth understanding of the situation and meaning for those involved.... Anchored in real-life situations, the case study results in a rich and holistic account of a phenomenon". Furthermore, the case-study method is appropriate since the issues explored required an in-depth analysis of financial policy settings across multiple universities whose context was not clearly evident (Yin, 2009).

## Sampling

The three universities identified for this comparative case study were determined using the following guidelines:

- Public research university with a total enrollment of at least 15,000 students and an annual operating budget in excess of \$250M
- Provides diversity in terms of financial management policies on the use of fund balances
- Provides accessibility for the purposes of retrieving internal documentation and interviewing senior management

The first criterion related to enrollment and operating budget levels was identified to ensure the universities being examined were similar in size as the research literature maintains that the size of an organization is an important source of slack (Thompson, 1967). More specifically, larger, loosely coupled organizations are recognized as having more capacity for slack. Furthermore, as noted previously, public universities were targeted in this study in order to assess the effect that state governance policies have on the use of slack as a campus resource. The second criterion on the diversity of policy environments was identified to better compare and contrast the various policy settings that exist in the public domain of higher education today. The third criterion was established to strengthen the breadth of information and data analysis available to consider during the research analysis. The process for identifying the initial set of institutions was heavily weighted on access to the universities based on contacts

within my professional network and from colleagues who were willing to serve as references.

### Interviews

University administrators were identified for interviews based on their knowledge and involvement in the budget process as well as their role in managing fund balances. As such, the targeted interview participants included the chief financial officer, two academic deans, and one departmental administrator with budgetary authority. These particular positions were also selected because they represent a valuable diversity of perspectives relating to institutional governance, policies, culture, and decision making processes. Each of these perspectives, in turn, connected to key theoretical topics such as budgetary slack, bounded rationality, and dominant coalition. Additional interview subjects were identified during the interview process using the snowball effect, which essentially utilized recommendations from interview subjects as to other people that may shed light on this particular study. In sum, fifteen senior administrators were interviewed for this study, including five from each university.

In preparation for the study's interviews, a pilot interview was conducted with a colleague familiar to the topic using preliminary interview questions in an effort to ensure that the interview questions were easily understood and that they addressed the full range of questions related to the study (Stake, 1995; Merriam, 1998; and Yin 2009). Based on feedback from an initial pilot interview, the original questions were revised and reframed before beginning the formal

interview process. A final set of interview questions was then developed in alignment with the study's overall research questions and analytical framework (See Appendix C).

In advance of each interview, participants were provided background information on the study for their review (See Appendix A). Interview participants were also informed that each interview was considered confidential including their name and the name of their institution. Appropriate steps were taken to ensure respondents' confidentiality and anonymity as appropriate. This study required approval by the Internal Review Board at the University of Georgia before the research study could commence.

### Data Collection & Analysis

This comparative case-study included an assessment of interview transcripts; state, board, and institutional level policies; carry forward balance statements; strategic planning documentation; online resources; and various other materials from each of the three institutions. Each university in the study was the basis of a separate case study, including a detailed description on the governance and financial management policies of the institution.

The data analysis was an inductive process as common themes and emerging patterns were identified in the collected interview data and documentation using the constant comparative method of data analysis (Merriam, 2009). As an initial step, the collected data from interview transcripts and other relevant documentation was organized into as many categories as

possible, each representing a different broad concept. In doing so, I began to consider the dimensions of each concept, their relationships with other concepts, and the conditions under which the concepts were pronounced or minimized. Since the study's research questions and key theoretical issues on slack helped inform the interview questions, the initial categories identified aligned closely with key topics addressed in the literature (Yin, 2009).

Following the initial categorization process, the data was further analyzed using coding techniques outlined by Corbin and Straus (2008). This coding process provided a deeper understanding of the data and uncovered additional themes and relationships between multiple concepts, which in turn, became more detailed and accurate through the process (Corbin and Straus, 2008).

All interviews from this study were recorded using audio tapes. Interview participants were given the option to turn off the recorder at any time. The interviews were transcribed and are available in digital format. Additionally, interview notes, field notes, and other documentation reviewed during the data analysis portion of the study were retained for future reference.

### Trustworthiness of the Data

The data collection and subsequent analyses conformed to the highest standards of qualitative research. This study established the trustworthiness of its findings by demonstrating that findings were: (1) credible, (2) transferable, (3) dependable, and (4) confirmable (Lincoln and Guba, 1985).



To ensure credibility, member checking was used in the form of debriefing sessions with interview participants immediately following the interviews. Member checks allowed interview participants to confirm my initial understanding of the data gathered (Merriam, 2009). Furthermore, data triangulation was used to confirm information was consistent across multiple sources including the interview transcripts, documentary evidence, and observation.

Although this study focused on the use of budgetary slack in public universities, the research, recommendations and principles outlined should be transferable to other types of higher education institutions. However, the findings from a study that examines three public universities should not be used to make generalization about the higher education as a whole. The findings from this study could be applicable to public universities that are assessing opportunities to better align resource allocation decisions with strategic planning efforts as well as public institutions exploring the need for increased operational autonomy from the state, particularly as it relates to the management of year-end fund balances.

In instances when information or data was inconsistent between sources (e.g. policy vs. interview notes), the relevant interview participants were contacted to rectify the discrepancy and to ensure the credibility and dependability of the data. Merriam (2009) maintains that the dependability of qualitative research is improved when outside researchers concur with the findings of the study or at least recognize the results are consistent and make sense. To address this need for external validation, data triangulation, peer

examination of the study's findings, and an audit trail were used to allow others to examine the process of data collection and analysis.

The fourth construct, confirmability, involves ensuring the data can be validated by someone other than the researcher. In other words, another researcher should be able to reconstruct this study and confirm that the findings do not reflect the biases of the researcher but rather follows an objective methodology for conducting the research (Toma, 2006). This need is addressed by identifying objective interview questions that align with the issues identified in the literature, conducting member checks following interviews to ensure the credibility and reliability of the data, and through a detailed audit trail that allows others to follow the process.

### Study Limitations

As a practitioner in the field of strategic planning in higher education, I recognize my personal biases related to this research subject. It was important to be objective in my interviews and to develop a framework for analyzing documentation and coding interview transcripts. This study also required specialized knowledge related to institutional budgeting and accounting practices that often varied between institutions, so it was important to be transparent in my understanding of the financial nuances and to clearly articulate my position and the questions that were being explored.

This study was also limited in that research was focused only on a set of public research universities that were similar in size and structure. It is difficult for

case study findings to be used to make generalizations to colleges and universities in general, particularly those with different finances, policies, and governance structures.

Finally, it was both a limitation and strength of the analysis that I have some familiarity with each of the universities examined. These universities were chosen not only because they met the case selection criteria but more importantly because of my personal knowledge of the institutions and my access to various senior administrators within the organizations. I believe the overall study benefited from the familiarity and access, which clearly facilitated data collection and interviews, but it is important to bear in mind my prior knowledge and understanding of the financial management policies of each university.

## CHAPTER 4

### RESEARCH FINDINGS

As stated previously, the focus of the study was to examine the variations in policy settings, the influence of environmental factors, and the broad scope of roles that unreserved fund balances serve within the context of three public research universities.

It is important to note that this study was not intended to highlight a particular institution but rather to explore, through qualitative analysis, the common themes and factors that influence the use of fund balances within the public domain of American higher education. As such, the universities examined in this study will remain anonymous as will the senior administrators who were interviewed for this study. The names of the three universities have been changed to Hoover University, Miller University, and Doyle University.

Based on the study's research analysis, three primary themes were identified during the initial data coding process. The first theme, variations in implementation, included the information and data identified in the study related to the policies and standard operating procedures that manage and govern the use of fund balances. The second theme, functions of slack, included the various roles that fund balances serve within the university. The third theme, environmental factors, included the key internal and external factors identified that influence the use of these discretionary funds.

After the initial analysis of the collected data and interview transcripts, four additional themes emerged including: one-time funds; ad-hoc decision making; spending down; and shadow budgeting. Furthermore, several of the study's primary themes have sub-themes that were identified during the data analysis process as well. A summary of the primary themes and corresponding sub-themes identified in the study are included in Table 1. Finally, the last section of this chapter provides a supplemental data analysis of the fund balance trends over a multi-year period at Doyle University.

In sum, the chapter is divided into the following sections based on the major themes identified in the research analysis, including: 1) Variations in Implementation; 2) Functions of Slack; 3) Environmental Factors; 4) One-Time Funds; 5) Ad-hoc Decision Making; 6) Spending Down; and 7) Shadow Budgeting; and 8) Additional Quantitative Findings.

Table 1: Summary of Key Themes & Sub-Themes Identified

Primary Theme	Sub-Theme (if any)
Variations in Implementation	Hoover University, Miller University, Doyle University
Functions of Budgetary Slack	Strategic Catalyst, Financial Buffer, Resource for Equity and Conflict Resolution, and Other Functions
Environmental Factors	External Governance & Policies, Internal Management Structure, and Public Perception
One-Time Funds	
Ad-Hoc Decision Making	
Spending Down	
Shadow Budgeting	

#### Primary Theme: Variations in Implementation

The first theme, variations in implementation, was one of the central issues examined in this study as universities continue to operate under a diverse set of financial management policies and procedures that govern the use of budgetary fund balances.

For years, public universities have argued that state policy restrictions limit their ability to compete with their private peers, particularly with a competitive landscape that increasingly rewards organizations that are agile and responsive to market demands and opportunities. Numerous public universities have made news headlines over the past decade as these institutions have pursued greater flexibility and autonomy from state regulations (e.g. Colorado, Wisconsin,

Virginia, Florida, Georgia, etc.). One common request by public universities to state legislators is for greater flexibility to carry-forward unspent state funds across fiscal periods. University leaders argue that the complexity of the 21<sup>st</sup> century university requires agility and flexibility in their operations; therefore, institutions should not be limited by a funding model that requires all budgeted transactions to occur exactly as predicted within a narrow 12-month fiscal period. In response to these demands, state legislators have extended a varied level of operational autonomy for their public universities, typically on an incremental basis and with accountability demands that have to be met in order for benefits to continue.

During the study's interviews, the impact of state policy restrictions on operations was a recurring topic of frustration and concern for administrators. The administrators interviewed were consistently of the mindset that more operational freedom was overdue and necessary in order to compete in the marketplace of American higher education. Moreover, they believed that state legislators' were reluctant to grant additional operational flexibility to the public universities not from a lack of understanding of the benefits but rather a reluctance to lose control. As one administrator stated during an interview:

There's not a one of those legislators that would suggest this was a good way to run their own private business. Not a one! Yet, when they get elected to the legislature they become a political animal so it becomes all about control. It's about their unwillingness to move away from this idea that we can carry forward funds. It's about the legislative control that they believe that gives them over your ability to make discretionary spending decisions.

Despite this underlying level of frustration with state policy restrictions, the three public universities in this study have each made incremental progress over the past decade in terms of their ability to carry forward unspent state funds across fiscal periods. Interestingly, the various approaches to implementing policies and procedures to guide the use of fund balances still vary widely between the three public universities in this study. In other words, increased flexibility from state regulations did not result in a consistent approach for managing these funds. To that end, the following three sections examine the policy environments at each of the three universities as it relates to the use of fund balances.

#### *Hoover University*

The first institution examined in this study, Hoover University, is a public research university governed by a statewide board of trustees. The board of trustees also governs the other public universities in the state. The state's legislature appropriates state funds to the board of trustees, which in turn, are allocated to the public universities based on a funding formula model that is primarily driven by student credit hour production. State funding at Hoover University is recognized as only the state appropriated funds allocated to the public universities from state tax revenue. Institutional revenue from tuition and research grants and contracts are not recognized as state funds.

As it relates specifically to budgetary fund balances, the board of trustees' policy requires that each public university return unspent state funds to the state treasury at the end of each fiscal year. Hoover's institutional policy allows for all



unspent, non-state funds, including tuition revenue, indirect cost recovery funds, and private gifts to carry-forward across fiscal periods. In terms of internal allocation, the university allows schools and departments (i.e. unit-level) to carry-forward 100% of the fund balances in their operational budget to the next fiscal year. For instance, if an administrative unit has a fund balance in contractual services at the end of the fiscal year, then that particular unit will carry-forward 100% of those unspent funds as a one-time budget increase in the ensuing year. In some cases, fund balances are categorized as restricted if the fund balance exists as a result of expenses that are committed but not spent in the fiscal year as anticipated. Unreserved fund balances in the operating budget are funds that have not been committed or spent, therefore these funds carry-forward within the budget of the originating school, college, or non-academic division as discretionary one-time funds for the next fiscal year. This delineation between restricted and unreserved fund balances hold true for the other two universities in this study as well.

Another significant contributor to annual fund balances at Hoover University is unspent (lapsed) salary funds. Lapsed salary funds can carry-forward but Hoover's institutional policy requires that these funds be distributed at the end of the fiscal year using an internal allocation formula. In general, lapsed salary funds include the personnel expenses (salary and fringe benefits) associated with salaried employees of the university. Lapsed salary funds typically result from a position which is vacant for all or part of the fiscal year, a

permanent change in salary rate which is not effective for the entire year, or employment at a temporary rate that is lower than the amount budgeted.

According to Hoover University policy, lapsed salary funds are allocated at the end of the fiscal year as follows:

- 25% is allocated to the originating school, college, or non-academic division, to be distributed at the dean's or non-academic vice president's discretion, with preference given to the originating department or unit. These funds are used by the department as temporary budget increases for operating expenses or equipment acquisitions.
- 50% is placed in the university's special reserve fund for equipment replacements and upgrades. This reserve fund is available to all functions eligible for funding through the general education budget, to replace or upgrade equipment of all types. These funds are under the supervision of the Provost's Office.
- 25% is added to the unallocated fund balance in the general fund until the unallocated fund balance is the same proportion to the general education budget as it was on July 1, 1995. Any excess amounts should be placed in the equipment replacement reserve.

Furthermore, any lapsed salary funds at Hoover University associated with wages for hourly employees and graduate student stipends are allocated at the end of the fiscal year to the originating department as a one-time increase to their budget in the ensuing year. Also, released salary funds, which result from a position where external grant funds replace a portion of the university funded

salary, are allocated at 100% at the fiscal year end. Released salary funds are allocated as one-time funds for operational expenses to the originating school, college, or non-academic division, which are then distributed at the dean's or non-academic vice president's discretion.

Finally, three additional observations related to Hoover's carry-forward policy are worth noting. First, Hoover University is required by board policy to receive approval with any budget revisions that occur during the year. The significance of this reporting requirement is that it requires administrators to justify the reallocation of fund balances during the year to Hoover's budget office and the board of trustees. I discuss later in this chapter the significance of this requirement to receive approval with mid-year budget revisions, particularly as it relates to the reallocation of fund balances before the end of the fiscal year period.

The next additional observation at Hoover to mention is the role that carry forward balances serve as the primary source of funds for the university's reserves and contingency accounts. The university is able to fund and replenish reserve accounts using carry forward balances, which in turn, are imbedded into the next year's budget to buffer the university from unforeseen expenses as well as to support ongoing building maintenance and repairs costs.

Third, the institution lacked a board policy on carry-forward funds. Hoover's board policy addresses that all state appropriated funds are to be returned at the end of the fiscal year as directed by state law but the specific use of carry-forward balances is not mentioned. Since there is no specific policy by

the board of trustees on non-state funds, Hoover University developed an institutional policy to direct the use of fund balances under the assumption that the university would always spend state appropriated dollars within a given fiscal year. In other words, the university spends state funds first before other institutional funds such as tuition revenue and indirect cost recovery funds in order to justify their institutional policy that grants the flexibility for non-state funds to carry forward in the budget. It is important to note that Hoover's state appropriated funds represents less than 20% of its total revenue; therefore, the university is in a better position to justify such an approach with balances of non-state funds as opposed to other state institutions with a greater percentage of their revenue coming from the state.

#### *Miller University*

The second institution, Miller University, is a public research university governed by a statewide board of trustees that oversees all public colleges and universities in the state. Similar to Hoover University, the board of trustees allocates state funds using a funding formula model based primarily on student credit hours generated. State funds are recognized as state appropriated funds, tuition revenue, indirect cost recovery funds, and revenue generated by institutional fees and goods and services. Private funding received by Miller University is not recognized as state funds.

Until recently, all public agencies in the state were required to return unspent state funds to the state treasury at the end of the fiscal year. In 2003, the state adopted legislation that permitted Miller University and other state

colleges and universities to carry forward unspent continuing education revenues, technology fee revenues and indirect cost revenues. In 2008, state legislators amended this legislation to allow universities up to 3% of tuition revenues to be carried forward as well. This legislative amendment also extended the original sunset clause set to repeal the bill from the end of FY 2010 to the end of FY 2013.

Despite the increased flexibility from the state, Miller's board of trustees followed this state amendment by stipulating that universities and its schools limit carry-forward balances to the first 90 days of the next fiscal year. One senior administrator explained this decision as a way for the board of trustees to limit the perception risks associated with showing a surplus, particularly during a time when legislators were trying to find more ways to impose budget cuts

At the unit-level, schools and non-academic departments are allowed to carry-forward up to 3% of their operational budgets since the original source of budgetary funds allocated by central administration to the schools and departments is not distinguishable (i.e. state appropriations versus tuition revenue). It is important to note that schools and non-academic departments with a fund balance at the end of the fiscal year are not automatically provided access to these funds. Instead, schools and non-academic departments are required to submit proposals to the provost and chief financial officer to justify how they will use carry-forward funds for one-time purposes. In recent years, the senior leadership of the university has aligned the use of carry-forward funds on the most pressing operational needs of the university. This centralized proposal

process and alignment with strategic priorities is discussed in further detail later in this chapter.

In terms of the budgeting process, Miller University receives board approval on their annual budget, which consists of estimates made prior to the actual fiscal period. As conditions change, the university is allowed to make periodic revisions to their budget. According to university policy, budget amendments are prepared by university departments and submitted to the budget office after approval by the appropriate vice president. Miller does not restrict unit-level administrators from revising their budget during the year in terms of how they spend their annual budget funds. However, a budget revision at the unit-level that requires a budget increase is submitted to Hoover's budget office, who in turn, submits a quarterly report to the board office summarizing budget amendments. Board approval is only necessary when budget revisions exceed a million dollars. The following excerpt from Board policy provides additional detail on when the university should seek approval of a budget revision from the board office or board of trustees:

Institutions are authorized to amend their annual operating budgets without prior approval of the board or trustees except for any amendment that exceeds \$1,000,000 and involves state general fund appropriations, auxiliary enterprise funds or student activity funds shall be submitted to the board of trustees for approval. Prior approval by the board of trustees shall not be required for any budget amendment involving special purpose state funds, non-state funds, or internal revenue sources.

Institutions shall be required to report quarterly on all budget amendments to the board office's chief fiscal officer under procedures developed by his/her staff. The board office reserves the right to require prior approval of the budget amendments at any public institution that he/she determines has failed to manage its

budget within available resources or in a manner consistent with board of trustees' goals and priorities. Under these circumstances, the board office may request the institution to develop a remediation plan to assure more appropriate decisions on future budget changes.

Another important and relevant component of Miller's annual budgeting process is their use of contingency funds. Each year, the university includes appropriate reserves for contingencies in the budget based on a listing of probable needs and the likelihood of developing needs within a fiscal year. According to institutional policy, vice presidents, deans, and directors can request for funds from the university's central contingency funds to support "changes in scope of ongoing programs or for support of new programs". University guidelines on the use of contingency funds describe the proposal process as follows:

At the appropriate time in the budget cycle, (usually quarterly) the associate deans will request input from each subordinate budgetary unit regarding unit needs which might be served by a one-time allocation from contingency funds. As these funds will be allocated on a university-wide basis, unit considerations will be guided by well-developed statements of priority justification. The dean and director may use contingency funds to initiate priority programs.

It is important to note that contingency funds at Miller University are one-time funds that the university sets aside at the beginning of each fiscal period as reserves to protect the university from unforeseen circumstances (i.e. rainy day). Since these funds are lapsable, university administrators at Miller are continually monitoring the reserve accounts and other budgetary fund balances that must be reallocated and spent before the end of the fiscal year.

So why are contingency and reserve funds relevant to this study? The first reason is that unspent reserves, like other budget accounts, create a fund balance, so an institution's carry-forward policy and fiscal year constraints influence how an institution manages risks with reserve funds. The second reason contingency and reserve funds are relevant is that one-time, carry-forward balances are often the source for establishing and replenishing these funds the following year for institutions with the ability to carry forward balances.

Finally, because of Miller's carry-forward restrictions, the university has a detailed protocol for vice presidents, deans, and department heads instructing them on the various deadlines that exist to encumber funds for certain services such as physical plant projects, printing services, and information technology as the end of the fiscal year approaches. This also marks the time when proposals are submitted to the provost and chief financial officer for use of university carry forward balances and unspent contingency funds. As noted previously, these guidelines and proposal requests are necessary since budget funds allocated for particular projects and purchases are required to be expended before the end of the fiscal year. While the 90-day carry-forward extension is helpful, central administrators at Miller still have a limited timeframe to execute all planned financial transaction within the fiscal year period.

### *Doyle University*

The third institution, Doyle University, is a public research university that is governed by a single board of trustees. According to the state constitution, because public institutions of higher education are state agencies, all of Doyle's



funds are revenues of the state that must be appropriated by the legislature, including tuition revenue, grant and contract funds, and state appropriated tax dollars. Private funds raised through affiliated foundations, however, are not controlled by the state.

Historically, the state has required Doyle University to return all state funds to the state treasury at the end of the fiscal year. In 2005, Doyle University, along with other public universities in the state, received increased autonomy from state regulations including the flexibility to carry forward all unspent state funds at the end of the fiscal year.

This decision by the state legislature did not occur overnight. To the contrary, the legislative action in 2005 came after a decade of discussions and failed attempts by the public universities to negotiate increased operational autonomy with the state legislature. Nevertheless, each of the administrators interviewed at Doyle spoke positively about how the recent increase in operational autonomy has benefited their institution. One administrator remarked on the progress the university has made but acknowledged that progress was a result of the university's ability to build trust with state legislators.

I would say that we've made great progress in the times that I've seen. We were once in a period when we were a governmental agency so everything we had at the end of June went back to the state. Then we went through a period when we are able to say "may I keep my [fund] balance" and the state might allow you keep the balance. Then we got to where we are today where by state policy in the appropriation act, institutions can carry forward balances.

Doyle's financial policies do not provide specific details on the use of carry-forward balances beyond the recognition that vice presidents and deans have the discretion to allocate budgetary fund balances from their reporting units as they deem necessary. At Doyle, 100% of budgetary fund balances, including lapsed salary funds, are returned to the vice presidents and deans, who oversee multiple major budgeting units (i.e. MBU's). According to one Doyle administrator familiar with the budgeting process, vice presidents and deans have the discretion on whether or not to return carry forward balances to the originating office where the funds are being held. In some cases, vice presidents and deans allow their reporting units to automatically keep their carry forward balances; others require an annual proposal to request and justify the use of these funds, while others simply sweep up all fund balances for their own use. One Doyle administrator used this example to explain the process: "If a faculty member leaves in classics then classics does not necessarily get to keep that salary savings. The department can request these funds from the Dean of the school, but it is not guaranteed."

Similar to Miller University, major budgeting units within Doyle are also allowed to revise their budget throughout the year when fund balances become available. When asked whether MBU's have the flexibility to reallocate fund balances before the fiscal year end, one administrator responded:

Yes, we can transfer funds throughout the course of the year without approval. We give MBU's a budget target but we do not tell them how these funds should be spent, including whether funds are used for personnel or non-personnel expenses.

In terms of contingency funds, Doyle University has reserves imbedded in the budget to respond to unforeseen circumstances and to fund operational needs such as building repairs and renewal, however; because these funds carry-forward, university administrators are not looking to reallocate the unspent contingency funds within a particular fiscal period as was the case with Miller University. Instead, contingency funds carry forward across fiscal periods.

### Primary Theme: Functions of Slack

The study's second research question focused on the various roles that budgetary fund balances serves within the three public universities under review. The next three sections of this chapter explore in greater detail the roles that were identified during the campus interviews and subsequent data analysis. A fourth section under this primary theme examines an additional function of fund balances within the university organization that was identified during the data coding process. In sum, the functions are organized in the following sub-themes: 1) Strategic Catalyst; 2) Financial Buffer; 3) Resource for Equity and Conflict Resolution; and 4) Other Functions.

#### *Sub Theme: Strategic Catalyst*

The strategic role of slack, while important, was generally not identified as the highest priority among administrators interviewed. Instead, fund balances were typically allocated on an ad-hoc basis and used to support ongoing operational needs or held as contingency funds for unanticipated organizational costs before being reallocated for strategic purposes. One Doyle administrator

explained her thought process as fund balances become available in her department:

As a manager, you start thinking in the back of your mind about the list of things that you'd like to do if you have any new dollars when someone retires or leaves the institution. You may do something completely different personnel wise or you might do something completely different. That is the opportunity. You should know going in what is going to happen but if not, every time a pot of money comes available then you need to be thinking about the new initiatives you want to invest in.

Interestingly, when interview participants were asked what role fund balances serve in facilitating strategic behavior within the organization, it became apparent that there was not a consistent understanding of what defines strategic versus operational projects and initiatives. As such, the responses relating to the strategic role of budgetary slack depended on how the person being interviewed defined the term strategic.

For instance, administrators at Hoover University gave a wide range of examples describing the strategic use of fund balances. One Hoover administrator described the university's decision to establish a new health insurance program for graduate students – an initiative that this administrator believed was a competitive and strategic necessity for the university:

One case when we had to have some level of flexibility, we created this graduate student health insurance program. This initiative had all kinds of financial unknowns; we didn't know how many students were going to participate. We have no control over the premium other than going out to bid every few years to use the marketplace to get a new quote. So we went into this project sort of estimating [costs]. As time has gone on by, we have found that 700-800 students have participated in the program. We only have so much money centrally to fund this program. So each year, we get a bill from the external insurance vendor, so we have to pay that bill down. So the past few years, we've had to fund the additional

costs for this program with various internal reserve funds. In the past, we would not have had a chance to fund this type of program if we were not able to carry-forward funds.

Another Hoover administrator described the upgrade of the university's telephone system as a strategic use of one-time carry forward funds:

So we had to replace our phone system recently. That initiative started about three years ago, so we took some of our unallocated fund balances to purchase the new system. We are being repaid by the line rates that we charge out to our campus units. So we're taking funds that are really only good for one-time use and convert them in ways that creates a recurring benefit.

A third administrator at Hoover provided an example on the allocation of lapsed salary funds that the university uses to advance the technology resources as an example of how one-time carry forward funds are used for strategic purposes.

We have a [technology advancement] program, which is funded by the [university's] lapsed salary program. The program was established to continue to advance technology on campus. The program upgrades technology for faculty every three years so they have updated computers and software. The program is funded at around \$750,000 each year from lapsed salary funds.

While these examples provided by Hoover's administrators may be justified as strategic efforts, these initiatives were focused primarily on addressing short-term operational needs and there was minimal coordination or interaction between the organizational units to align the use of these funds within a broader organizational framework.

In contrast, administrators at Miller University discussed a centralized process for allocating fund balances to schools and departments. Interestingly, Miller is the university in this study with the least amount of autonomy and flexibility from the state to manage fund balances, yet is the school with the most

centralized process for allocating fund balances for strategic projects and initiatives. Since state regulations require Miller to return unspent state funds at the end of fiscal year or after a 90-day extension, administrators are carefully managing fund balances to ensure these funds are being spent effectively. As such, Miller's schools and departments submit proposals before the end of each fiscal period to the provost and vice presidents requesting the use of fund balances for one-time purposes such as startup funds and equipment purchases. The administrators interviewed at Miller generally had positive remarks about this annual proposal process.

A Miller administrator emphasized the benefit of pooling fund balances in order to make "big purchases":

In the end, however; the carry-forward policy has been very important for us, particularly when we're making big purchases using this payment plan that we make up ourselves as fund balances become available. For instance, the president's initiative is focused on bringing in new talented faculty. This initiative requires significant startup funds in order to bring in the superstar faculty to our campus. Central makes sure that schools understand that [Miller] can do something big for the university by pooling unused funds centrally. So I think they have responded well to that guidance.

Another administrator identified Miller's faculty hiring initiative as a valuable approach for using a central pool of fund balances to advance the university's strategic plans:

We recently started the presidential faculty hiring initiative – so rather than just dolling out money and giving schools full discretion on faculty hires....Instead, the Provost office uses excess funds to hire faculty through a call for proposals efforts that required Deans to submit proposals for new faculty lines with a justification as to how these new positions align with the university strategic plans and current or emerging strengths.

A third administrator at Miller described how the university's annual proposal process for allocating fund balances aligns with specific campus needs:

Colleges will likely have one time funding needs and request for funding from the Provost. For instance, this past year the Provost was focused on funding student centric investments with one-time funds. This past year, the Provost funded projects for improving classroom space like refurbishing classrooms and upgrading technology to enhance the learning environment. The year before [Miller] used one-time money to support research infrastructure improvements.

While Miller's centralized proposal process for carry-forward funds has enhanced the cohesion of strategic investments at the university-level, unit-level budget managers still have the discretion to reallocate fund balances as they deem appropriate throughout the fiscal year. To that end, one administrator at Miller was asked to elaborate on whether they believe that the unit-level decisions to reallocate fund balances were strategically aligned with the university's priorities:

To an extent, yes...We've spent a lot of time over the past 3-4 years developing a new strategic plan to inform deans and vice presidents. I think most of these individuals understand what the top 3-4 of priorities are for the university as they are investing in new opportunities.

Another Miller administrator agreed that the university has an effective process for reallocating fund balances at the school and department level, but said that the planning process that once helped guide these aligned decisions was no longer being implemented:

We had in place a few years ago, a 5 year program planning process and I really thought that was a valuable process. So every college and school had to develop a 5-year program plan that lined up with the university's overall strategic plan, which outlined their long-term resource needs. Throughout the course of the fiscal year

they would use those 5 year program plan to guide the use of those allocated funds. So I think when Deans had to show their progress made each year toward 5 year program plan, I think these program plan did move the university further in a consistent strategic fashion.

Also, when you had a 5 year program plan, every Dean knew they were going to have to go into their budget meeting the following year show the progress they made. I think there was more willingness for a Dean to actually entertain not doing something. You know, getting rid of something. As it relates to strategic planning, I just heard a quote today: A good strategic plan, something rose and something goes. I really like that because we think about strategic planning as what is going to guide where we invest but it should guide what we divest. I think those 5-year program plans helped guide make those types of decisions as well.

Without having that really strong tie between the resource allocation process and strategic planning both at the central level and unit level then I think you lose consistency and cohesion in terms of the use of fund balances. There's no question that at the central level that everything that the President and the CFO are talking about aligns up with the University's strategic plan but I'm not sure how effective we are in connecting those decisions at the unit level, particularly in the use of these fund balances.

Doyle University administrators also addressed how the university aligns the allocation of fund balances with the university's strategic plans; however, decisions on how to spend carry-forward balances were much more decentralized than Miller University. A Doyle administrator described this process further:

In terms of how strategic initiatives are funded, each dean and VPs will have their own operating reserves that they have the authority to use. VPs have a targeted operating reserve budget which means they have that amount every year to allocate on a one-time basis.

Another Doyle administrator said that she is well aware of the university's strategic plans and tries to follow its priorities when making budgetary decisions:



We try to work and take into consideration what the plan is for the university. We take those plans and try to follow the academic direction of the programs and the future direction of the university so we can provide support as necessary. It is important to have these discussions about 5- and 10 year planning horizon. As a part of our budget, we develop a 10-year pro forma that tries to take into account our long-term needs.

Finally, there were two additional observations related directly to the strategic function of slack that are important to mention. The first observation was the use of one-time fund balances to pay for startup packages. Start-up funds are used as a faculty recruitment tool since new faculty members often have unique resource needs such as laboratory space and research equipment. One Miller administrator emphasized that nearly one-third of his fund balances were being applied to startup packages for new faculty.

An interesting aspect of startup funds is that administrators often collaborate in the hiring of new faculty since multiple sources of funds are often required to financially support recruitment packages. As such, the recruitment of new faculty is often processed through the provost office and other central administrators. This collaborative and centralized decision-making process enhances the likelihood that the university is effectively hiring new faculty members in alignment with the university's current teaching and research needs as well as long-term strategic plans.

#### *Sub Theme: Financial Buffer*

A second function of budgetary slack identified in this study was the role that fund balances serve as a financial buffer for unforeseen circumstances.

This particular role was identified by interview participants who served in roles at both the university and school and department level.

At the university-level, central administration allocates some portion of unreserved fund balances from the previous year to reserve accounts (i.e. rainy day fund) to protect against the university's financial risks such as a sudden drop in enrollment levels or unexpected operational cost such as facility repairs and maintenance. Administrators from each of the universities acknowledged having reserve funds imbedded into the budget to manage unknown risks. One chief financial officer interviewed addressed this topic further:

As a CFO, one of your jobs is to manage risks, and you have contingencies that are imbedded into the budget to manage unknown risks, at some point as risks do not come to fruition within that fiscal year, you then have fund balances available to reallocate for other priorities.

For Hoover University, administrators identified numerous contingency funds including an unallocated reserve fund equal to 5-6% of the institutions overall operating budget that served as the university's rainy day fund. This particular reserve account is funded and replenished annually from a portion of the university's lapsed salary funds that accrue each year. Hoover also maintains a reserve account for ongoing operations and maintenance and for major building repairs and renovations. As noted by one Hoover administrator, industry best practices recommends that a university annually allocate 1-3% of the total value of the campus property to building renewal and repair in order to avoid deferred maintenance costs. As such, the university budgets each year as close as possible to the 3% guidance level, however; this administrator explained

that the university has never reached that level due to limited resources and the multitude of ongoing operational needs that arise each the year.

Hoover's risk management approach to unforeseen organization costs is consistent with the other universities in the study as well. For example, Doyle maintains a contingency fund for major repairs and renewals at 3% of the campus property value as well as a three month operating reserve for the overall university. Doyle also encourages a similar level of reserve funds with several of their self- sufficient academic schools and auxiliary units. At Miller, administrators maintain several contingency funds including a \$2M revenue reserve in case enrollment projects are not met and a \$2M general contingency fund that supports unforeseen operational needs throughout the year. One senior administrator at Miller provided an insightful perspective on how the university plans for and uses its general contingency funds:

[Miller University] has a general contingency fund which we utilize for unforeseen expenses. It is just an unallocated balance. We have this fund budgeted in an expense category. We also have revenue reserves. The revenue reserves are what we use to address if we are falling short of what we had projected in terms of tuition revenue. So those are the buffers that we have in place to address unforeseen expense and revenue issues.

So, if we have \$300M of tuition dollars budgeted in revenue, we have an expense line in our budget that is revenue reserves. We are showing it as an expense but it is really not. Our revenue equals our expense but we have a couple lines of expenses that are not necessarily paying people or being directed to a particular expense. So throughout the course of the fiscal year, we are monitoring those reserve funds closely.

The general contingency fund is used for capital improvements, deferred maintenance, or to help with instruction expenses. So if we have more students than expected in a particular area, then we can use these contingency funds to help us add temporary faculty

to ensure that we can deliver the courses we need to deliver. So there are some other expense categories that the contingency fund can help us address. For example, it helps us address start-up needs. If the vice president for research all of sudden needs support to fund a multi-million dollar startup package for a faculty member that we are recruiting then the general contingency is there to provide support.

There are a lot of things outside of the core uncontrollable expenses that are more academic in nature that the general contingency is designed to help us respond to. So that is why we meet every two weeks to monitor the use of these contingency funds to make sure we are allocating funds throughout the year to meet high priority needs while preparing for the unknown.

At the school and department level, administrators at Hoover and Doyle University also manage their own reserve accounts much in the same way as university level administration. For example, one Doyle administrator said that vice presidents will even look for ways to hold back a portion of their departmental budget funds as additional reserves:

When VPs receive funding for their MBUs, they can pull some funds off the top and then the deans will pull some of the top before allocating to units. So all along the way, VPs and Deans are giving a hair cut in order to hold reserves for unknown emergencies and strategic opportunities.

One academic dean at Hoover explained the importance of establishing reserve accounts at the school and department level using a recent example when two international graduate students lost their funding support from their host country so the university used reserves to fund two assistantships for these students:

We had two graduate students in the pharmacy school that came to our university based on support from an agency within the Libyan government. When the Libyan government turmoil started, their funding disappeared. So these two students were sitting here asking themselves where is our funding going to come from. We

were watching this situation closely so when it became apparent that we were going to have to support these students. We felt that we needed to support these students because they have nothing to return to back home to. So, our department made a decision to fund these students with a graduate assistantship with some of our carry forward funds. If we don't have any of this contingency money available then we would have told those students no because of the lack of funding.

Finally, perhaps one of the most significant roles of fund balances as an environmental buffer occurred during the recent economic recession as dramatic declines in state tax revenues led to drastic budget reductions at universities across the nation. Universities utilized carry forward balances and reserve accounts to absorb the budget cuts and protect the institution's academic and operational units. At Hoover, one administrator discussed how reserve accounts protected the core academic operations during the recent economic recession:

Right now, university wide, we [Hoover] are operating with a lot of departments carrying forward a healthy amount of reserves, whether they are coming from overhead, carry-forwards, earnings from summer school profits, and those types of things. The departments are sitting on enough of a safety net as well as the university. When we've faced some of these mid-year budget cuts we have been able to weather them without too much of a problem because of these contingency funds that we've built up. So, as time goes on, we will build those reserve funds back up using fund balances so that we operate with a certain safety net. That is how households operate. You have your checking account and you have this other savings fund to turn to during difficult times.

At Doyle, a finance administrator discussed this role of fund balances as a buffer to the recent budget cuts.

For example, we received a budget cut from the state in May of last year so our general contingency funds help us in the event that we get a budget cut from the state. We want to shield our units from a having major changes in the middle of the fiscal year.

At Miller University, the recent economic recession led to a dramatic reduction in in state appropriated funds, but university administrators were able to leverage available slack resources and implement short-term cost reductions such as employee furloughs and a hiring freeze to absorb the budget cuts.

*Sub Theme: Resource for Equity and Conflict Resolution*

The third primary function of budgetary slack identified in this study was the role that fund balances serve to support equity management within the university organization. As noted in chapter 2, slack helps to mitigate conflict between supervisors and managers, serves as a buffer between interdependent parts of an organization, and reduces political activity as more resources minimize the tension between interdependent units that compete in the resource allocation process (Cyert & March 1963; Pondy 1967; Moch & Pondy, 1977).

While this study did not specifically identify the term conflict resolution during the interview process, administrators at each of the universities acknowledged utilizing fund balances to improve resource equity and to reduce political activity within the organization. At Hoover University, for example, administrators use an internal allocation model to redistribute lapsed salary funds each year for projects and initiatives that are spent at the discretion of the deans and vice presidents. At Miller University, the university's central administration collects all budgetary fund balances centrally before the end of the fiscal year then reallocates these funds using an internal proposal process based on campus needs. Doyle University provides deans and non-academic vice presidents with the authority to reallocate fund balances of any reporting unit as

he or she deems necessary. This centralized approach to reallocating fund balances provides the administrators with the flexibility to “spread the wealth”.

Moreover, at Hoover University, revenue from summer school courses was identified as a source of discretionary, one-time funds that academic administrators use to supplement various departments. While summer school revenue at Hoover may technically be considered budgetary slack in terms of the institution’s capacity to absorb additional enrollment growth, Hoover administrators have likely integrated some portion of these funds within their budget based on historical enrollment trends in the summer months. Nevertheless, these funds are discretionary, one-time funds that are supplemental to an academic unit’s annual budget; therefore, a contributing source for the university’s annual fund balances. One Hoover administrator explained how he uses these one-time funds to support multiple departments within his school regardless of who generated the funding:

This [summer school] revenue is discretionary for us but I don’t think that I would be doing my job well if I didn’t budget some part of that on an ongoing basis. But there is some of that money that becomes discretionary that I often invest at the department level. The departments are teaching courses and generating these dollars. For example, English makes a lot of money because a lot of students take English, Math, and Economics in the summer sessions. But English isn’t doing anything special for receiving that revenue, so I don’t think they deserve all of that money.

I do want to reward them for trying to increase summer enrollment so I will return some money to them. I return to the departments, by in large, about the same mount each year.

So I may return about fifty thousand dollars a year to particular department that they, in turn, use for graduate students. So this is soft money that this department budgets every year for graduate students.

Finally, as it relates to this role of fund balances in minimizing organizational conflict, one administrator at Doyle offered an interesting perspective on the consequences of using discretionary funds in this manner:

Presidents and provosts have to be liked by the faculty and to tell a classics faculty member that we are going to be taking more new money in nanotechnology than we are in classics is a very hard conversation to have. Educators have an amazing ability to think strategically but they don't do a very good job implementing a strategic plan. I think there's a huge difference between the two. It's like knowing the right thing to do but the inability to pull the trigger and make it happen.

This Doyle administrator explained this challenging decision making process not necessarily as a criticism, but rather as recognition that senior administrators will often use discretionary fund balances to mitigate the ongoing risks related to the politics of internal resource allocation decisions before funding a strategic initiative that would result in winners and losers within the organization.

#### *Sub Theme: Other Functions of Slack*

This study identified several important roles that fund balances serve within the university organization. In some cases, the use of fund balances was strategically oriented and in other cases served as an environmental buffer for the unknown. In terms of frequency, however, the role of supporting ongoing operational and maintenance needs for the campus was by far the most prevalent topic identified during the study. In most cases, fund balances served as an operational plug to a hole that was simply left unfilled by university administrators due to resource constraints or other more pressing operational



needs. Deferred maintenance is one example of a major ongoing expense for universities that continues to have unmet funding needs.

To that end, I would characterize a fourth primary function of fund balances within the three public universities in this study as an ‘operational plug’ for ongoing operational needs. These operational expenses are known but they are often deferred by administrators until the funding becomes available. Beyond deferred maintenance expenses, other ongoing, operational needs identified include new facilities, classroom space, equipment, travel support, and temporary faculty and staff. These operational needs are not necessarily strategic or operational uses of fund balances; instead they are funds that are used to support the non-essential, day-to-day operations of the university.

In terms of this function as an operational plug, an administrator at Miller explained how a portion of the university’s general contingency fund was often reallocated to support various operational needs before the end of the fiscal year, particularly as certain risks were mitigated such as enrollment levels:

The general contingency fund is also used for capital improvements, deferred maintenance, or to help instruction expenses. So if we have more students than expected in a particular area, then we can use these contingency funds to help us add temporary faculty to ensure that we can deliver the courses we need to deliver.

A Hoover administrator interviewed said that most of his carry-forward balances were used to support equipment needs and travel since his operational budget has not increased in over ten years.

We have to invest these funds as one-time funds, which is why we use carry forwards to purchase equipment and support travel expenses. We use carry-forwards to offset the fact that our

operating budgets have not increased substantially in nearly 12 years. We haven't had an increase in travel funds in decades despite having significant growth in our number of faculty so the availability of one-time funds is crucial.

Another Hoover administrator said that one-time funds were often used in combination with private funds to pay for their capital construction projects on campus.

The vast majority of our capital improvement projects on campus are supported by donors and through our ability to utilize one-time funds using unreserved fund balances. For example, with all of our recent growth, we need new space for our faculty, so we're going to use unreserved fund balances to fund new construction projects to meet those needs.

A third administrator at Hoover administrator also emphasized the use carry forward funds to purchase equipment:

Equipment money that is carried forward each year can be significant at the department level but most of this carry-forward money is being saved to purchase or replace equipment in the future.

If you take the science department for instance, and a faculty member comes to me and says I need research equipment and it will costs \$700k. That is a lot of money but we have about \$300k in carry-forwards available that we could apply towards the purchase of this equipment. So, I hold this \$300k fund balance in my budget and plan to save over the next year as fund balances become available to purchase this equipment.

### Primary Theme - Environmental Factors

The study's third primary research question focused on the environmental factors that influence the use of fund balances within a public research university.

The next three sections of this chapter examine each of the prevailing environmental factors that were identified during the study, including: external

governance and policies; internal management structure; and the public perception risks of fund balances. Several of these themes overlap but are still important to examine on individual terms.

*Sub Theme: External Governance & Policies*

The first environmental factor identified in this study related to the influence of the university's external governance and policy restrictions. Throughout the study, a recurring topic of discussion by administrators related to how policies of the state legislature and board of trustees controlled and influenced the use of unspent state funds, regardless of the institution's current level of operational autonomy from state control.

One administrator, for example, explained how their university was hindered by state regulations:

How, with our restraints in terms of budgets, approvals, and finances, with so many hands in the cookie jar, do we manage the risks of the unknown from a financial perspective and how do we deal with meeting or not meeting those expectations? At the most basic level, we are undeniably hindered and over controlled with budgetary restrictions from our board and state legislators when it comes to our general operating funds. It's the only fund that is controlled at that level.

Interestingly, despite this concern over state policy restrictions, this same administrator recognized that their university should be pleased with the level of autonomy their institution has compared to public university in other states:

Some states are so restrictive that they have to appropriate every single penny so if you have tuition in excess of what you estimated then you can't spend it. Thank goodness we have flexibility compared to some other states.

For Miller University, who only recently received increased autonomy from the state to carry forward fund balances; one administrator explained the importance of amending this state policy by removing the sunset clause in the legislation:

The legislation that has given us that capacity to carry forward funds for 90 days has a sunset so we don't have that flexibility in perpetuity. The sunset on that legislation actually ends in 2 years. The original legislation was for 4 years and then extended two years. So our ultimate objective is to have that sunset provision removed altogether so that we can have this carry forward flexibility in perpetuity.

When asked whether Miller would be successful in negotiating these terms with state legislators, the administrator responded:

We will have those conversations in hopes that we've finally proven that we're trustworthy. How successful will be, I don't know. We couldn't have managed the past several years without any carry-forward balance flexibility. The atmosphere would have been so different.

At Doyle University, the topic of discussion on state regulations was surprisingly similar at Miller and Hoover despite the significant level of autonomy Doyle has received in the past decade from the state. In fact, there were several observations identified during the interviews related to this issue with Doyle administrators. The first was the notion that, yes, Doyle has increased autonomy from state oversight, but there is still no assurance that legislators will not renege on their commitment if the state's economic situation became dire enough, particularly if Doyle was showing a significant amount of reserve funds in their financial statements. Consequently, Doyle administrators were sensitive to the perception risks of showing too much cash reserves when other state agencies

were experiencing significant budget reductions and staff layoffs. I discuss this issue on perception risk in the next section of this chapter.

A second issue identified at Doyle was related to a state law which states, “Institutions can carry balances only as necessary to cover the cost of operations.” One administrator said this law may appear straightforward but “there’s been an academic debate as to whether the routine and major repairs of buildings are normal operating costs.” This administrator said that the university takes the position that these are routine operating costs, “therefore as long as university is not building balances relative to that then we should be okay.”

Thirdly, given this ongoing debate on operational autonomy between public universities and state governing bodies, I found one recent development in Doyle’s state particularly interesting. According to a Doyle administrator, a recent commission established by the Governor inquired as to whether the state’s public higher education system should have a rainy day fund similar to the state to add dollars to in good years and draw from in bad years. This particular recommendation by the Governor’s commission was a concern for this administrator for several reasons:

That puts up a lot of red flags. Does that mean the state is going to be contributing to this fund? Does it mean the state is going to take money away from each institution’s tuition and put in a state pool and then decide how it is going to be allocated? So, there are all kinds of bad things that could happen.

This Doyle administrator explained that he and university leaders from other state universities subsequently met with the Governor’s commission and explained that this is not something the state should do. He said the university

leaders argued that the state ought to encourage institutions to internally create the appropriate reserves that will allow them to function in good and bad times and that university's should leverage budgetary fund balances rather than creating a new statewide rainy day fund. This administrator further explained: "They [the state] ought to recognize that the boards [of trustees] in our state have a responsibility to run this place in a business like way, and they ought to be able to build the necessary reserves to do it."

At the time of this study, the Governor had not decided on whether a rainy day fund should be established for the state's higher education system. This Doyle administrator, however, felt the Governor would take the position of having each university manage their own reserve funds. Nevertheless, the findings of the Governor's commission further supports the notion that carry forward balances serve an important role as a buffer to economic uncertainty, particularly when a university has autonomy to manage these funds as necessary.

#### *Sub Theme: Internal Management Structure*

The next environmental factor identified in the study related to the university's internal management structure. Throughout the interviews there was a clear divide between central and unit-level administrators in terms of their perspectives on how allocation decisions were made with fund balances. For central administrators, there was value associated with having control over a centralized process for aligning resources and effectively managing the use of discretionary, one-time funds. At Miller University, for example, the three senior vice presidents meet on an ongoing basis to review budget issues:

So in terms of the entire budget system process, you have at the central level the president and the 3 senior vice presidents who are making the major budgeting decisions for the university. In terms of what level cut we might have to impose. Every other week the budget office meets with the senior vice chancellor and the Provost updating them on budget issues – constantly updating them on revenue projections, uncontrollable expenses, and how that is impacting our overall balance.

For Hoover University, lapsed salary funds are reallocated to senior level administrators, who then supervise or have full discretion on how these funds are spent. This is significant given that personnel expenses often exceed 70% of a university's overall budget. At Miller University, the use of all fund balances are controlled centrally, however; as detailed earlier in this study, schools and departments are able to submit proposals to justify the use of carry forward balances up to 90 days into the next fiscal period. At Doyle University, deans and vice presidents have the discretion on how carry forward balances are handled with each of their reporting units. In other words, some deans and vice presidents will allow carry forward balances to go back to the originating unit, some will allow the carry forward balances to be returned to the units following a justification proposal, and others will hold all the carry forward in their reserves for their own discretion.

At the school and departmental level, the centralized control by the top senior administrators was often perceived with skepticism by deans and directors that were interviewed in this study. One academic dean further explained this skepticism on centralized budgeting decisions:

Any tuition revenue over what is paid for the faculty is discretionary revenue that is divided up between the schools and centrally. The way that money is divided up internally is a secret. The money

received goes into this black box and out the other comes some formula. If you probe this black box, you will not get any information. I'm pretty good with numbers but I can't any information. All I know is the money that we receive. I walk in and they hand me money and say here is how much money you've made so I say "thanks".

Consequently, due to control issues and limited transparency on decisions being made by the senior administrators (i.e. domain coalition), the presence of the principal-agency conflict may result in unit-level managers placing their own needs before the needs of the university. For example, one senior administrator at Doyle acknowledged that this internal dynamic may incentivize unit-level managers to reallocate fund balances during the year through cost transfers, budget revisions, or even through an increase in the level of spending during the last quarter of the fiscal year to ensure that all funds are spent under their control:

Now MBU's can carry-forward state funds, however; we are not seeing any improvement at the department level. The Schools have not continued these practices down to the department levels. The departments are still incentivized to issue cost transfers at the end of the fiscal year because the Dean's office are still taking back their carry-forward balances. So, we didn't help influence the practice at the department level. The Dean's office need one time money to fund start-up packages for new hires so there's good reason for the Dean's office to create reserves but it did not stop the incentive for departments to issue cost transfers at the end of the fiscal year end in order to use up the money they received from their Deans. My hope for this practice to end did not end with this flexibility to carry-forward state funds at the institutional level because departments are still incentivized to use all of their funds.

#### *Sub Theme: Public Perception*

The next environmental factor identified in this study relates to the negative perception that excess fund balances may have with external



stakeholders particularly state legislators who want to know that state funds are being used prudently. The significance of this political dynamic with state funding is that administrators at public universities often feel compelled to minimize the perception that the universities are financially secure or in possession of a large amount of reserves. As such, public universities, not unlike other state agencies, often lobby with the external message that the university needs more state funds in order to sustain their current operations and to pursue long-term strategic goals. Given the current economic recession, several administrators interviewed in this study were particularly sensitive to the perception risk of showing excessive fund balances and reserves during a time that legislators were looking for additional ways to cut the state budget. One administrator explained how this issue of excess fund balances was brought up several years earlier by state legislators:

At some point around 2003, the legislators asked for all cash balances and investments from every public university in the state. It was in preparation for their appropriation cutting session that they were about to go through. So they were explicitly going down that path if you've got cash and been a good manager of your resources, then we are going to punish you for it.

This ongoing conflict between legislators and university leadership is interesting in that legislators are looking for ways to cover their state's budget deficit, so any excess or surplus funds available at state agencies become a target for scrutiny. On the other hand, administrators at universities are focused on managing the financial complexities and organization risks of a major research university using these reserves and other contingency funds. Several

administrators interviewed characterized this situation as “a double edge sword” for public universities.

Another interesting and somewhat ironic observation identified at each of the universities was the fact that fund balances were being influenced not only by the perception risk associated with state legislators but also with board of trustees and internal management within each university.

At the board level, one administrator explained how members of the board staff had visited their campus several years before and raised caution to their senior administrators over the university’s “excessive amount of unreserved cash balances.” This statement by the board of trustees was troubling for this administration given the recognition of how important these funds are to support ongoing and unanticipated operational expenses. One administrator explained this concern further:

It was clear from those comments, that the [board] was not pleased in unreserved cash balances at our institution. What the [board staff] did not realize was that a major portion of those funds were allocated for repairs and renovations for our campus.

This administrator further explained that these one-time fund balances are critical for the university since their state does not appropriate funds for capital construction projects or building repairs and renovations.

From the board and legislative perspective, they see it as, you don’t need any funding. These are funds that you had for operations but you did not need them. The reality is that these funds were generated from some of our main funding sources that we have purposely allocated to repairs, renovations, and sometimes construction because there is no legislative appropriation for capital or for repairs and renovations in our state.

As mentioned earlier in this chapter, Miller University's board of trustees decided to limit their public colleges and universities to only carry forward fund balances for up to 90 days into the next fiscal period due to the external perception risk if the university showed excess surplus funds in their financial statements. A financial administrator at Miller explained this board decision further:

The 90-day extension is something that we have done at the university level for the departments based on some concerns that the board [of trustees] have expressed to us. [Showing a surplus?] Exactly.

[So it's like a double edge sword?] Yes, it absolutely is. But we have to strike a balance because if you are carrying forward these large balances and if I'm a legislator then I'm saying then obviously you have more resources than you really need. So you have to strike that balance.

At Doyle University, the external perception risk was also a concern despite the university's increased operational autonomy from state control. When asked how Doyle manages the perception risk of have excess reserves, one administrator explained how state legislators or board members may even view his reserve funds within their auxiliary units as an additional source of contingency funds for the university during difficult economic times:

It is always difficult to manage perception regarding our reserve funds. The university, board, and state expect us to fund all of our programs, and then we have to have reserves. We're undergoing a \$200M build out of new housing. There's not a penny of state money going into that. So we are pumping in our cash reserves and borrowing to fund this project. Do I worry sometimes when I look at our cash balances? Sure. But, you have those concerns, especially in the type of the environment that you working in with the political aspects of it, so there's always a risk. But if you are going to do what you have to do then you have to generate those reserves. I think as long as our board has set some of those

policies then I think it gives us some credence in saying that we need to put that money away. But if we start falling on some severe times and the rest of the institution is struggling then I'm sure there could be times where they'll be asking whether some of these funds could be used to support the institution's mission. But that hasn't happen.

One particular reason Doyle administrators remain cautious of showing fund balances and operating reserves is due to the state's decision during the recent recession to take back fifty percent of the state's community college system's reserves. This decision by legislators weakened the trust level for several of the administrators that I interviewed with at Doyle. As one Doyle administrator explained:

Maybe, if we can trust the state? We have the ability [to carry forward balances] but when bad times hit, the state went and took funds from some of the institutions. We can't trust them. We can't trust the system. One [legislative assembly] can change rules that a previous assembly established. So as long as there is any thought that we could lose the money we are going to continue to be cautious. We try to manage in a smart way, which is why we don't let the schools just spend down balances at the fiscal year end. Internally, we let the schools carry forward their funding to discourage silly spending and this 'Christmas in June' mentality.

Another Doyle administrator added that he feels fairly confident that the state won't interfere with the university's reserves:

The only catch in our state is that what people are afraid of is that if you have 5 or 10 million in the balance, which for a \$2.2B operation is not unreasonable, will the state, when it gets into trouble, come in there and take it even though they said we can carry forward balances. So you have a trust factor that is always important. We feel very confident with the auxiliary enterprises. We feel, on a scale 1-10, a 6 or 7 that they are not going to mess with our carry forward balances. We have been increasingly carrying large balances. We will squeal like stuck pigs if they start coming after those funds.

Regardless of the level of autonomy the universities in this study possess with carry forward balances, administrators at Doyle, Miller, and Hoover University all remained cautious of the state government's perception of these surplus funds.

This perception risk associated with showing excess fund balances also holds true within the organization at the unit-level of these universities as well. For instance, at Miller University, one administrator explained how unit-level leadership was diligent in reallocating fund balances throughout the year to avoid the risk of losing their carry forwards to central administration's discretion during the fiscal year end proposal process.

One unit-level administrator interviewed during the study said that he recently received push back on a funding request to central administration because he was holding several hundred thousand dollars in carry forward account at the time he was requesting more money. This administrator explained that he was holding these carry forward funds at the time because he was saving up to purchase an expensive piece of research equipment for several faculty members in his academic department. Consequently, this administrator said that he was increasingly sensitive to the perception risk associated with having large carry forward balances, particularly at a time when he is requesting additional funds from central administration:

There comes the danger though because I'm carrying forward \$300k so the Provost is going to write me and say "how are you asking for me for money when you have this money in your carry-forward account." I respond that we are trying to save money for this equipment which is fine with the Provost but this gives you an idea of how fund balances can be perceived.

Finally, at Doyle University, deans and vice presidents have the discretion as to how they manage fund balances with their reporting organizational units. As such, unit-level managers recognize that excess fund balances may influence the year-end decisions with supervisors when requesting additional budgetary funds. Consequently, unit-level managers are incentivized to manage this risk by reallocating available funds before the end of the fiscal year. The issue of mid-year budget revisions and cost transfers is explored further in a subsequent section of this chapter.

#### Primary Theme - One-Time Funds

The next primary theme identified in this study was related to the role of fund balances as one-time funds. Throughout the study, administrators consistently emphasized the importance of recognizing fund balances as one-time funds. The purpose for the emphasis was to recognize that fund balances should not be spent on expenses that are recurring in the budget such as personnel costs. Instead, administrators maintained the importance of using one-time funds on operational expenses such as equipment, travel, faculty start-up packages, building repairs and renovations, and at times on temporary personnel.

One Doyle administrator explained this issue of recognizing fund balances as strictly one-time dollars in greater detail:

What one has to be sure they are doing in those cases is, in fact, using those funds for one time purposes. And not, it is all too often that the risk you often encounter is to use those one time monies to start up something that has ongoing expenses.

I think one has to be real careful managing one time balances to be sure people are focused on the fact that, yeah, we have all this money today, it ought to be used to pay down our debt and to buy this piece of equipment but it should not be used to hire a new staff member. It has not been an enormous problem for us because we have controlled a lot of that centrally and we have been very careful not to fall into that trap.

This is not a perfect science. Certainly there are cases where we made investments with one-time funds then had to backfill behind it. It's a formula for disaster if it happens too often.

Several administrators described creative ways in which they have used one-time funds to free up ongoing revenue streams. As mentioned earlier in this chapter, one administrator used one-time funds to invest in a new phone system for the university. Individuals were then charged a fee for this upgraded phone service, which in turn, created a recurring revenue source once the initial capital investment was paid off. Another administrator explained how their university occasionally requested approval from the board of trustees to pay off a recurring debt expense using one-time fund balances.

Beyond the emphasis of using fund balances for one-time purposes, administrators in the study also discussed the primary sources of these one-time funds. An administrator at Miller University explained that there were a few major sources that contributed to the creation of fund balances at their university:

What is really going to contribute to the fund balances centrally are going to be your bigger pieces such as personnel, revenue, and your major uncontrollable expenses such as utilities and fringe benefits. Those are the things that are going to contribute to the movement of fund balances in the general budget.

The utility expenses mentioned above are a form of recoverable slack if the university is able to reduce utility costs through an increase in efficiency measures within the organization. Moreover, the various revenue sources which

create discretionary fund balances for the university may be considered a form of potential slack. As discussed in chapter one, potential slack is identified as the future resources or revenue streams that can be generated by the university through external sources.

Two additional sources of discretionary revenue identified in this study were summer school revenue and graduate student application fees. These two revenue sources could be considered potential slack if these funds became available as a result of the university more effectively using its existing resources. Otherwise, these funds would simply be discretionary, one-time dollars generated from institutional services and fees. In the case of graduate school application fees, financial slack may be present if the number of applications was increased due to the university shifting its approach to marketing certain graduate programs.

One Hoover administrator, for example, shared a time when technology enabled their department to more effectively utilize their revenue from application fees by shifting to an online application form.

Another important source of discretionary funds is our application fees for graduate school. We've always had application fees, but in the past, these funds were just barely enough to cover the printing costs for the application materials. When we went electronic with our application forms and then after we increased the application fee, we were able to generate more money through self-generated application fees, which were able to carry-forward. So we were able to plan things with these funds.

Moreover, another Hoover administrator explained how summer school revenue serves an important source of discretionary one-time funds for their school:



For instance, summer school revenue is one time funds that is dependable. Our college gets a cut of the tuition revenue that we receive for teaching certain courses in the summer. We pay the faculty that teach those courses and then we receive a portion of the additional revenue from each course.

In this example, these one-time funds are not a product of budgetary slack unless the school's administration was able to increase summer school revenue by requiring that existing faculty teach more summer classes, by increasing class sizes, or more effectively recruiting students to fill all the available seats in a particular class.

During the interview discussions on the term one-time funds, administrators were asked how they balance the use of these funds between the operating budget and reserve funds for unforeseen expenses. Several administrators acknowledged that this was a challenge for them but it was a complexity that they spend a considerable amount of time assessing to ensure that effective decisions were being made.

At Doyle University, for example, one department had a significant amount of fund balances that had accrued over time. This department began to use these one-time funds to pay for recurring expenses so central administration had to step in to help their department rebalance their budget without using their carry-forward balance.

Sometimes the balance between these funds is a challenge. This happens more at the lower level. For example, [a particular office] at one point had very large carry-forwards. They were using carry forwards to fund ongoing salaries so they could never submit a balanced budget. They had such a large carry forward fund that they felt comfortable submitting an unbalanced budget. We met with them over a series of meetings and said this just doesn't make sense. We asked them to give us their carry forward funds and we

would give them a base budget increase because we need to right size your budget instead of having this unbalanced situation. We try to look out for those situations. We try to encourage units to not use one-time funds to cover ongoing costs.

Finally, one additional observation on the use of one-time funds mentioned during the interviews related to the concern that several administrators had with the university's senior leadership in using one-time funds effectively. More specifically, one administrator discussed the challenge that his President and Provost had in determining how fund balances should be allocated for immediate versus long-term operational needs:

One-time funds are created by continuing revenue streams. It's hard to have this conversation with a Provost and President because they live in the here and now and their preference is to put every available resource on the ground into operations for classrooms and faculty. Things like a waste water treatment facility is not on anyone's list but if you let that facility deteriorate or if you let us grow beyond its capacity then everyone is going to want us to take care of it.

Another administrator at Doyle had a similar perspective but focused more specifically on the short-term perspectives of academic deans, who are often willing to make decisions with one-time funds without regard to the long-term financial implications to the university.

Deans, at most institutions, have horizons that are 5 years in duration and so they will be inclined to think in 5 year horizons and not 25 year horizons. Can I get a new building built while I'm here? Can I get a new faculty member while I'm here? I only have one-time money which will at least get him here then I can figure out how to pay for him long-term. Being cognizant of those issues and trying to watch for is what seasoned, street-smart budgeters are inclined to do.

## Primary Theme – Ad Hoc Decision Making

The next theme identified in this study related to the tendency for administrators to reallocate fund balances on an ad hoc basis. Administrators in the study identified several contributing factors for this ad-hoc approach. First, a significant portion of a university's budget is directly related to personnel expenses, which in turn, results in lapsed salary funds serving as a primary source of a university's fund balance at the end of each year. The challenge, however, is the difficulty in knowing when an employee will be leaving the university. This uncertain employment timeline limits an administrator's ability to integrate lapsed salary funds into their long-term plans. As one Miller administrator described: "the allocation of one-time funds is ad-hoc and shooting from the hip so you're not going to see much alignment with these funds to some centrally coordinated strategic plan."

Another Hoover administrator questioned what makes something strategic given the ad hoc timing of when fund balances become available.

Honestly, I'm not really sure what makes something strategic. It seems to be very ad-hoc when we decide to use [carry forward] funds to invest in new incentives so there's no centrally coordinated process for aligning strategic initiatives with central funds.

Another Hoover administrator emphasized the responsibility that this ad-hoc culture places on him.

We have a very ad hoc culture in terms of the use of one-time funds but this freedom places a lot of responsibility on me. For example, we are hiring an artist in residence that is world class. I'm able to do that with some of the one-time funds that I have set aside to pursue new opportunities. It just depends on how many positions we have to fill and how quickly we can rehire those positions.

Whereas, if you just had a fixed budget that had so much for travel, so much for commodities, so much for contractual services, and you have to go on a 12-month period, then you are just barely doing the job. There's just nothing that you can do if you wanted to take a step forward.

While administrators consistently used this term ad hoc to describe the approach to reallocating fund balances, a more in-depth review of the study's interview transcripts revealed time limitations due to policy restrictions as the primary factor influencing how fund balances were being allocated. One administrator at Miller argued that their university's not ad-hoc in their budget planning but rather limited by the reality that universities are just slow with expenditure decisions:

What I found is, unlike state government, which seems to move quicker in terms of changing expenditure decisions, universities are very slow. Everything happens in years rather than months. In a practical matter, if we realize half way through the fiscal year that we had \$2M fund balance in our utility budget, I wouldn't then turn around and ask the academic side how they would invest the \$2M for six months.

What we do is we would run a multi-year projection budget. I meet with our budget director on a monthly basis to recalibrate. I would go ahead and move that \$2M into the projections for the year and begin to start with the President and Provost about this funding that will be available next year. So if we need to make some investments for next year, strategically for the campus, we may have a little more capacity than we currently have. These funds would be built into some type of continuing obligation. The university just cannot react that quickly, it can't make decisions and it can't spend wisely that way and I can't manage it with the state and everything else.

The influence of time limitations on an administrator's decisions on how to allocate fund balance is consistent with the bounded rationality theory and the tendency for individuals to satisfice their decision behavior due to time

constraints, incomplete information, and the competing demands of organized interests (Cyert and March, 1963; Lindblom, 1968).

#### Primary Theme: Spending Down

This next primary theme identified was this idea of spending down all available state funds before the end of the fiscal period to avoid returning the funds to the state treasury or even to central administration depending on the institution's policy on carry forward balances. Within this sub-theme of spending down budgetary funds, there were three prevailing topics that are important to highlight.

The first topic to address is the references that several Hoover administrators made related to the internal culture that existed prior to the university allowing carry forward balances. One administrator explained how their department would purchase common consumables such as copy paper if funds were available at the end of June.

Before the policy, we were in fact finding ways to spend money in June. Back in the days when I was chair of a department, we were buying copier paper or we were trying to pre pay copier contracts a year ahead because we had the money. We were trying to make the best use of the money that we could. But we were floundering a bit but we did not want to give money back so we tried to use it for other things. However, we often could not turn that money into uses that we wanted a lot of times because the funds were in fixed categories.

Another administrator reiterated how departments would spend unused funds on supplies such as copy paper and printer cartridges using the premise that these supplies would eventually be used.

Prior to the time the decision was made for us to carry-forward departmental budgets, we had to spend out all of our departmental budgets at the end of the fiscal year. And that was a very awkward situation. Talk about stocking up on printer cartridges and copy paper. It also presented a lot of problem like travel and payroll that would cross over fiscal years. We couldn't set up payroll before the new money was available so it would be challenging issue to deal with.

A Hoover administrator explained how the carry forward policy caused a positive change with the 'use it or lose it' mentality by departmental managers.

In the late 1990's, we started the use of carry-forward funds. What we allowed for started with the non-personnel areas of people departmental budgets. We expanded that policy further to include wages and graduate stipends at the departmental level. I'll tell you that this policy change caused a change in philosophy by departmental managers. People used to rush at year end with a use or lose it mentality. If I don't spend all of my money then someone will take it away. People also thought if I show a balance in a certain budget category then central will think that I don't need all that money so someone will reduce my budget if I don't spend all my money. We used to request our accounting, procurement, and payable staff to not take vacation in the month of June because that month was by far the busiest time of the year because of all the spending that was occurring before the end of the fiscal year. As soon as we changed our policy and began to allow carry-forwards then departmental managers immediately became frugal and began to save money for future needs.

At Doyle University, one administrator reflected on the spending culture prior to the university implementing a policy on carry forward balances:

I used to oversee the internal audit function. There was no carry forwards at the time. That is not a good way to manage. It is very inefficient. The ability to carry forward funds gives you that ability to look longer term and plan for the future and hopefully build some balances and do some things that span multiple years. And you have the resources to do that. You are getting rewarded for managing efficiently. Otherwise, it's spend it because you'll lose it.

Even at Miller University, where carry forward flexibility is limited, one administrator commented on the ‘use it or lose mentality’ when the university had no flexibility with these funds:

While we’re hoping to hold onto to money through the years to take care of future needs. I can tell you from when procurement reported to me that most of the buying occurs at the end of the last two months of the fiscal year. All this is people hoarding money during the year just in case then you have to run and spend it or lose it. This is a very inefficient practice.

The second topic to address related to spending down budget funds is the issue of cost transfers and budget revisions within the university organization. As it turns out, administrators often use this term of spending down funds, but it was not necessarily an intentional act to use unspent funds in order to avoid returning these funds to the state. To the contrary, administrators were focused on spending funds that had limited flexibility or policy restraints in order to preserve the institutional funds that they had full control over. In other words, if a university has flexibility with indirect cost recovery funds but is required to return state funds back to the treasury, then university administrators would often issue a cost transfer to exchange the source of payment for various expenses from the more flexible indirect cost funds to the restrictive state funds. The result of this transaction would be that the fund balance of the indirect cost accounts would increase while the state funds would decline. While it could be perceived that a university was spending down state funds near the end of the fiscal period, according to administrators interviewed in this study, the reduction in state fund balances was often a transfer of cost between internal revenue sources rather than spending on new expenses.

Similar to cost transfers, administrator also acknowledged processing budget revisions during the year in order to reallocate fund balances well before the fiscal year end. Miller and Doyle University, for instance, provide departments with the flexibility to revise their budgets throughout the year without approval in most circumstances. Miller is required to receive board approval on budget revisions greater than a million dollars; however, the board office does require that Miller submit a quarterly report on all budget revisions. In contrast, Hoover University is required to receive approval on all budget revisions that occur throughout the year so it is more difficult for Hoover administrators to reallocate fund balances. The next section addressed how universities such as Hoover adapt to restrictive policies such as the board's approval requirement on budget revisions.

Consistent with this observation on budget revisions and cost transfers, one Miller research administrator, explained how their department would spend state funds down before using more flexible departmental funds such as their research foundation accounts. Departmental managers will issue cost transfers to reassign costs from flexible institutional accounts to state funds if money is available at the end of the year.

There really isn't a need to have a use or lose it mentality because there are greater needs than resources. However, [our university] will use state funds rather than research foundation because there's greater flexibility with these funds.

Another Miller administrator also emphasized how their institution makes sure they use state funds before some of their more flexible budget accounts.



Instead of having the foundation pay for something each year, you just use your state funds. At the end of every fiscal year, you wouldn't find more than few hundred thousand dollars out of 4 or 500 million dollars. The means by which to that is a strategic process....we are going to make sure that we spend all of those state dollars all the way down. That doesn't mean we really spend a bunch of money at the end of the year. It just means that we charged all those things against those funds.

Several administrators also acknowledged reallocating fund balances during the year. At Miller, for example, one administrator said that deans were continually exploring ways to reallocate fund balances before the fiscal year end approaches.

In the middle of year, if we have a fund balance, then schools/units can move these funds however they choose, so there's no budget revision approval process. There's likely a focused approach by Deans to reallocate fund balance well before the end of the fiscal year end.

Another Miller administrator explained how their department will hold until fund balances during the year as a reserve fund and then begin to reallocate those funds in the third quarter of the fiscal year recognizing these funds would be returned to the state if unspent.

To some extent, the research office will hold onto lapse salary funds anticipating emergency needs knowing that specific needs arise throughout the year. Around the 3<sup>rd</sup> quarter, the research office will start to look at fund balances and then reach out to research units to determine their operational and strategic needs.

At Doyle, one administrator discussed how the university previously required units to report on how they intended to use carry forward funds. Doyle's administration subsequently eliminated this request since departments became incentivized to spend down simply for the reason that they did not want

to go through the hassle of submitting a proposal and justification on how they would use these funds.

Up until 4-5 years ago, we used to require units to fill out this form and ask what units carry forward balances would be and request the intended use of these funds. We decided to eliminate this request to know what these funds would be used for because we wanted to eliminate this idea of spending at the end of the fiscal year. What we were seeing wasn't necessarily spending as it was moving where was something was paid for. Something may have been paid for in overhead or gift money and then they would realize that state funds would be available at the end of the fiscal year so they would issue cost transfers to move a purchase that occurred 3 months ago to state funds. So tons and tons and tons of cost transfers would occur the last month of the fiscal year, which are just unnecessary. That is a transaction that benefits no one. MBU's were incentivized to move these funds because they did not want to carry forward state funds if it meant they would have to request and justify the need to carry-forward these funds within their budget.

The third topic related to spending down budget funds was the recognition by administrators that there was no shortage of needs for the university.

Therefore, as the fiscal year end approaches, administrators understand that if there are unspent fund available then there are operational needs that these funds can be applied toward. In other words, several administrators said that they did not understand this criticism of spending down state funds. They said if they had an unreserved fund balance then there was undoubtedly an operational expense such as a startup package or building repairs that could be addressed. One Miller administrator, for example, said that he always has resource needs for the university's research enterprise:

It's helpful for [Miller] to use the foundation and state funds to support research support. [Miller] spends all of its state funds first then the foundation. We typically don't have issues with having leftover state funds available at the end of the fiscal year because

there's always a need for research support like startup funds because we already need more money that we receive from the state. So the money that is earmarked in our state funds can be used for bridge funding, grant matching, individual project support so there's a great deal of flexibility under the tag of research support.

### Primary Theme: Shadow Budgeting

The next primary theme, shadow budgeting, is a term intended to characterize the tendency for universities to creatively work around budgetary policies that are restrictive in nature. For example, some public universities are required to receive approval from their Board office anytime a budget revision is processed. For a major public research university, the ability to perfectly anticipate budget needs is unrealistic; therefore, budget revisions are frequently needed throughout the year to realign the budget. As such, university administrators are often forced to address these restrictive financial policies using unallocated budget funds, which are essentially in place to provide administrators with spending authority and flexibility to process budget revisions without board approval on every transaction that is processed. One administrator interviewed in this study further explained how the university builds this flexibility into the budgeting process:

The reality is that if we ever had to make a budget revision or decision during the year with the unreserved general funds, which is tuition and state funds as they two largest components, and if we didn't have flexibility built in, then every budget revision would require approval and it would shut this institution down.

We probably do 1200-1500 revisions a year. Some of those revisions are a result of an unexpected occurrence or if we have a need come up in the middle of the year. We have built into our budget both funded and unfunded budgetary authority. We call

them unallocated accounts just nothing technical just a term used here internally. The unfunded accounts are there for flexibility purposes so that we can do revisions, reallocations across functions, across departments, across spending categories, to allow us to continue to function on the fly so that we don't have to ask for revision approvals continuously.

For example, if you wanted to add one position in your office during the year, if we didn't have this position in the budget, then I would have to go to the board and ask for an increase in our budget for salaries and fringe benefits. What I have instead, are these unallocated accounts that are in place to give us some flexibility. It gives me the ability to say that I've got some salaries and fringe that are unallocated so give me some contractual service for the same amount. The budgetary authority is the same, we just swapped personnel costs for contractual so we make the revision and just continuing on down the road.

Moreover, several additional administrators explained they have a variety of creative ways in which they manage fund balances within the university's budget due to restrictive state policies. For example, one administrator explained their institution's shadow budgeting process dealing with carry forward balances:

We have two sets of fund balance numbers. One number that anyone who can maneuver around a financial balance sheet can figure out what the number is. Then there's another number that no one but probably me and [one other administrator] can figure out.

Those two numbers collectively make up our fund balances that we use to run this place to absorb the downside, to prepare for the upside, and to protect against unknowns and risks. Some of these funds are visible, and the visible piece is what I believe we can politically tolerate people worrying about.

There's a whole host of other mechanisms that we have that you'd never be able to follow or trace it all down if you're not in the budget office and that is going to be two to three times more than the visible fund balances.

Interestingly, there were a few other examples of shadow budgeting identified in the interviews worth noting. One example, relates to the recent 90-day extension that Miller University received with year-end carry-forwards. While Miller's board of trustees set this policy to prevent universities from showing excessive surplus funds, the 90-day extension essentially allows fund balances to be applied to expenses for the next fiscal year, which in turn, allows the university to push fund balances to the next year.

One Miller administrator was asked if they have a 90-day ability to extend carry-forwards into the next fiscal year, can they simply prepay some of the costs in the next year's budget so you're essentially pushing the carry-forwards to the next fiscal year?

Yea, that is one of those things we do with carry-forwards that you can't see. Prepayments of all kinds of things are things that we do in the hidden bucket with our carry-forwards.

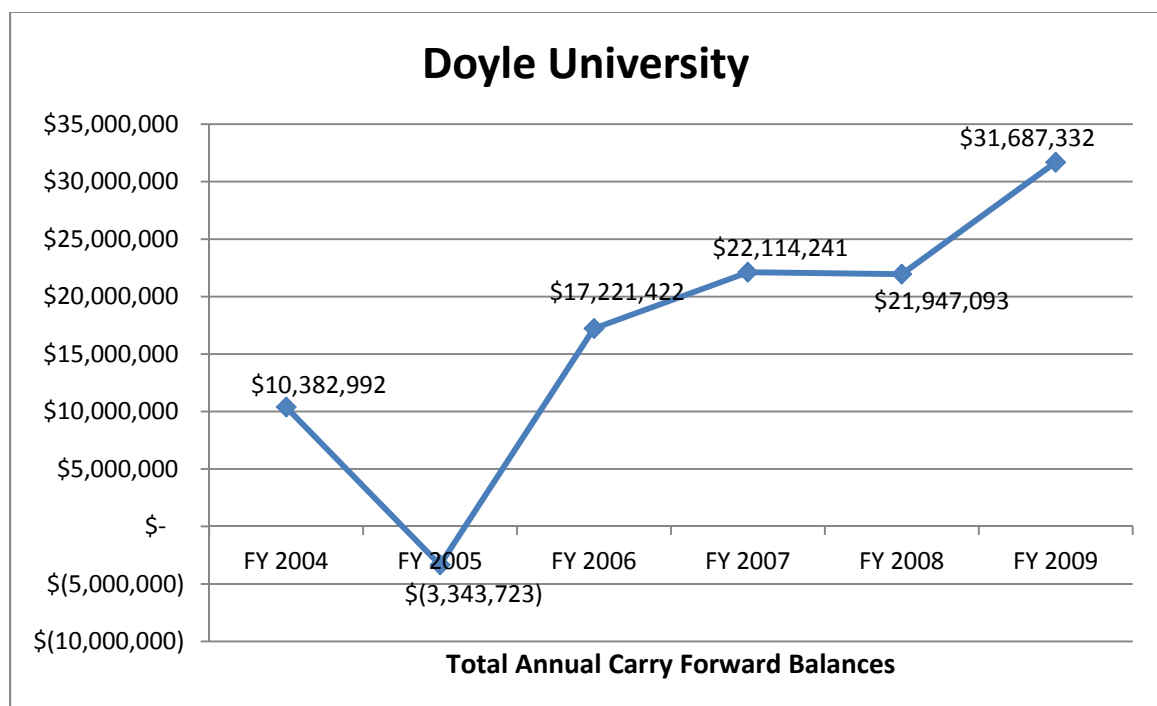
#### Additional Quantitative Analysis

A supplemental analysis of Doyle University's fiscal year-end fund balances was conducted for FY 2004 through FY 2009 (See Chart 1). It is important to note that this information was provided by a Doyle administrator during the interview process. As such, this analysis was not a part of the original research design of the study. However, the data analysis does provide several interesting patterns worth considering in the context of this qualitative study.

First, Doyle University experienced a significant increase in fund balances between FY 2005 and FY 2009. A financial administrator at Doyle explained that the dramatic increase that occurred between FY 2005 and FY 2006 is a result of

the university's implementation of its carry-forward allowance policy. Prior to this time, state policy required that Doyle return state funds at the end of the fiscal year. This observation supports the notion that state policies restricting universities from carrying forward state funds creates a "use it or lose it" culture, where administrators are incentivized to spend down state funds before the end of the fiscal year.

Second, this administrator at Doyle also noted that the university's other substantial increase in carry forward balances between FY 2008 and FY 2009 was a result of the university's chief financial officers informing senior administrators to expect budget cuts in FY 2009 due to the looming economic recession. This observation supports the notion that university administrators leverage budgetary slack to absorb periods of economic uncertainty.



Source: Doyle University Budget Office

Figure 1: Doyle University - Carry Forward Balance Trends (FY 04-09)

An in-depth quantitative research study on carry-forward trends is necessary to confirm the observations from this one particular university's financial data. The observations from this data analysis should only be considered in the context of Doyle University.

## CHAPTER 5

### CONCLUSION & IMPLICATIONS

This chapter includes a summary of findings related to the study's primary research questions along with several additional findings that were identified relevant to the study but outside the scope of the research questions. This chapter concludes with recommendations that could improve the effectiveness of slack as a campus resource and some suggestions on future research.

#### Key Findings Relevant to the Primary Research Questions

This first section summarizes the findings related specifically to the study's primary research questions. The key concepts being explored with each question includes the university's policy setting, the environmental factors influencing fund balances, and the primary functions fund balances serve within the university organization.

#### *Policy Setting*

The focus of the study's first research question was aimed at exploring the various policy settings and procedures that guide the use of fund balances within an institution. The three universities in this study operate under a diverse set of financial management policies and procedures governing their use of budgetary fund balances. Despite these varied approaches, two prevailing philosophies



existed in terms of how fund balances are managed at the end of the fiscal year—“use it or lose it” or “save it to use later”.

This research found that the ‘use it or lose it’ culture exists in some form at all three universities in this study regardless of the policy environment. In fact, there was evidence to suggest that public universities with a policy environment that requires state funds to be returned to the state treasury may foster a ‘use or lose it’ culture under which individuals are incentivized to spend down any remaining state funds during the last quarter of the fiscal year.

Interestingly, this same culture was identified at one of universities that had received flexibility and operational autonomy from the state, including the ability to carry forward unspent state funds to the next fiscal period.

Administrators that were interviewed at this particular institution explained that flexibility from the state to manage these funds did not mitigate the perception risk of showing excessive balances of state funds, particularly during the recent economic recession as state legislators were exploring additional ways to cut the state’s budget. Consequently, administrators at this university carefully manage its cash flow as a way to minimize the amount of state funds being shown in the financial statements.

Furthermore, the ‘use it or lose’ culture was also identified at the school and department level when a university’s carry-forward policy shifted the control of fund balances from unit-level to central level administrators. In fact, several unit-level administrators that were interviewed in this study indicated their preference to spend down their fund balances rather than return these funds to

central administration, which would require unit-level administrators to submit proposals in order to justify the use of these funds.

It is important to reiterate that the actions of both university and unit-level administrators to “spend down” funds at the end of the fiscal year is not accomplished solely through accelerated purchasing of goods and services in June. Instead, a frequent response identified in the study was for administrators to process cost transfers or revise their budgets mid-year so that available fund balances were reallocated before the end of the year for other purposes or applied to pay for an expenses that may have otherwise been paid using an institutional account with more flexibility. For example, if a department buys a new piece of equipment using their departmental overhead account, but has unspent state funds at the end of the fiscal period, departmental administrators were incentivized to reassign the costs of this equipment to the lapsable state funds in order to preserve the more flexible department overhead funds that carry forward. Similarly, unit-level administrators often processed budget revisions and cost transfers throughout the year to avoid returning unspent funds from their annual operating budget to central administrators.

Furthermore, the analysis suggests that a “save it to use later” philosophy exists when the policy environment provides a university with the flexibility to carry forward state funds across fiscal periods. While this policy environment reduces the risks of having administrators spend down state funds in June, this philosophy still creates unique challenges that may negatively influence the entrepreneurial and strategic culture as the control of these funds shift from the

central administration to the individual units within the organization. In fact, administrators in this policy environment suggested that fund balance allocation decisions were often made on an ad-hoc basis, with minimal alignment with institutional level strategic plans, and with potential issues related to principal-agent conflict between university and unit-level administrators.

### *Environmental Factors*

The study's second research question focused on the examination of the environmental factors that contribute to these varied policy environments. The research analysis identified domain coalition, bounded rationality, and public perception risks as three particular factors that significantly influenced the use of fund balances.

As explained in an earlier chapter, the domain coalition is the network of individuals within and around an organization that most influence the mission and goals of the organization (Cyert and March, 1963), including the university's President, Provost, Deans, Vice Presidents, and Board of Trustees. The domain coalitions in control of the fund balances in this study were often looked upon with distrust and frustration by unit-level administrators due to the lack of transparency in how these funds were reallocated. There was also evidence that administrators often based their decisions on how to allocate their fund balances in a way that would maximize their level of control of these funds (i.e. principal agent conflict). Unit-level administrators, for example, would use funds from their general operating budget before departmental overhead accounts in order to

preserve the funds that provided these individuals with the greatest level of flexibility in the long-run.

Another interesting finding related to the domain coalition, was the political activity that occurs within this influential network of senior administrators. One particular dynamic that stood out during the interviews was role that chief financial officers have given their responsibility to allocate fund balances into reserve accounts to mitigate operational risks while balancing the ongoing funding requests by other senior administrators such as the provost and president, who are often focused on pursuing their own strategic programs and initiatives within a short timeframe.

The second environmental factor identified in the study was bounded rationality. The research analysis identified the time limitations associated with the twelve-month fiscal period as a significant factor influencing institutional and individual decisions on the use of fund balances, particularly public universities with policies that require all state funds to be spent within the fiscal year calendar. Consistent with the research literature on bounded rationality, this study found that administrators were required to satisfice in their decisions in order to select an acceptable use of fund balances before the end of the fiscal year rather than carry-forward balances to further explore a more optimal use for these funds. As such, administrators in this study were often allocating fund balances to support less risky, and perhaps less strategic, operational needs such as deferred maintenance, equipment purchases, faculty startup packages, and building repairs and maintenance.

The third significant environmental factor identified in this research was the perception risks and the negative connotation associated with showing excessive surplus balances. This issue was mentioned previously in this chapter as well as identified as a primary theme during the study's research analysis, but I do not believe the influence of external stakeholders and constituents can be overstated in this study. In fact, senior administrators at all three universities placed a significant amount of emphasis on minimizing the visibility of carry-forward balances and reserve funds to external stakeholders in order to avoid the perception that the university could afford less funding from the state or that the university in some way was an inefficient operation. Regardless of the university's policies dealing with carry-forward funds, administrators were sensitive to showing excessive fund balances; therefore, there were carefully calculated efforts by senior administrators to allocate these funds into flexible university accounts or to creatively manage the university's cash flow in order to minimize the amount of fund balances being shown. For example, one university allocated a portion of their fund balances to a building repairs and maintenance account recognizing that these facility expenses could be deferred if these funds were needed for more pressing operational needs throughout the year. In some cases, building repairs and maintenance funds often became a contingency account for senior administrators while minimizing the perception risks of having excessive fund balances at the end of the year.

### *Functions of Budgetary Slack within a Public University*

The study's third research question focused on identifying the roles of budgetary slack (fund balances) within the three universities. More specifically, fund balances were identified addressing conflict and resource equity issues within the organization, serving as a buffer for unforeseen circumstances, facilitating strategic behavior, and supporting ongoing general operational needs. As such, several key findings related to the functions of slack were identified in this study.

First, university administrators occasionally allocated fund balances as a resource to reduce goal conflict and political tension between the various units competing for resources within the university organization. In fact, each of the universities in the study had internal policies directing at least a portion of the year-end fund balances to central administrators for reallocation at their discretion. This internal mechanism for centralizing a portion of discretionary funds balances, in turn, became a source of funds that central administrators were able to use to ensure that resources were being distributed equitably and based on high priority needs of the institution.

Secondly, administrators often used carry-forward funds as a buffer for unforeseen financial circumstances. More specifically, these funds were allocated for contingency and reserve accounts to address ongoing operational risks such as a decline in enrollment or unexpected building repair and maintenance expenses. In recent years, a public university's reserves have likely served as a critical buffer to the decline in state appropriations for public

colleges and universities. The multi-year analysis of carry-forward balances at Doyle University (see Figure 1) also supported this finding by illustrating that administrators anticipated internal budget cuts by increasing their departmental carry-forward balances as a short-term strategy to absorb a reduction in funding.

Third, the function of slack as a facilitator for strategic behavior, while important, was generally not identified as the highest priority among administrators interviewed. Instead, the strategic use of unreserved fund balances was consistently identified as an ad-hoc process that lacked a consistent model of allocation, particularly one that aligns with the institution's strategic plan. This limitation may be influenced by control issues related to the domain coalition and bounded rationality since a centralized process for allocating fund balances would shift the control of allocation decisions away from unit-level administrators while the fiscal year time constraints may force administrators to make allocation decisions before optimal solutions can be adequately explored .

Another important observation to reiterate related to the strategic function of slack is that university administrators in the study lacked a consistent understanding of what defines strategic versus operational projects and initiatives. As such, the responses relating to the strategic role of fund balances depended on how the person being interviewed defined the term strategic. In general, administrators typically provided examples of short-term operational projects and initiatives to describe how fund balances were being allocated for strategic purposes.

Finally, I would characterize the fourth, and most prevalent, function of fund balances identified in the study as an 'operational plug' for ongoing operational needs. These operational expenses are known but they are often deferred by administration until the funding becomes available. Beyond deferred maintenance expenses, other ongoing, operational needs identified include facility upgrades, classroom space, equipment, travel support, and temporary faculty and staff. These operational needs are not necessarily a strategic use of fund balances; instead they represent the funding needs necessary to support the non-essential, day-to-day operations of the university that are often deferred due to resource constraints.

### Additional Findings

In addition to the findings related to the primary research questions, this study identified several additional findings that are relevant to the topic of budgetary slack and fund balances within higher education.

#### *Carry Forwards versus Fund Balances*

The initial focus of the research analysis focused on examining financial policies to better understand the level of flexibility that each institution had to carry forward fund balances at the end of the fiscal year. During this initial phase of the study, I mistakenly referenced fund balances and carry forward balances interchangeably without appreciating the subtle differences between the two terms, particularly in a university policy environment that allowed unit-level administrators to revise their budgets and process cost transfers between



funding sources throughout the year. In fact, after several initial interviews, I recognized the significance of assessing the role of fund balances not solely in the context of what happens to these funds at the end of the fiscal year, but also in terms of how these funds are reallocated throughout the year through internal budget revisions and cost transfers.

Moreover, since some universities allow school and departmental administrators to revise their budgets or to reassign expenses to different discretionary funding sources throughout the year, the total amount of fund balances available may not be reflected in carry-forward balances at the fiscal year end. Instead, unit-level managers often issue budget revisions and cost transfers during the year to reallocate fund balances as they become available; therefore, these funds are absorbed back into the organization well before the fiscal year end. Two particular universities in this study provided unit-level administrators with the flexibility to revise their budgets throughout the year. As such, institutional policies guiding the use of mid-year budget revisions and cost transfers are equally as important to understand as carry forward balances. In other words, to better understand the role of fund balances, it is important to consider these funds as they are generated during the year as well as reclassified as carry-forward balances after the end of the fiscal year.

#### *Sources of Fund Balances*

University administrators are unable to perfectly anticipate the organizational costs within the twelve month fiscal year calendar. As such, fund balances are created within the budget for numerous reasons including

employee attrition, an increase in organization efficiency, or due to a buffer of resources that managers instinctively imbed into their budgets to prepare for the unknown circumstances.

Throughout the interviews, administrators were asked about these various sources contributing to fund balances each year. The interview participants consistently focused on personnel funds as the primary and most significant source of fund balances at their university. One administrator further explained the significance of personnel cost within the university organization:

It's important to understand in higher education that yes energy costs and equipment costs are important but the real cost of higher education is people. We are labor intensive organization by any measure. Unlike manufacturing companies where we try to reduce the input per unit of output, we still measure the quality of higher education by how many faculty we have per student, which may be a dated concept. Maybe technology will help with that. But still, 70% of our budgets are people. If you are talking about trying to have resources to operate an institution it is hard to do it if you are not cognizant of the workforce and costs.

In the context of fund balances, I believe this observation on the significance of personnel costs within the university budget is important to highlight for two reasons. First, budgetary slack is inevitable not merely for the inexact science of predicting actual costs in an annual budget, but more specifically for the inability of an administrator to accurately predict employee turnover rates and the amount of time it will take to refill vacant positions. As a result, a large amount of fund balances from lapsed salary expenses are generated within the university organization each year, particularly given the fact that personnel costs may represent over seventy percent of a university's budget.

Interestingly, only one of the three universities in this study had defined an internal allocation formula specifically for lapsed salary funds.

### *Strategic Value of Centralization*

The two universities in the study with the ability to carry forward state funds had decentralized the decisions on allocating fund balances to the schools and departments that generated the funds. Consequently, these two universities lacked an institutional process to ensure that the allocation of fund balances were for purposes consistent with the long-term vision and strategic priorities of the university. Ironically, the university with limited flexibility to carry-forward state funds had implemented a centralized process that required unit-level administrators to submit a proposal to vice presidents to justify the use of their fund balances. As such, central administration would often align the fund balance proposal process with strategic priorities of the university. Three recent examples of funding priorities for the annual proposal process identified in the interviews included startup packages for new faculty in emerging disciplines, technology infrastructure upgrades, and student service initiatives.

The lack of a centralized process for allocating fund balances may also promote the ad-hoc culture of decision making that was identified during the study, particularly given the potential volatility and unpredictable nature of fund balances across fiscal periods. During the interviews, several administrators explained how they would begin thinking about their operational needs only as fund balances became available. This ad-hoc approach to reallocating fund

balances becomes even more challenging for universities that are faced with time limitations at the end of each fiscal year.

### Recommendations

Based on the research analysis and findings, I would offer two primary recommendations for consideration to state policy makers and public university leaders as they deal with managing fund balances. First, public university leaders and state policy makers should eliminate policy restrictions requiring unspent state funds to be returned at the end of the fiscal year. Instead, universities should be given the flexibility and autonomy to manage fund balances as these institutions deem necessary. Otherwise, university administrators become encouraged to spend down state funds or identify creative accounting approaches to circumvent state policies that limit a university's ability to carry-forward state funds.

Furthermore, policy restrictions on carrying forward state funds may place public universities at a competitive disadvantage vis-à-vis other private and for-profit universities in an industry that increasingly values organizational agility and responsiveness to emerging market needs. These policy restrictions may have significant implications on how the university effectively manages organizational risks and pursues strategic opportunities recognizing that time limitations force administrators to satisfice and make decisions based on adequacy rather than identifying optimal choices.

To address any accountability concerns by state policy makers, universities' board of trustees may wish to monitor the use of one-time funds on an annual basis to ensure these funds are being spent in alignment with the university's mission and strategic priorities. Furthermore, the university's board of trustees should also establish guidelines as to how their public universities should balance the use of one-time funds for purposes ranging from reserve accounts, strategic initiatives, and ongoing operational needs. By establishing a more proactive and transparent approach to managing fund balances, universities may find less pressure by external stakeholders when holding what is perceived to be an excessive amount of surplus funds. Instead, university administrators can show how fund balances serve a critical role in protecting the institution from economic volatility, facilitating strategic behavior, and addressing ongoing operational needs.

Second, university administrators should institutionalize a process for allocating unreserved fund balances in order to achieve goal congruency and to more effectively balance the allocation of these funds for its various uses (i.e. strategic efforts versus reserve funds). Otherwise, the decentralization of the university's budget authority may limit how effective the use of fund balances are in facilitating strategic behavior at the school and department level.

In order to enhance this strategic role, administrators should also consider a more deliberate approach to aligning resource allocation decisions with institutional level goals and priorities. For example, Miller

University's centralized call for proposals and Hoover's lapsable salary allocation model are two examples of how a university might amend their carry-forward policies to more effectively and strategically manage fund balances in the loosely coupled university organization.

### Future Research

Future quantitative research on organizational slack within universities, might examine fund balance trends at multiple universities over the past decade, to add valuable insight on the influences that organizational governance and various environmental factors have on fund balance allocation decisions. Quantitative study might also address how shifts in fund balance levels correlate with the economic circumstances as well as how policy environments at public and private universities influence these shifts. Analysts might also examine more closely on how bounded-rationality and satisficing might influence university leadership to allocate available slack resources for short-term organizational needs versus strategic opportunities. Further research is also needed to improve our understanding of whether and how the centralization of fund balance allocation improves the strategic alignment of unit-level spending of these discretionary, one-time funds.

Additional qualitative research could address the same issues examined in this study but from the perspective of other key actors in these domains, such as policy makers and legislators as well as departmental and other mid-level business managers within a university. This particular study focused specifically

on the perspective of senior level administrators, so integrating these findings with the perspectives of other internal and external constituency groups could amplify knowledge regarding the management and use of discretionary fund balances.

Finally, this research should be extended beyond the scope of the current analysis. Notably, examination of additional public universities, private universities and colleges, comprehensive institutions, and community and technical colleges is warranted.

### Conclusion

In conclusion, this research study identified important findings related to the policy settings, the influence of key environmental factors, and the various roles that unreserved fund balances serve within the public university organization. As such, this research has helped improve our understanding of slack but in a very narrow context of higher education. Therefore, as with any issue of policy and practice, further research in varied contexts is needed in order to better understand how slack resources can more effectively be utilized as a campus resource.

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## APPENDIX A: EMAIL INVITATION TO STUDY PARTICIPANTS

### Letter of Invitation to Study Participants

Date:

Dear:

I am a doctoral student in Higher Education Administration at the Institute of Higher Education at the University of Georgia. I would like invite you to participate in a research study that will explore the role of budgetary fund balances in driving strategic behavior within the university organization. The purpose of this study is to assess what role, if any, that budgetary fund balances play in facilitating strategic decision making in higher education. More specifically, this study will examine how three public research universities allocate unreserved fund balances during the year and at the end of the fiscal year and for what purposes are these fund balances internally allocated. Furthermore, this study will explore the various mechanisms, organizational structures, practices, and policies that govern the use of fund balances at each of the institutions being studied.

Your participation would involve an interview session and should only take about 45 minutes to complete. Your involvement in this study is voluntary, and you may choose not to participate or to stop at any time without penalty or loss of benefits to which you are otherwise entitled. The results of the research study may be published, but your name will not be used and your institution would remain anonymous.

My aim in this study will be to explore the following research question: how do universities allocate unreserved fund balance at the end of the fiscal year and for what purposes are these fund balances internally allocated. Although this study focuses on one specific type of slack within three major public universities within the American higher education industry—the research, recommendations, and principles outlined will ideally be scalable and can be applied to nearly all other types of higher education institutions in some form. Thus, this research will be applicable to all those who manage resources at colleges and universities and that are involved in institutional and unit-level planning and financial management. A detailed examination of approaches to the management of fund balances at fiscal-year end can provide insights as to

how universities can more effectively fund strategic decision making and ensure goal congruency across the organization.

If you have any questions about this research project, please feel free to contact me by email at [jwmorris@uga.edu](mailto:jwmorris@uga.edu) or by phone at (601) 291-4247. My dissertation chair is Jim Hearn, who can be reached at [jhearn@uga.edu](mailto:jhearn@uga.edu) or by phone at (706) 542-8729. Questions or concerns about your rights to participate as a research participant should be directed to The Chairperson, University of Georgia Institutional Review Board, 612 Boyd GSRC, Athens, Georgia 30602-7411; telephone (706) 542-3199; email address [irb@uga.edu](mailto:irb@uga.edu).

I am also attaching a consent form for your review and further information. Please indicate if you wish to be a part of this study via email or phone. Thank you for your consideration. Please keep this letter for your records.

Sincerely,

Jim Morrison, Ed.D. Candidate  
Institute of Higher Education  
University of Georgia



## APPENDIX B: INFORMED CONSENT FORM

### Informed Consent Form

#### Slack as a Campus Resource: How Three Public Universities Manage Fund Balances to Facilitate Strategic Behavior and Absorb Environmental Variation

You are invited to participate in a research study. The purpose of this study is to assess what role, if any, that budgetary slack plays in facilitating strategic decision making in higher education.

#### Information

The aim of this study will be to explore the following research question: how do universities allocate unreserved fund balances and for what purposes are these fund balances internally allocated? More specifically, this study will examine how three public research universities allocate unreserved fund balance during the year and at the end of the fiscal year and for what purposes are these fund balances internally allocated. Furthermore, this study will explore the various mechanisms, organizational structures, practices, and policies that govern the use of fund balances as a facilitator of innovation and strategic decision making. The goal is to interview 3-4 senior level administrators at three public research universities with knowledge of the budgeting process.

The interviews which might be audio taped with your consent, will consist of one 45 minute session per participant over the next 4 months. Participants may also be asked to complete a 30 minutes follow up interview to clarify information provided in the initial interview. I will take notes during the interview and digitally record with your consent. I want to make sure that each participant in the study is comfortable discussing the financial management processes at their respective institutions. I will provide each interview participant with a copy of the interview transcripts for his/her review to ensure that statements were accurately recorded and confidentiality maintained throughout the interview transcript. It is also important to note that your involvement in this study is voluntary, and you may choose not participate or stop at any time without penalty or loss of benefits to which you are otherwise entitled.

#### Benefits

Although this study focuses on one specific type of unreserved fund balances within three major public universities within the American higher education industry—the research, recommendations, and principles outlined will ideally be

scalable and can be applied to nearly all other types of higher education institutions in some form. Thus, this research will be applicable to all those who manage resources at colleges and universities and that are involved in institutional and unit-level planning and financial management. A detailed examination of approaches to the management of fund balances can provide insights as to how universities can more effectively fund strategic decision making and ensure goal congruency across the organization.

### Confidentiality

The data collected during the study will be kept confidential and stored securely. The data will only be made available to the persons conducting the study. The recordings will be destroyed within one year once the study is complete. Your name will not be used in oral or written reports that could link you to the study, however due to the small number of participants and their responsibilities at the university; it is possible your comments could be linked to you. To help mitigate this risk, the study will also not identify the names of the three public universities involved in the study. Instead, each university in the study will be assigned a random name throughout the study.

### Contact

If you have any questions about this research project, please feel free to contact me by email at [jwmorris@uga.edu](mailto:jwmorris@uga.edu) or by phone at (601) 291-4247. My dissertation chair is Jim Hearn, who can be reached at [jhearn@uga.edu](mailto:jhearn@uga.edu) or by phone at (706) 542-8729. Questions or concerns about your rights to participate as a research participant should be directed to The Chairperson, University of Georgia Institutional Review Board, 612 Boyd GSRC, Athens, Georgia 30602-7411: telephone (706) 542-3199; email address [irb@uga.edu](mailto:irb@uga.edu).

### Participation

Your involvement in the study is voluntary, and you may choose not to participate or to stop at any time without penalty or loss of benefits to which you are otherwise entitled. If you withdraw from the study before data collection is completed your data will be returned to you or destroyed.

### Consent

I have read this form and had all my questions answered to my satisfaction. I agree to take part in this study.

Subjects signatures \_\_\_\_\_ Date: \_\_\_\_\_

Investigator's Signature \_\_\_\_\_ Date: \_\_\_\_\_

## APPENDIX C: INTERVIEW INSTRUMENT

In alignment with study's overall research questions, this study explored a variety of questions during the interview process related to the use of fund balances within an organization, including the following:

- How does your institution manage unreserved fund balances during the year and at end of the fiscal year end?
- Does your institution reallocate the fund balances at the end of the fiscal year using a carry-forward policy or are these funds returned centrally?
- Are schools and departments required to receive approval for budget revisions, particularly as it relates to reallocating fund balances during the fiscal year?
- Does your institution allocate a defined level of fund balances to reserve accounts for risk management purposes (i.e. as buffer to environmental uncertainty)?
- How does your institution ensure that unit-level spending of funds balances is congruent with the universities overall mission and strategic goals?
- Are unit-level managers responsible for allocating some level of fund balances to reserve accounts or do units have full discretion on the reallocation of these funds?
- Are there financial policies and procedures in place at institutions that induce or inhibit the use of unreserved fund balances for strategic purposes?
- In terms of the purpose that unreserved fund balances are reassigned, what percentage would you estimate that fund balances are allocated for 1) strategic initiatives, 2) reserve accounts, and 3) immediate operational needs (e.g. deferred maintenance, new equipment, travel, etc.).
- What other information do you believe would be helpful to know about related to the use of fund balances at the institutional and unit-level?